

VIEWPOINT ON VALUE



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Despite strong demand, sector is plagued by uncertainty

Valuation date:
Timing is everything



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Why companies need to put a price tag on intangible assets

In today's marketplace, patents, copyrights, brands, customer lists and other intangible assets add significant value to many companies. However, because intangibles are often developed internally, they're rarely included on a company's balance sheet. The unique nature of these assets also makes them harder to value than hard assets, such as receivables or equipment. Here are some common reasons for businesses to identify and assign value to intangible assets.

Company decision making

Intangible asset values are important to know when managing a company's day-to-day operations. For example, businesses need to know how much intangibles are worth when they:

- Purchase general liability and business interruption insurance,
- Pledge intangible assets as collateral for financing,
- Enter into a joint venture with an individual or company to develop new products,
- License intangible assets to (or from) another entity, or
- Sell intangible assets to a third party.

Likewise, when companies buy or sell a business, the value of intangibles takes center stage. Sellers need to understand the types of unrecorded intangible assets they've accumulated over the years to set a realistic asking price. And buyers need to perform sufficient due diligence on the value of intangibles to make a reasonable purchase offer — and to avoid overpaying.

Financial reporting

When one company acquires another, U.S. Generally Accepted Accounting Principles

(GAAP) requires the purchase price to be allocated among the acquired tangible and intangible assets. These accounting rules now give private companies the option of electing to amortize goodwill over a period of ten years (or less, if the conditions warrant a shorter amortization period).

On an ongoing basis, public companies — and private companies that don't elect the alternate accounting treatment — must test unamortized intangible assets at least annually for impairment. This occurs when the asset's fair value falls below its carrying value on the balance sheet. Impairment testing also

Tricks to gauging intangible value

There's a quick and easy trick to demonstrate how important intangible assets are to the average company's value: Compare a few of your favorite public companies' market capitalizations to their net book values. In general, the higher the price-to-book value ratio is, the more intangible assets add to the company's value. High price-to-book ratios frequently are observed for manufacturers and homebuilders that rely on brands, investments in research and development, and the skills and reputations of their key owners and employees.

There may be other reasons for the price-to-book differential besides the presence of unrecorded intangible assets, such as the use of accelerated depreciation methods or temporary investor exuberance. Investors and other stakeholders usually want a more reliable estimate of value for intangible assets than this ratio provides. So, it's important to hire a valuation professional to get a reliable estimate of fair market value.

may be required when a triggering event happens, such as the loss of a major customer or introduction of new technology that makes the company's offerings obsolete.

Property tax issues

In most states, the local government collects property taxes on a business's real estate and certain types of tangible property, such as equipment. But intangibles — such as brands, licenses, contractual rights and proprietary technology — may be specifically exempt from property taxes.

Companies can use an appraisal of these assets to petition for a lower assessed value. Separating tangible and intangible asset values can significantly lower a company's property tax bill, particularly if it generates income from real property, as do luxury golf courses, recreation facilities and resorts.

When appraising intangibles, valuers often turn to the income approach, which derives value from expected future earnings and the associated risks of achieving those earnings.

Litigation matters

Disputes over intangible asset rights — such as patent infringement or breach of contract — often require a valuation of intangible assets and/or lost profit analysis. The value of intangibles also comes into play in minority shareholder disputes that result in statutory appraisal actions and divorce cases. In theory, if a business owns intangible assets, they should be included in the value it awards to minority shareholders.



And the value of goodwill can be a major sticking point in states that specifically include (or exclude) portions of this intangible asset when splitting up a marital estate.

Specialized assistance

In general, the same valuation methods are used for tangible and intangible assets, including the cost, market and income approaches. When appraising intangibles, valuers often turn to the income approach, which derives value from expected future earnings and the associated risks of achieving those earnings. The cost and market approaches are more difficult to apply, because it can be challenging to accurately estimate the cost to replicate a unique intangible or find truly comparable sales (or royalty rates) for similar types of assets.

Regardless of the intangible asset or your clients' reason for valuing it, be sure you work with a qualified appraiser. Every appraisal organization offers some type of continuing professional education courses on valuing intangibles. Before engaging a valuator for these hard-to-value assets, ask about their previous experience, published academic research and education in this specialized niche. ■

A closer look at valuation credentials

The business valuation (BV) discipline has grown up over the last few decades. Valuers — and the judges and attorneys who rely on them — have become increasingly sophisticated in complex financial matters.

Despite growth in the BV knowledge base, many gray areas persist, necessitating the use of credentialed valuation experts. Here's a road map to help you navigate common credentials and determine how dedicated a practitioner is to the field of BV science.

Decoding business valuation credentials

Several organizations offer BV credentials, including the American Institute of Certified Public Accountants (AICPA), the American Society of Appraisers (ASA) and the National Association of Certified Valuators and Analysts (NACVA), which merged with the Institute of Business Appraisers (IBA) a few years ago. The most common business valuation credentials you'll likely encounter are:

Accredited in Business Valuation (ABV). This requires a CPA license and AICPA membership. Candidates also must have taken 75 hours of BV coursework within the previous five years, pass an exam and complete six valuations (or 150 hours of valuation experience within the previous five years).

Accredited Senior Appraiser (ASA). These professionals undergo a series of six courses and exams, approval of a demonstration appraisal report, and five years (or 10,000 hours) of full-time business valuation experience for accreditation. After two years of valuing businesses, a candidate may use the Accredited Member (AM) designation, if all the other requirements have been met. The ASA also offers programs for members who want to specialize in valuing intangible assets and health care providers.

Certified Valuation Analyst (CVA). NACVA merged two credentials into one designation

(CVA) in April 2013. Formerly, the only difference was that CVAs were also CPAs, whereas Accredited Valuation Analysts (AVAs) required an MBA or other business degree. NACVA requires CVAs to take a five-day class, pass an exam, submit a case study or demonstration appraisal report for peer review, and complete two years of related experience (or perform 10 valuations).

The AICPA plans to launch a fair value credential related to valuing businesses and intangible assets in the spring of 2016, as well as rolling out a new credential for valuing financial instruments in the fall of 2016.

Accredited in Business Appraisal Review (ABAR). NACVA also offers a credential that certifies competence in reviewing valuation reports and analyses performed by others. ABAR candidates must hold another professional designation by a recognized appraisal association, complete a five-day course, pass an exam, prepare a sample business appraisal review report and submit four professional references.

Certified Business Appraiser (CBA). Since the NACVA/IBA merger, CBAs must take the same courses as those who earn the CVA designation. CBAs also must submit two demonstration reports and pass a five-hour exam.

Measuring fair value

Last year, during a meeting of the Standing Advisory Group of the Public Company Accounting Oversight Board (PCAOB), public companies, audit firms, valuers and investors expressed the need for a uniform set of

credentials for valuation specialists. Many believe that common education programs, exams, disciplinary actions, and professional ethics standards would improve the consistency of fair value estimates used for financial reporting purposes. However, the PCAOB hasn't yet issued any proposals, and the discussions are still in the preliminary stages.

Meanwhile, the AICPA plans to launch a fair value credential related to valuing businesses and intangible assets in the spring of 2016, as well as rolling out a new credential for valuing financial instruments in the fall of 2016. The AICPA hasn't yet revealed whether these credentials will be in the form of a new acronym or a special symbol that's added to a professional's existing BV credentials. The group is currently working on performance frameworks, fair value technical guidance, exams, experience and education requirements, and quality review guidance for these fair value credentials.

Monitoring compliance

Each organization also has its code of ethics and professional standards, such as the Appraisal Foundation's *Uniform Standards*



of Professional Appraisal Practice and the AICPA's *Statements on Standards for Valuation Services*. Although these standards tend to be fairly similar, it's important to review a valuator's report to ensure he or she is in compliance with all requisite standards.

In addition, each organization requires its members to take continuing professional education courses. Check whether a valuator is current on his or her educational requirements. Failure to stay atop continuing education could indicate that a valuator isn't familiar with the latest trends and research. ■

Rx for valuing health care providers

Despite strong demand, sector is plagued by uncertainty

Investors generally are more interested in *future* cash flows than historical performance. But how much money will, say, a hospital, assisted-living facility or imaging center make in today's volatile, regulated environment? Nowadays, valuing a health care provider can be like hitting a moving target, requiring the use of a valuator with specialized experience.

Opportunities and risks

The Affordable Care Act (ACA) provides growth opportunities as more Americans have access to affordable health care than ever before. But how much a specific provider will benefit from the ACA-driven demand depends on its specialty, patient demographics, geographic location and other factors.

Another question mark is whether new patients who are unfamiliar with health care services will require more attention from the staff than existing patients to educate them about preventive care, undiagnosed medical conditions and billing issues. Also, having more patients means that a provider could face more malpractice claims, raising the cost of insurance.



When projecting future growth, valuers consider how much unused capacity a provider currently has. If it needs to incur additional fixed costs — such as renting additional office space, purchasing more medical equipment or hiring another full-time nurse — those costs need to be factored into the cash flow projections, too.

Added costs

Another key objective of the ACA is to rein in health care costs. Private insurance companies often base their reimbursement schedules on federal Medicare schedules, which have decreased in recent years. Payers are also increasingly critical when approving charges, resulting in an increase in state and federal investigations for questionable billing practices, such as:

- Phantom or repeat billing,
- Self-referrals,
- Unbundling of medical services, and
- Upcoding for more expensive services than were actually provided.

As patients are held more accountable for health care spending under the ACA, retail providers — such as an urgent care clinic in a Target or CVS — have emerged as a new source of competition for doctors and hospitals. All of these factors present added risk to providers.

Extra overhead

Beyond the effects of the ACA, providers face ongoing administrative burdens as they comply with the Health Insurance Portability and

Accountability Act (HIPAA). Compliance requires capital investments and staff training to achieve HIPAA's provisions for electronic medical recordkeeping, physician quality reporting and medical service coding. Failure to comply could result in steep penalties.

As more patient data is transmitted electronically and stored on computers under HIPAA, providers must take proactive measures to protect it from theft by unethical employees and external parties. These costs add to a practice's overhead and eat away at profits.

In recent years, many providers have merged to spread overhead costs over a larger base and negotiate more favorable reimbursement rates. Doctors, nurses and technicians often prefer working for these larger groups, which allow for more flexible, family-friendly work hours and more predictable take-home pay.

When a publicly held health care entity acquires another provider, investors may question the price, postacquisition compensation arrangements and other deal terms. Valuers are increasingly called on to assess the reasonableness of high-profile health care deals and demonstrate that management acted in good faith.

A balanced approach

Federal regulations regarding Medicare reimbursement schedules and patient privacy are ever-changing. And the ACA continues to face legal challenges and congressional threats to repeal all or part of the law. When they appraise health care providers, valuers work to balance these risks and rising costs with the potential growth opportunities. ■

Valuation date: Timing is everything

In an uncertain market, value can fluctuate significantly over time. So it's important to choose the valuation date carefully. Often, the date is prescribed by law or a judge. But sometimes attorneys are allowed to decide between different dates. Here's a closer look at this fundamental decision.

Estate tax valuations

When valuing assets for estate tax purposes, executors can decide to use the date of death or an alternate valuation that occurs six months later. It usually makes sense to estimate fair market value at both dates — or at least to evaluate whether market conditions have changed materially between the dates.

If an estate chooses the alternate date, it must be used for *all* assets in the estate. In addition, the IRS may consider sales proceeds to be indicative of fair market value if they're sold soon after the date of death.

Divorce cases

When divvying up a marital estate, state law or a judge may dictate whether it's appropriate to estimate the value of business interests on the filing date, the trial date or an alternative cutoff date that's based on the end of the company's fiscal year. In some states, attorneys may request a specific date based on what's most "fair" to both spouses.

Minority shareholder disputes

In cases involving dissenting or oppressed minority shareholders, the appropriate valuation date is generally the date immediately preceding the wrongdoing that triggered the litigation. But, depending on state law, a party sometimes may argue for a different date.

For example, there might not be sufficient financial data to perform a valuation. Or an



unrelated external event may have temporarily increased (or decreased) the business's value around the time of the alleged wrongdoing.

Subsequent events

The valuation date serves as a cutoff for the information that can be used to estimate value. In general, valuers can't consider any events that happen after the valuation date, unless the information was "reasonably known or knowable" on the valuation date.

However, there's a key distinction between events that affect value and those that are indicators of value. A valuator may consider an arm's-length sale or bona fide third-party offer that occurs within a reasonable time frame as an objective indication of value, as well as intervening facts and circumstances that have drastically changed the value of the business since the valuation date.

Wise choice

Choosing the appropriate valuation date can be just as important as choosing the valuation method. Unfortunately, there's no universally correct answer. Discuss this issue with your valuator to make sure you're using the appropriate date based on relevant laws, circumstances and information available. ■



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John M. Leask II (Mac), CPA/ABV, CVA, values 25 to 50 businesses annually. Often, Mac's valuations, oral or written, are compiled in conjunction with the purchase or sale of a business, to assist shareholders prepare buy/sell agreements, or to set values when shareholders purchase the interest of a retiring shareholder. Here are examples:

- **Due Diligence & Assist with Purchase of a Business.** Mac has assisted purchasers of businesses by determining or reviewing the offer. He helps negotiate the price, perform due diligence prior to closing and/or helps structure and secure financing. Services have included, but are not limited to, verifying liabilities and assets, reviewing sales and expense records, and identifying critical issues relating to future success, and helping management plan future operations.
- **Family Limited Liability Partnerships, Companies & Closely Held Businesses.** Mac regularly values various sized business interests for estate and gift tax purposes. He provides assistance to estate and trust experts during audits of reports prepared by other valuers.

Mac also helps business owners and their CPAs and/or lawyers in the following ways:

- Planning — prior to buying or selling the business
- Prepare valuation reports in conjunction with filing estate and gift tax returns
- Plan buy/sell agreements and suggest financing arrangements
- Expert witness in divorce & shareholder disputes
- Support charitable contributions
- Document value prior to sale of charitable entities
- Assist during IRS audits involving other valuers' reports
- Succession planning
- Prepare valuation reports in conjunction with pre-nuptial agreements
- Understanding firm operations & improving firm profitability

More information about the firm's valuation services (including case studies) may be found at www.LeaskBV.com.

To schedule an individual consultation or to discuss any other points of interest, Mac may be reached at 203 - 255 - 3805. The fax is 203 - 380 - 1289, and e-mail is Mac@LeaskBV.Com.

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 **John M. Leask II CPA, LLC.**
Business Valuation Services

If you have a business valuation problem, Mac is always available to discuss your options — at no charge.