How does the economy bias valuations?

In a perfect world, a business valuation would be a totally objective assessment of a company's worth.

But many factors can influence the outcome, including parties involved and the purpose of the valuation. That type of bias might be readily identified and understood.

Some companies grow during recessions. Conversely, some fail in good times.

What may not be so clear is the influence of the general economy in the valuation of a company and why it is crucial the valuation includes an analysis of the industry and economy.

People tend to assume the current situation will continue, so if the economy is booming, there will often be a sense of urgency that can bump business values upwards. Everyone wants to cash in on rising markets.

The opposite can also happen. During the recent recession, property values plummeted, and there was a pervasive belief that business was bad everywhere, for everyone.

Distress sales and foreclosures created a further downward drag, as the pool of comparable transactions shrank in number and sales price.

In actuality, some companies grow during recessions. Conversely, some fail in good times. The following situations can all be true:

- A company in a growing sector is undercapitalized and undermanaged, so it fails.
- Despite challenging industry performance, a business operates prudently, riding out the recession until better times.
- Some industries perform well during recessions.
- Certain industries are unaffected significantly by either recession or growth.
- A business seizes growth opportunities by buying up defunct or failing companies in its sector.
- A product or service is in decline and becoming obsolete.
- The poor economy has affected sales to the point that the business is in distress or bankruptcy.

To minimize economy bias, there needs to be a deep understanding of the sector and industry. A good or bad economy can cause micro-bumps or declines in overall performance.

What's the long-term history and outlook? Some industries have experienced a long, slow death as production has moved overseas. Consider the paper industry, which also affects the associated sectors of trucking and logging. Once the mills closed, truckers and loggers needed to find new markets or go out of business.

Other industries have become more efficient, thereby lowering the cost of items. This can be a double-edged sword. For example, there is burgeoning demand for consumer gadgets, but repair and service companies are practically obsolete. It's just not worth it to fix cheap devices.

Demographics are another factor beyond company or industry control. Analyzing the present and future

See **Economy bias** *inside*

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Valuations and litigation support information from the office of:

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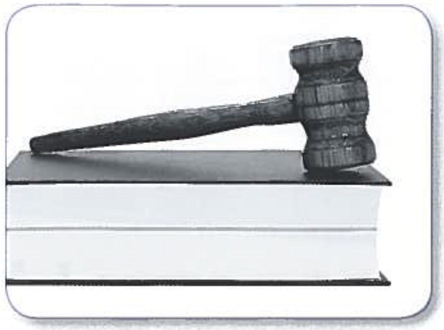
Five overlooked ways forensic CPAs can help attorneys

Attorneys who use forensic accountants are familiar with the analysis and testimony an expert can provide in matrimonial cases, commercial disputes, lost profits claims, criminal and civil cases, and other types of litigation.



Typically, financial experts are called on to calculate, analyze and prepare reports, as well as refute the opposing expert's testimony. Experienced litigators use forensic accountants throughout the development of a case. The following are five often overlooked areas where a forensic accountant may prove to be invaluable to a successful outcome.

1. Pre-case analysis

Every attorney understands that each case should be judged on its economic merits. Pre-case analysis by a forensic accountant will help determine if the financial outcome will exceed the cost of litigation.

Prior to accepting a case, attorneys should invite their expert to an initial client meeting to review relevant financial evidence and evaluate the merits of the case. By determining the economic feasibility of a case, forensic accountant can help eliminate needless protracted litigation in matters that have little or no financial value.

2. Assistance in preparing the pleading

Financially based cases often require the pleading to contain concepts that are best expressed in precise technical terms. Many times pleadings fail to identify the correct financial concepts and therefore contain vague and incomplete allegations.

Forensic accountants can assist attorneys in making sure the goals of the case and specifics of the allegations are clear.

3. Preparation of production request

Because cases differ by industry, business type, subject matter and number of litigants, unique records are required in every forensic analysis of financial data.

It is essential to the success of a case that the exact data needed is requested by its precise nomenclature. Improper terminology often results in production delays or not receiving the appropriate data.

Additionally, should the opposing counsel object to the production request, the forensic accountant could provide the explanation necessary to sustain the merits of the request.

4. Scripting direct and cross-examination

As a result of their investigative work, experts are in an excellent position to prepare questions to be used in their overt testimony. Complex financial data usually confuses the average trier of fact and often results in middle-of-the-road decisions. Forensic accountants know which financial points concisely portray the case.

By determining the salient questions to be asked during direct testimony and using written or graphic presentation aids, forensic accountants script the "story" of the case. Testimony that is simple to understand and avoids overly technical issues will most effectively support your argument.

Conversely, armed with the knowledge of the opposition's data, forensic accountants can develop question scenarios that will bring out inconsistencies or weaknesses in the opposition's case.

5. Mediation

Perhaps the most overlooked area regarding the proper use of forensic accountants is in the area of mediation. During this dynamic process, a financial expert should evaluate every financial offer, counteroffer or compromise.

Tax implications often need to be considered before arriving at a settlement. Forensic accountants can assist attorneys by clearly explaining to their clients the economic impact of any proposed agreement. Finally, the working of the final settlement should be critiqued to ensure compliance with various financial criteria. ■

Economy bias *continued from front*

customer base is critical, whether selling to businesses or consumers. Is it growing or shrinking? Are trends killing the market for the company's products or services? Is the company seeking and responding to new opportunities?

For certain sectors, suppliers are another area to consider, as well as trends in those industries. If raw materials are sourced in a politically unstable area of the world or are subject to environmental scrutiny, that could be key to future viability of the company. Wholesale price trends and number of suppliers can also influence profitability.

The operating geography also needs to be examined. The scope of that picture will be different depending on whether the company is global or operates in a specific city or neighborhood.

If customers are local and the area is in decline, it could greatly affect value. Conversely, redevelopment plans or large companies coming in might provide opportunity for those who can sit on their investment.

Tourism is an industry that can be volatile in down markets. The long-term visitor trend for an area should be examined to determine if declining sales are likely to reverse when disposable income bounces back.

Once a solid picture of the industry and environment has been developed, analysis of company performance can be reviewed in this context. Peer performance and industry financial ratios can shed light on whether the company is adequately managed considering current challenges and opportunities. This is in addition to the standard financial statement review and assessment of liquidity, liabilities and equity.

Poor management might mean a golden opportunity for the right owner, since possible profits are being eroded. Or the company's goodwill might be nonexistent, in which case an asset sale could be the way to go. – *Elizabeth Penney, M.B.A.* ■

Why it's vital to know the value of your business

Would you be surprised to learn that most business owners don't know the value of their own businesses?

More than half of business owners have never had their company valued and don't anticipate doing so, research shows, and many believe they don't need a valuation unless they are planning to sell their company.

This belief can be short-sighted.

The reasons a business owner would choose not to have a valuation done run the gamut – from the assumed costs involved, to not believing it is necessary, to simply not understanding the impact of not doing so.

An accurate business valuation can be a valuable tool in many instances, and overlooking this critical part of your asset portfolio can lead to unintended consequences, both fiscally and personally. Many have faced burdensome taxes and personal animosities over perceived entitlement to a value of a business.

In addition to giving business owners important information about the quality, viability and possibilities about their businesses, business valuations are used for a variety of specific situations:

▲ **Estate, gift and trust planning.** A family-owned business is often a significant part of an owner's net worth. Proper estate planning can help to transfer interests in the family business to the next generation or other designated people. This can save tax dollars as well as assist in the smooth transition of leadership in the business, thereby helping to secure the continued success and profitability of the company for generations to come. Without proper planning, the death of an owner may result in the death of a significant asset. A business valuation can be a means to accomplish the long-term goals of the owner.

▲ **Owner buy/sell agreements.** Whenever people go into business together, it is highly advisable that a formal buy/sell agreement be used to outline the process that will take place should an owner or owners decide to leave the business, become incapacitated or die. Part of that process would be the valuation of the business itself, to provide all of the owners with the proper numbers to effectuate a buyout. Having a valuation done on a regular basis provides the owners with the tools they need to plan for these future occurrences and possibly to obtain insurance coverage needed to fund a buyout. Long and costly litigation can result when a buy/sell agreement does not exist or fails to address how to value the business.

▲ **Mergers and acquisitions.** When one company buys out another or merges with it, a business valuation is essential to determine the fair price to be paid for this transaction. Having a valuation done could point out the various strengths and weaknesses of both companies and help assess if this is a transaction that is beneficial and cost effective. Having a regular valuation done can also help prospective sellers identify the right time to sell or merge and will provide the buyers with a base from which negotiations can begin.

▲ **Divorce settlements.** An ownership interest in a business that was acquired during a marriage is usually an asset subject to division among the parties in a divorce. This can often be one of the most significant assets the divorcing parties own. Therefore, a value needs to be placed on the business so that the

parties can determine the distribution of the assets held in the marital estate. Often a business owner does not know the value or guesses at it – which can lead to poor results for one or both sides during a divorce litigation. With a business valuation in hand, the parties can determine the value of marital assets and then how to divide all of those assets.

▲ **Litigation matters.** Over the life of a business, there may be times when legal matters are initiated. This could be for a variety of issues, such as shareholder disputes, insurance claims for lost business or possibly eminent domain proceedings. In all of these instances, the value of the business can be an integral part of the litigation. Armed with the knowledge of the value, the litigant can put forth a case based on careful analysis and documentation.

For larger companies, a business valuation would be needed if the company has an employee stock ownership plan (ESOP) or if the company wants to go public in what is known as an initial public offering.

Benjamin Franklin once wrote, "In this world nothing can be said to be certain, except death and taxes." He wrote this in 1789, and it stands true today.

While death cannot be avoided, proper planning and use of a business valuation can often help alleviate tax burdens while also providing business owners with pertinent information that will assist them in a variety of situations. – *Lynne Broza, CPA/ABV, CFF* ■

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Study: Litigators most in demand as hiring increases

Salaries have not returned to pre-recession levels, but many firms are willing to increase salaries to attract the right legal talent, according to a new Robert Half Legal survey on hiring.

Better benefits, flexible scheduling, telecommuting and subsidized training are also being thrown into the mix to appeal to top prospects, the study of 200 attorneys in the nation's largest law firms and corporations found.

More than half of the attorneys surveyed said it is challenging to find skilled legal professionals today. Top candidates who have specialized skill sets, a stable work history, technology expertise and interpersonal skills and who meet the requirements of the position often receive multiple offers as well as counteroffers.

Law firms are looking to hire attorneys with three to seven years' experience in high-growth areas who are able to assume full caseloads, bring in clients and target new business prospects. In particular, according to the survey, firms are searching for senior-level lawyers "with portable books of business or consulting backgrounds."

The practice area most in demand is litigation, with 38 percent of respondents saying their firm will have the most job opportunities in that area in the next two years.

Specialties next highest in demand are general business/commercial law, 19 percent; healthcare, 6 percent; intellectual property, 6 percent; personal/family law, 5 percent; and labor/employment law, 4 percent.

Corporate legal departments are looking for attorneys with strong backgrounds in compliance, corporate transactional law and contract administration to keep up with the demands of government regulatory compliance.

Internal corporate teams are being expanded to handle more matters in-house to save on outside legal fees. They are looking for attorneys with previous law firm experience and knowledge of their business sector. Hiring of new law school graduates has increased only slightly.

As demand for top candidates has increased, so have retention fears as law firms and corporate offices work to avoid losing their top talent to competing firms.

Half of the lawyers responding said increased compensation and bonuses is the best retention incentive. Assigning challenging work and a variety of assignments is seen by 20 percent as a strong retention incentive. Flexible work arrangements (12 percent) and professional development opportunities (11 percent) were also named as helping with retention.

To assist with business growth, many legal offices are looking for patent attorneys with a degree in science-related disciplines, as well lawyers who also hold an MBA. ■