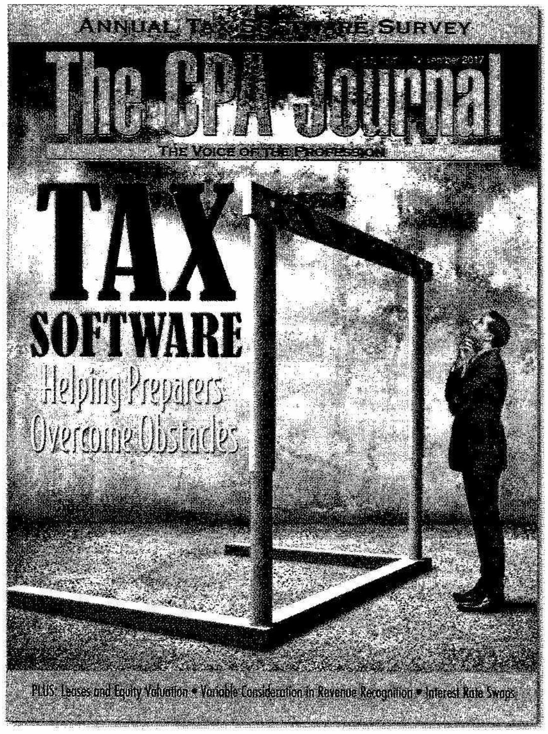
Important Clarifications on Valuation Standards

I read with interest the November 2017 article issue. "Helping Business Owners Understand Valuation Approaches" (Sidney Kess and Edward Mendlowitz. http://bit.ly/2BmvfQv). I congratulate the authors on a timely and succinct discussion of the matter. I have, however, the following three comments:

First, there are actually two types of reports that are "an official opinion and carries the most weight of any valuation prepared by CPAs." A detailed valuation report, as described in the article, is commonly used for estate and gift tax planning, as this is the only type of report that the IRS will accept. A summary valuation report, however, is often used in litigation and testimony. Although the summary report also carries an opinion, it does not detail all the calculations that were used to arrive at the opinion.



Second, the valuation standards also have a series of exceptions, including a jurisdictional exception that in practice has led many domestic relations judges to accept reports that do not comply with the valuation standards but more efficiently address a question of fact in a matrimonial litigation.

Finally, the AICPA standards require that a member (i.e., a CPA) must report a value only under the valuation standards. Accordingly, CPAs who perform "informal" valuations may expose themselves, and possibly their clients, to a claim of lack of due care. There are exceptions to this rule as well, so such valuations should be carefully documented and reported.

It is helpful to share this information with all CPAs so that we as a profession can continue to elevate the status of this important service.

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The Authors Respond

Yigal Rechtman is right on target; everything he said is accurate. There is a grave point to his comments: valuing a business is a serious service usually done for a serious purpose. The focus of the article was on valuations in conjunction with financial planning for an individual who owns a business. We tried to provide an overview of how a business is valued so the CPA financial planner would have an understanding of the overall process, the inputs into the valuation, and the variations of services.

It is our experience that many accountants offer "estimates" of a business's value when performing a financial planning engagement. We believe that this should not be done unless the financial planner is qualified to perform such valuations and then does so in the prescribed manner. Attempting to provide a value as an adjunct to the plan for the sake of expediency or in an effort to save the individual the fees for a thorough valuation could be a disservice that might result in a plan that is misleading when considering the individual's purposes for the financial plan.

Closely held businesses can have multiple values depending upon the purpose and standard. A valuation for gift planning would result in a completely different value than one for a divorce, a sale to someone who wants to own the business as an investment, a sale to someone who wants to work full time in the business, or a sale to someone who sees a synergy or has a strategic intent. Also, the business provides cash flow to the owner, and the significance of the cash flow needs to be considered in combination with the other sources the individual has and their net worth. It is confusing and needs the highest skills of the financial planner; a proper valuation should therefore be obtained.

We thank Rechtman for his comments, for pointing out the additional valuation methods, and for providing this opportunity to expand our caveats and cautions to our colleagues.

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