

Burkert Valuation Advisors, LLC

VALUATION AND LITIGATION CONSULTANTS

Spotlight on Value: A Professionally Prepared Business Valuation Report

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What should an advisor look for when reviewing a formal valuation report prepared on behalf of a client? Simply put, the most technically correct calculations can be worthless if the accompanying report is not written in a clear and concise manner. Many times, the report is presented in an arena where an uninformed third-party reader (trier of fact) is required to make leaps of faith over chasms that Evel Knievel would not have attempted because the information is not complete and/or the assumptions are not supported. Thus, I have prepared a 16-point checklist of the most commonly accepted elements of a professionally prepared business valuation report to serve as a benchmark.

1. “As of” date and report date. The value of a business changes over time. The “as of” date pinpoints the particular time, and valuation reports are based upon the facts that were known, knowable, or foreseeable as of the valuation date. The report date indicates when the work was completed, and the appraiser has no responsibility to update the report for events and circumstances occurring after the issue date.

2. Purpose of valuation and standard of value. Businesses have different values for different purposes (e.g., gift/estate, dissenting shareholder, purchase/sale) and/or under different standards of value (e.g., fair market value, fair value or acquisition value). Various assumptions, guidelines, methodologies, regulations, revenue rulings, and case law will have a greater or lesser impact depending on these critical factors. The purpose and standard of value should be clearly identified.

3. Interest being valued. Is the security common or preferred, voting or nonvoting? What percentage interest is being valued, and what is the bundle of rights and restrictions associated with that interest? For example, various assumptions, methodologies, adjustments, and discounts will depend on whether the interest being valued is a minority interest or a controlling interest.

4. Company history and description. The appropriate narrative outlines the historical development of the company and an explanation of the “who, what, when, where, why, and how” of what it does. After reading this section of the report, do you understand the nature of the operations; the products and services offered; the customer base and concentration issues; sales patterns, marketing strategies, and channels of distribution; materials purchased and supplier relationships; competition and market share; any related party transactions; and pending litigation, claims, and assessments?

5. *Ownership.* Detail of the capital structure and a current share breakdown should be provided. A review of significant changes in ownership, including the pricing and terms of these transactions if they are an indicator of value, should be disclosed. The impact of any restrictive agreements affecting the shares should be discussed. These restrictions could be contained in buy-sell agreements, options to purchase stock, rights of first refusal, trust agreements, or other similar documents.

6. *Management.* Management's ability to react to changing market conditions can affect value. Risks associated with key man situations and having adequate succession plans can also impact value. Their background, strengths, weaknesses, service tenure, and any employment agreements or covenants not-to-compete should be highlighted.

7. *Financial analysis and normalization adjustments.* An essential step in the valuation is an analysis of the company's financial performance over time relative to both itself and to industry peers. Such a comparative analysis of the financial statements provides an indication of historical growth, liquidity, leverage, profitability, and relative performance - all of which influence the value of the company's equity. The normalization adjustments need to be adequately explained and defensible in light of the company's operating history and the interest being valued.

8. *Economic and industry outlook.* All investments are subject, more or less, to the broad macroeconomic forces that run through the general economy, e.g. interest rates, inflation expectations, unemployment numbers, consumer spending, and growth in gross domestic product. Another factor affecting a company's earnings capacity is the risk profile of the industry in which that enterprise operates. Industry condition should focus on the overall attractiveness of the industry and may strongly consider the advent of new technology. Industry structure should analyze the company's position in its competitive environment and may need to assess the impact of a global marketplace.

9. *Overview and reconciliation of valuation methods.* A discussion of all of the methods considered and how they were used, as well as those methods not employed and why, should be explained. Some valuation professionals disagree as to whether just one method should be selected or if multiple methods should be weighted. Either way, the synthesis of the valuation conclusion should be discussed and make sense.

10. *Development of discount/capitalization rate.* The risks associated with a company impact the risks associated with the continuity of its income stream going forward to a buyer. In most cases, the discount/capitalization rate is a key element in the valuation, and there should be a detailed explanation of how the various components of the rate were developed. Many of the factors discussed above should be incorporated in the appraiser's assessment of risk, and the nexus of the factors to the risk should be apparent.

11. *In-depth discount and premium analysis.* Courts are no longer satisfied by blind application of discount and premium studies. The narrative needs to discuss the concept of the particular discount/premium being applied, present the results of applicable studies, highlight the appraiser's familiarity with the differences in the studies, provide reasons as to why the studies' results may/may not be applicable to the subject company, and opine as to whether the discount/premium should be higher or lower and why.

12. Allow the reader to re-create all calculations and conclusion. The report should provide a clear roadmap to the successive steps taken and decisions made in arriving at the valuation conclusion. Obfuscation may preclude adequate disclosure.

13. Statement of assumptions and limiting conditions. The special considerations, general assumptions, and limiting conditions pertinent to the valuation are an integral component in understanding the valuation conclusion. They should be prominently included in the body of the report or in an appendix thereto.

14. Valuator's certification and professional qualifications of valuator. Statements regarding independence and qualifications should be provided. With respect to the former, the appraiser should not have a present or prospective interest in the company. With regard to the latter, Courts look more favorably on experts with credentials than those without them.

15. Data/reference sources. A simple bibliography allows the reader to see what authoritative sources were consulted.

16. Finally, the report is written as if it may go to court. Whatever needs to be said, needs to be in the report. The analysis must be thorough, complete, and based on supportable evidence and sound reasoning.

Post Script – Under the heading of “BV Liability Builds Up for CPA Firms”, the following recap of “As Business Valuation Niche Grows Among Firms, So Do Liability Claims”, Roger Russell, *Accounting Today*, September 3-23, 2001, pp. 1 and 44 appeared in the December 2001 issue of *Shannon Pratt's Business Valuation Update*:

The 2001 Accounting Today Top 100 Firms survey proved for the second year in a row that business valuation is the hottest growth niche in the industry. It also revealed that business valuation liability is great compared to the level of billings generated. The reasons for high liability for CPA firms undertaking BV projects seem to be as follows:

- Pressure to undertake projects based on long-term client relationship
- Lack of practice and formal training
- Lack of professional designation

Given the high number of assumptions that a BV project involves, the risk of litigation and liability is also high. Attaining one of the offered professional designations would increase the analyst's skill as well as credibility. Properly drafted ... reports that clearly state the purpose and date of valuation are also useful in limiting liability.

Rod is a co-founder of Burkert Valuation Advisors, LLC. With over 25 years of combined experience in public accounting and private industry, he has provided business appraisal and litigation consulting services for companies operating in a wide variety of industries and for various purposes. He is also an instructor for the National Association of Certified Valuation Analysts and a past chairman of its Executive Advisory Board and its Education Board.

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