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10 Things To Know About Business Valuation

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1.) Why are business valuations needed?

All types of companies require valuations for a variety of purposes including:

- **Selling a company** - Business valuations help determine an appropriate asking price when a company's owners decide to sell.
- **Estate and gift tax** - Estate planners rely on business valuations when considering the tax impacts on asset transfers.
- **Marital dissolution** - Frequently, one of the assets included in the marital estate is interest in a closely held business. A valuation determines the value of the business for the divorce proceedings. Marital dissolution laws and standards of value vary from state to state.
- **Employee Stock Ownership Plans (ESOPs)** - ESOPs are employer-funded employee incentive ownership arrangements. An independent business appraiser must value a company's ESOP stock annually.
- **Buy/sell agreements** - Buy/sell agreements allow one stockholder to acquire another stockholder's interest. They can provide for a smoother transfer of ownership.

2.) What is USPAP? What are business valuation standards and why do they matter?

In addition to standards set by organizations such as the Institute of Business Appraisers (IBA) and American Society of Appraisers (ASA), qualified business appraisers follow the

Uniform Standards of Professional Appraisal Practice (USPAP), defined and maintained by The Appraisal Foundation (www.appraisalfoundation.org). The Appraisal Foundation is recognized by the U.S. Congress to be the official source of appraisal standards and qualifications in North America. USPAP defines generally accepted standards for professional appraisal practice.

USPAP Standard 9 addresses how business valuation work should be performed and Standard 10 addresses how business valuations should be reported. The standards were recently updated on July 1, 2006. The extensive revisions require more specific analysis, more consideration for value-impact factors and a greater effort to reconcile the various aspects of the appraisal process with its conclusions.

Adherence to standards reinforces a business appraiser's expertise and the credibility of their work. Appraisers who fail to perform their work in accordance with USPAP standards are subject to criticism and may have difficulty defending their conclusions in litigation.

3.) How do business appraisers determine a company's value?

Business appraisers use three primary approaches that help determine a company's value:

- **Income Approach:** The Income Approach weighs the expected benefits from investing in the company against the required return for assuming the risk and uncertainty associated with it. This approach can account for changes in expected revenue

growth, working capital needs, future capital expenditures and differences in financing.

- **Market Approach:** The Market Approach evaluates a company based on completed transactions of comparable companies. This approach answers the question, "What are similar companies selling for in the marketplace?"
- **Cost or Asset Approach:** The Asset Approach measures the fair market value of a company's assets, less its liabilities. Frequently used for underperforming companies, this approach is not appropriate for companies with high intangible value.

4.) Is the date of a valuation important? Do business valuations expire?

A business valuation is the estimated value of a company at a specific point in time. The valuation date, whether statutorily mandated or not, is very important. The value of a company can vary at different points in time due to internal and external factors.

Since a business valuation is based on a specific point in time, the valuation does not expire. Likewise, if the profitability and infrastructure of a company remains relatively stable, over a short period of time, the value may not significantly change. However, if the company experiences significant change or is exposed to a changing economic environment, a revised business appraisal may be needed.

5.) Can a business have more than one value?

Yes. A business can have multiple values at a single point in time. Value is determined by the price a hypothetical, ready and willing buyer will pay for a business. As such, a business may have different values to a willing buyer with no synergistic benefits, versus a strategic acquirer that could realize enhanced value. For a business appraiser to provide an accurate valuation, it's important to understand the purpose of the appraisal.

6.) How do I judge a business appraiser's qualifications?

Professionals in varying occupations may claim to be business appraisers, but only accredited business appraisers have the training and expertise needed to provide accurate and defensible business valuation reports. The Certified Business Appraiser (CBA) and

Accredited Senior Appraiser (ASA) designations are the most prestigious in the business appraisal industry. They require the most training and experience of the appraiser, unlike the Certified Valuation Analyst (CVA) and Accredited in Business Valuation (ABV) designations which require less rigorous accreditation procedures.

- **Certified Business Appraisers (CBA)** - Accredited by the *Institute of Business Appraisers (IBA)*, CBAs must complete: all required coursework, a proctored test, two vigorously reviewed valuation reports and 24 credits hours of continuing education every two years. There are only 425 CBAs in the United States.
- **Accredited Senior Appraiser (ASA)** - Accredited by the *American Society of Appraisers (ASA)*, ASAs complete the same criteria as CBAs, and require five years of business valuation experience.
- **Certified Valuation Analyst (CVA)** - Accredited by the *National Association of Certified Valuation Analysts (NACVA)*, CVAs take a proctored exam and maintain their CVA credential status while taking some courses. They are not required to have past experience or face a peer review board.
- **Accredited in Business Valuation (ABV)** - Accredited by the *American Institute of Certified Public Accountants (AICPA)*, ABVs are only required to complete: ten business valuations, a proctored exam, 60 credits of continuing education and five reports every three years. They do not undergo intensive peer review.

7.) How do I critique a business valuation?

A valuation without a reasonability test is open to criticism, rebuttal and rejection because it cannot answer the question, "Why is your value justified?" One critique is a "purchase price justification" test, which confirms whether a lending institution could finance the company at its estimated value to a qualified buyer with a reasonable equity stake. This test confirms whether a business's cash flow can finance the acquisition debt, pay applicable state and federal taxes and provide a return to the investor.

8.) What types of business valuation reports are available?

Comprehensive and Limited

A **Comprehensive Valuation** includes detailed explanations for all aspects of the valuation analysis. These reports are the most inclusive business appraisals available and strictly comply with business valuation standards. Comprehensive Valuations are recommended for estate tax audits or gifting of a business interest where a third party, such as the IRS, may be reviewing the document. Other purposes include litigation support, buy/sell agreements and stockholder disputes. Comprehensive Valuations are usually 60 to 80 pages in length.

A **Limited Valuation** is a shorter, internal-use report that typically excludes detailed analysis of the business and the industry. Limited Valuations are often used for planning purposes such as sale or acquisition of a business interest, business planning and estate planning. Limited Valuations are usually 30 to 50 pages in length.

9.) What information is needed to perform a business valuation?

The following documents are necessary to provide an accurate valuation:

- Profit and loss statements, balance sheets and federal income tax returns for the last three to five years
- Interim profit and loss statements and balance sheet for the current year
- Copies of any forecasts or projections

Other documents requested include:

- Information that describes the company's services and/or products
- List of significant assets and inventory
- Details of any liabilities (significant leases, loans)
- Reports by other professionals and consultants

10.) How much does a business valuation cost?

Most certified business appraisers quote a project fee or an hourly rate, with outside expenses billed separately. Typically, a Limited Valuation costs between \$4,000 and \$6,000 while a Comprehensive Valuation costs between \$6,000 and \$15,000.

The following link contains an article from Inc. Magazine with regards to business valuation fees: <http://www.inc.com/articles/2003/07/25684.html>