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Reviewing a Business Valuation

This article is a brief outline of some of the items I consider important when reviewing a business valuation.

REASON FOR THE APPRAISAL

The need for a business valuation is triggered by various events including marital dissolutions, death of a business owner, gifting of a business interest and the transaction of a business interest. A business appraisal for one of these triggering events may not be used for another purpose without first consulting the business appraiser.

STANDARD OF VALUE

Most business appraisals are at fair market value (FMV) while others are at fair value or investment value. FMV is used in most marital dissolutions and for estate and gift tax purposes. Closely read the appraisers standard of value defined in their valuation report.

THE BUSINESS APPRAISER

Read the appraiser's curriculum vitae and note the years of business valuation experience, the number of businesses appraised, types of business valuations performed and the quality of their valuation credentials such as ABV, CFA, ASA, etc.

VALUATION METHODS CONSIDERED

There are three main valuation approaches, (1) the cost, (2) the income and (3) the market approach. The cost approach is appropriate for an asset intensive business while the income approach is applicable to businesses with a history of good earnings or expect to produce solid cash flow. The market approach is based on a comparison of recent business sales to the business being valued. Valuation multiples can be derived from recent business sales and applied to the company being valued.

Try to determine which and how many databases of business sales (i.e., Pratt stats, Biz Comps, etc.) the appraiser consulted in determining the value under the market approach. Recent transactions between unrelated shareholders in the business should also be considered in determining the market value of the business.

DOCUMENTS REVIEWED

A business valuation is only as good as the information considered by the appraiser. At a minimum, an appraiser should review the last three years of tax returns and financial information of the business. Furthermore, the appraiser should ask for additional information on assets representing a large portion of the balance sheet. The appraiser should also review any covenants not to compete and any buy-sell agreements.



MANAGEMENT INTERVIEW

After the above information is reviewed by the business appraiser, the appraiser should interview the management team at the company's place of operation. I consider the interview of management to be the most critical step in collecting information about the business. An interview of management usually takes about an hour but is well worth the time.

QUESTIONS OR COMMENTS

Please call me with your comments at 916.756.5622.

— Thomas Collins, CPA / ABV, CFA