

## When do you need a Business Valuation?

If one of your business partners, accountant, or legal advisor has ever advised you to have your company valued or appraised, chances are that you have quite a few concerns and questions about the process. In fact, most business owners are unsure about what to expect when they hear the term “business valuation” or “business appraisal,” which is not at all uncommon as many accountants and legal advisors have differing internal definitions as well.

## What is a Business Valuation?

What exactly is a business valuation? To answer this question, consider the following example. Suppose you hold Apple, Inc. stock in your portfolio and you want to know how much it is worth. Well, all you have to do is pick up your smart phone, run your finance app, and look up the price of APPL and multiply by the number of shares you own. Through this simple exercise, you have valued your Apple, Inc. shares or what you would receive in cash if you sold your shares at that current price.

In concept, valuing your privately-held business is the same as valuing APPL stock. However, because your business is private, there is no finance app or newspaper stock table to which you can conveniently turn. This is where we come in, as there is a pseudo-science, or some say an art form, that provides the foundation for skilled business appraisers to estimate what your business is worth. In essence, business valuation is a process and a set of procedures used to estimate the economic value of your ownership interest in a business.

While a business valuation can take many forms, from something as simple as being a discussion topic in a meeting; or providing summary letters and supporting schedules; or providing a full appraisal report. An in-depth appraisal report is subject to rigorous industry standards and analyzes your company’s financial information as well as qualitative factors (industry outlook, management quality, etc.) to determine its fair market value.

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Why aren’t your internal financial statements enough? Why can’t your accountant just run the numbers and come up with a value? How much is this going to cost?

Considering the depth and scope of some of these questions, business valuation is a relatively simple concept to understand. 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.

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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. Business owners nearing retirement may want to know the fair market value so they can plan their exit strategy accordingly.

Reasons for a business valuation typically fall under three general categories: tax, litigation or transaction. Within each of these areas, many approaches and methodologies are used to determine a company’s value. We will help you and your advisors to determine and define the ultimate purpose of the valuation and its intended use (internal company review, insurance in case of audit), often times what is actually required is much different than what was originally thought, typically saving the client some significant costs, as business valuation reports can range from short, preliminary estimates to lengthy, detailed appraisal report documents. After the purpose is defined, we will determine the scope of work and methodologies used.

## Tax purposes

- ◆ **Gift and estate tax.** 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 purposes

- ◆ Valuations are required for purchase price allocations of tangible and intangible assets under ASC 805 related to an acquisition of a business. Valuations are also required under ASC 360 to test for impairment of goodwill.

## Litigation purposes

- ◆ **Shareholder disputes.** Shareholders in closely-held companies 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, a formal buy-sell agreement may require an independent business appraisal and baring an agreement it is always needed to settle disputes on the value of the shares in question.
- ◆ **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 is allocated the value of the shares of the other spouse. 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.

## Transaction purposes

- ◆ **Mergers and acquisitions.** Business 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 a transaction, as final values can either justify a buyer's investment or cause them to reconsider.
- ◆ **Financing.** When obtaining debt or equity financing, often the lender or investor 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.
- ◆ **Employee Stock Ownership Plans ("ESOP").** The formation of an ESOP and the subsequent sell of shares to the related trust requires an independent appraisal as regulations prohibit the trust from paying more than fair market value for the shares. The trustee relies upon the independent business appraiser to provide guidance on the value. These plans must be independently appraised annually to establish fair market value for administrative purposes, purchase price and the value of 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 shareholder 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.

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"), Accredited in Business Valuation ("ABV"), Certified Valuation Analyst ("CVA") and Certified Business Appraiser ("CBA"). 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.