Inside the Appraisal Process:
What Estate Planners Need to Know (But Rarely Hear) — A 360° View

Business Appraisal / Valuation

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A little about Exit Strategies Group, Inc.

Business Valuation / Appraisal & Business Sale Representation

Exit Strategies provides accurate, independent business valuations (appraisals) that meet the highest professional standards. We serve clients throughout California and beyond, in many industries. Our business valuations are commonly used in:

- Estate, gift and other tax filings
- Dispute resolution, expert witness and litigation support
- Shareholder buy-sell transactions
- Exit planning
- Mergers and acquisitions transactions

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The Appraisal Process

a) CPA/Attorney homework
b) Define the engagement together

Pre-Engagement

c) Discovery: docs, interviews, research
d) Research and analysis
e) Valuation approaches and methods
f) Apply discounts and premiums
g) Reconcile indicated values

Development

h) Produce narrative report

Reporting

Pre-Engagement : Define the engagement together

Business appraisal / valuation projects vary based on needs and circumstances, so we start with a conversation with you to determine:

1. **The purpose (intended use) of the business valuation**
2. **Who are the intended users?**
3. Business: description, name, owners, location(s), entity type
4. Financial highlights: revenue, earnings, trends, major assets & liabilities
5. **Interest to value: 100% or fractional (if fractional: capital structure, key shareholder agreement terms)**
6. **Whether real estate or asset appraisals may be needed**
7. **Appropriate valuation date**
8. **Appropriate standard of value**
9. **Appropriate scope of analysis**
10. Appropriate type of report
11. **Who is our client: company, shareholder(s), attorney, CPA, bank, etc.**
12. Access to business information
13. Any unique circumstances to consider
14. Deadline or desired time frame

Standards of Value

Standard of Value	Where defined:
Fair Market Value	**IRS Revenue Ruling 59-60; Treasury Regulations Subchapter B, Sec. 20.2031-1.**
Fair Value (dissenting SH, minority oppression cases)	Minority oppression statutes, CCC §2000. Study case law to determine how interpreted.
Fair Value (financial reporting)	FASB, SEC.
Investment Value	International Glossary of BV Terms. When the buyer is known (not hypothetical).
Most Probable Selling Price	IBBA

IRS Revenue Ruling 59-60

Eight Factors to consider in FMV:

1. Nature and history of business
2. Economic outlook
3. Book value of stock and Financial Condition
4. Earning capacity of company
5. Dividend paying capacity of company
6. Goodwill or other intangibles
7. Stock sales and size
8. Market price of similar stocks

What is Fair Market Value?

The most broadly used definition:

"the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts."

Source: IRS Revenue Ruling 59-60

(Treasury Regulations, Subchapter B, Sec. 20.2031-1 uses slightly different language.)

Fair Market Value Discounts & Premiums

- **Control** – the power to direct the management and policies of a business enterprise
  - A minority shareholder’s lack of control increases risk, resulting in a lower share value.
- **Marketability** – the relative ability to convert shares to cash quickly and at minimal cost
  - Closely-held versus public company stock
  - Minority versus controlling interests
  - Restrictions on the sale of stock, public or private

Scope of Work Options

- Typically two levels per professional standards*:

Valuation / Appraisal	**Tax valuations require full scope research and analysis.**
Calculation	Limited in scope, agreed upon procedures. Not acceptable to IRS. Not recommended for litigation.

* ASA and USPAP also allow a Limited Appraisal, which is between these two in scope.

Business Valuation / Appraisal Report Options

1. Detailed

    (100% replicable)

2. **Summary**

    (closer to detailed)

3. Restricted

    (USPAP: client only)

4. **Calculation**

    (not USPAP)

Difference is in the contents and level of information required

These are not the exact terms from any one standard.

Development section of the appraisal process

- **Company Survey** – depth of management, age of equipment, plant capacity, customer concentration, capital expenditures, SWOT, etc.
- **Financial Review** – 5-year history; ID trends, compare operating ratios to industry benchmarks, analyze capital structure (debt, WC, equity) components.
- **Economic and Industry Conditions and Outlook**
- **Determination of Appraisal Methods & Earnings Base** to use
- **Apply Discounts (Levels of Value)** – minority, lack of marketability
- **Reconciliation of Appraisal Methods and Conclusion of Value**
- **Tests for Reasonableness**

Appraisal / Valuation Approaches and Methods

Approach	*Methods*	Description of Methods
Asset	*Adjusted Book Value / Net Asset Value*	Value of an entity's underlying assets, net of liabilities.
	Excess Earnings (RR 68-609)	NAV plus value attributable to intangibles based on earnings in excess of required return on tangible assets
	Liquidation Value	Value in orderly or forced liquidation
Income	*Single Period Capitalization (SPC)*	Divides single period *normalized* earnings by an appropriate capitalization rate.
	Multi-Period Discounting (DCF)	Present value of future multi-period normalized cash flows, discounted using an appropriate rate of return.
Market	*Direct Market Data*	Compares the subject to similar businesses sold
	Guideline Public Companies	Similar to the SPC method, but uses comparable public companies to derive an appropriate capitalization rate
	Prior Transactions	Considers prior transactions in the subject interest

Note: Unique methods may be appropriate for companies in specific industries where reliable data is available.

Business Valuation / Appraisal Standards - Organizations

- **AICPA**
- **ASA** (also RE, PP, M&E appraisal)
- **NACVA**
- **Appraisal Foundation** (also RE and PP appraisal)
  - Uniform Standards of Professional Appraisal Practice (USPAP)

Other - IRS has some Internal BV Guidelines, Job Aids DLOM/S-Corp/Reasonable Comp.

1. *Terminology varies.*
2. *There are more similarities than differences.*
3. *Compliance with any of the 4 BV standards should satisfy the IRS.*

Business Valuation / Appraisal Credentials

The Pension Protection Act of 2006 and IRB 2006-46 define a qualified appraiser and appraisal for federal tax purposes. Accredited / Certified appraisers are qualified.

ABV Accredited in Business Valuation

- American Institute of CPA's (AICPA)

ASA Accredited Senior Appraiser

- American Society of Appraisers (ASA)

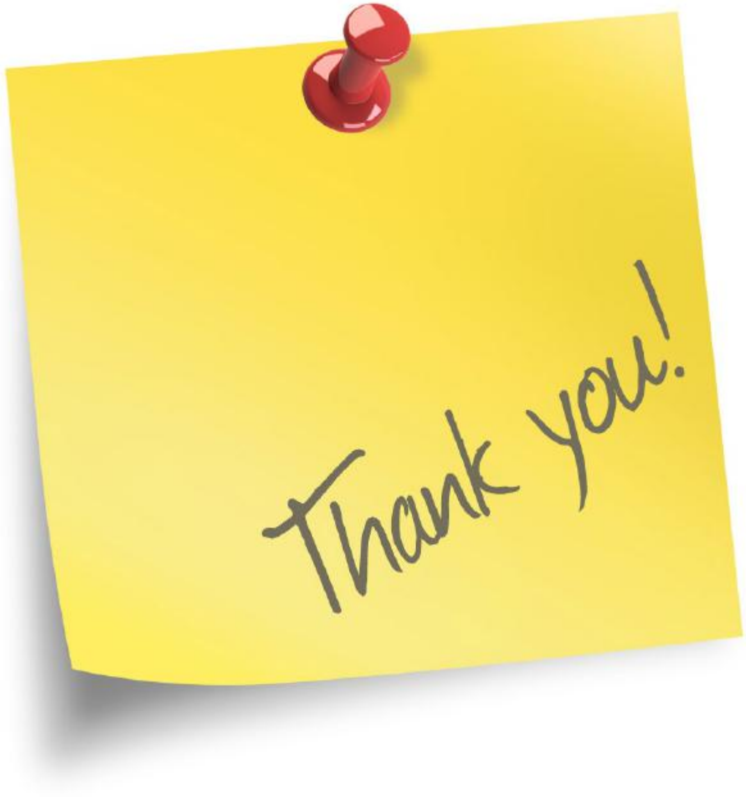
CBA Certified Business Appraiser

- Institute of Business Appraisers (IBA)

CVA Certified Valuation Analyst

- National Association of Valuators and Analysts (NACVA)

An appraisal by a credentialed appraiser is less likely to be audited.



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