



10 THINGS TO KNOW ABOUT BUSINESS VALUATION

Why are business valuations needed and
how is the value of my business determined?



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1. Why are business valuations needed?

The reason to obtain a business valuation typically falls under the following categories: transactions, tax reporting, financial reporting, and litigation. Examples of each category are as follows:

- **Transactions:** exit planning, buy-sell agreements, financing, intellectual property
- **Tax Reporting:** gift and estate tax, charitable donations, c-to-s conversions
- **Financial Reporting:** purchase price allocations, goodwill impairment testing, portfolio valuations, derivatives
- **Litigation:** marital dissolutions, shareholder disputes, bankruptcy, economic damages, fraud

2. What is USPAP? What are business valuation standards?

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). This is recognized as the official source of appraisal standards in North America. Adherence to standards reinforces a business appraiser’s expertise and the credibility of his or her work. Appraisers who fail to perform their work in accordance with USPAP standards may be subject to criticism and may have difficulty defending their conclusions in litigation.

3. How do business appraisers determine value?

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

- **Market Approach:** Evaluates a company based on completed transactions of comparable companies.
- **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 business valuation important? Do they expire?

A business valuation is the estimated value of a company at a specific point in time. The value of a company can vary at different points in time due to internal and external factors. Because a business valuation is based on a specific point in time, the valuation does not expire; however, the derived value may no longer be appropriate the older the valuation report gets.



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.

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 more training and experience than the Certified Valuation Analyst (CVA) and Accredited in Business Valuation (ABV) designations.

7. How do I critique a business valuation?

A valuation without a reasonability test is open to criticism, rebuttal and rejection. 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 taxes and provide a return to the investor.

8. 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 tax returns for the last four to five years; interim profit and loss statements and balance sheets for the current year; copies of any forecasts or projections. Other documents commonly requested include: information that describes the company's services and/or products, list of significant assets and inventory, details of any liabilities, and reports by other professionals and consultants.

9. What else can owners use a business valuation for?

Business valuations provide business owners with useful information such as where the risks are in their business, how the company's financial performance compares to its peers, where the value of the business is coming from and ways to increase that value. Business owners commonly use business valuations as a tool to enhance the operational and financial performance of their companies.

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. Depending on the scope of the valuation, a valuation can cost anywhere from \$5,000 to more than \$20,000.



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