



7007 College Boulevard Suite 400
 Overland Park, Kansas 66211
 tel: 913.897.3599
 info@AlliedBizGroup.com
 www.AlliedBizGroup.com

Events That Trigger a Business Valuation

By Kelly Skarda, Allied Business Group, Inc.

Many business owners are unsure about what to expect when they hear the term “business valuation.” If a business partner, accountant or legal advisor has ever advised you to have your company appraised, you may have concerns and questions about the process. Aren’t your internal financial statements enough? Can your accountant just run the numbers and come up with a value? Concerns about the cost may also arise.

Considering the depth and scope of some of these questions, *business valuation* is a relatively simple concept to understand. An appraisal report, performed by a *business appraiser*, analyzes a subject company’s financial information as well as qualitative factors (industry outlook, management quality, etc.) to determine its *fair market value*. Cost depends on the scope of the assignment and purpose for the appraisal, with larger, complex projects requiring more time—and a higher cost—than smaller, simpler engagements.

Professional business appraisers must adhere to the Uniform Standards for Professional Appraisal Practice (USPAP) guidelines, which require impartiality, competency and confidentiality. Some business owners do hire accountants to perform appraisals; however, valuation theory is complex and many people prefer to engage an independent third-party to ensure there is no perceived bias.

Valuations are performed for a number of different reasons. Business owners considering gifting a portion of their company may seek an independent appraisal for tax planning purposes.

An appraisal may be needed in a divorce case to equitably distribute the marital estate. Owners nearing retirement may want to know the fair market value so they can plan their exit strategy accordingly.

Reasons for a business valuation usually fall under three general categories: tax, litigation or transaction.

Tax purposes:

- *Gift and estate* – Perhaps the most common tax purpose for a business valuation is to determine the value of a business interest for federal estate and/or gift tax purposes. Business appraisers serve as an objective third party that is able to determine the fair market value of a company, which may include applicable discounts. The fair market value can then be used by the client to determine their tax liability. Valuations for estate tax purposes are subject to a constantly shifting body of laws, regulations and court decisions.
- *Charitable contributions* - Owners of closely held businesses may wish to give all or part of their interest in a business to a favorite charity. The IRS requires that donors provide documentation, in the form of a business valuation, to support the deduction for the year in which the gift was given.
- *Financial reporting* – Valuations are required to meet the standards of the Financial Accounting Standards Board (FASB). They include but are not limited to Standard No. 141, 142 and 157, all of which address

issues such as the determination of the fair value of assets acquired and impairment of goodwill.

Litigation purposes:

- *Divorce* - Divorce proceedings are often complicated by joint ownership of a closely held business, which must be valued along with the rest of the marital estate. In most cases, ownership of the business is neither divided nor liquidated; rather, one spouse retains the business and purchases the other's shares. An objective business valuation can determine the price of these shares, including any fixed assets, goodwill, inventory and other asset values. Each spouse may engage his or her own business appraiser or, in the interest of time and cost, both spouses may jointly hire a single appraiser to produce a valuation report.
- *Shareholder disputes* - Shareholders do not always agree on the best course of action for a company, or on a reasonable sale price should a shareholder wish to exit the business. In this case, especially in the absence of a formal buy-sell agreement, an independent business appraisal is often needed to settle disputes on the value of the shares in question.

Transaction Purposes

- *Mergers and acquisitions* - Valuations provide business owners who are considering selling their company with an objective opinion of value. Business valuations can also provide all involved parties with peace of mind during an M&A transaction, as final values can either justify a buyer's investment or cause them to reconsider.
- *Employee Stock Ownership Plans (ESOP)* - These plans must be independently appraised annually to establish fair market value for purchase price and or contributions.
- *Buy-Sell agreements* - A buy-sell agreement allows a partner or shareholder in a closely held business to purchase the interest of another partner or stockholder who withdraws from the business. Agreements often include the need for an independent appraisal to determine a per-share price. Business appraisers typically work in

conjunction with attorneys when drafting the valuation portion of the agreements.

- *Financing* - When obtaining debt or equity financing, often the end user will obtain an independent business valuation to validate their investment. For smaller business interests, an SBA loan may be an option for debt financing. An independent business appraisal is required for certain SBA loan packages.

Within each of these areas, many approaches and methodologies are used to determine a company's value. The client typically communicates the purpose for the report (gifting, possible sale, etc.) and its intended use (internal company review, insurance in case of audit) to the appraiser, who determines the scope of work and methodologies used. Valuation reports can range from short, preliminary estimates to lengthy, detailed documents.

Regardless of what kind of appraisal is needed, business owners and their advisors should seek appraisers with certification from a nationally recognized institution. Designations include Accredited Senior Appraiser (ASA), Certified Business Appraiser (CBA), Accredited in Business Valuation (ABV) and Certified Valuation Analyst (CVA). By working with qualified professionals and communicating needs and objectives, business owners can help manage the business valuation process and empower themselves by knowing their company's true value.