JIM HITCHNER'S VALUATION PRODUCTS AND SERVICES

Q&A

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A free Q & A periodical to promote education, build consensus and answer your questions in the financial valuation and litigation services industry.

Email your question to: jhitchner@valuationproducts.com

WORKPAPERS RETENTION

Question 1: Our firm retains valuation workpapers for 10 years and copies of reports indefinitely. One of my partners was asking what is recommended for keeping the workpapers for an S-corp conversion valuation. In case of audit 10 years from now, let's say the IRS brought up a built-in-gains issue; we would have a copy of the report and attachments, but maybe not the workpapers. Should we retain the workpapers in a permanent file?

Answer 1: First let's be clear that there is no BV standard requirement to keep the workpapers for that period of time. Having said that, your firm will have to make a determination as to whether it is prudent to retain the workpapers in addition to the report. Will the workpapers add to the disclosures made in the report other than that the workpapers might document that the actual work was done? (Isn't that really implied in the report and not necessarily an IRS requirement?) I would also point out that the IRS could audit the S conversion issues for up to 13 years, or three years after the 10th year return is filed, so you might be talking about retaining reports and perhaps workpapers for 13 years. However, the most conservative approach obviously would be to retain both the report and the workpapers until the entire issue is beyond the last statute of limitation. An interesting twist on this is if you are the valuation analyst but your firm does not prepare the return that is filed for the conversion. It is our firm policy not to provide workpapers as they are our property. Should the tax preparer's firm require that you keep the workpapers and report? Perhaps.

Answer by: Jim Alerding, CPA/ABV, ASA, CVA, Clifton Gunderson, LLP, (Indianapolis), one of only four members of the AICPA Business Valuations Standards Writing Task Force and served for the entire six years up to the June 2007 official release of the standards. Jim.alerding@cliftoncpa.com.

DELISTING ADJUSTMENTS

Question 2: I have a client that has an interest in a Company traded in the UK. The Company found material accounting misstatements and has been delisted. We are in the process of valuing our client on a net asset basis and this investment in the delisted Company is material. Can you tell us where to find substantiation for a discount for being delisted, whether in the U.S. or the UK?

Answer 2: The company is probably in some trouble and is obviously no longer liquid. For the U.S. you can look at the Morningstar/Ibbotson *SBBI 2009 Valuation Yearbook*, pp. 103-104 on Delisted Return Bias. You may also want to look at Duff & Phelps and the PWC study referenced. Ibbotson also publishes international cost of capital and risk premium reports that include the UK. You may want to see if they have any information on delisting.

Answer by: Jim Hitchner, CPA/ABV/CFF, ASA, Valuation Products and Services, LLC, Financial Valuation Advisors, Inc. and The Financial Consulting Group, LLC (Ventnor City, NJ) jhitchner@valuationproducts.com.

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ASSET VS. STOCK DEALS AND AMORTIZATION ADJUSTMENTS

Question 3: In valuing a company, many companies are asset deals vs. stock deals. In an asset deal (and also sometimes in stock deals) you can amortize intangible assets and goodwill which can be a substantial benefit. Should we be addressing this in the valuation of companies?

Answer 3: It depends. In the world of M & A, buyers most definitely weigh the pros and cons of deal structure in determining the price they would pay, and one of the pros of doing an asset deal is that the buyer gets to amortize acquired intangibles. But obviously sellers often prefer stock deals.

For non - M & A valuations, the issue becomes murky. For financial reporting (control-based valuation), it is appropriate to model in a DCF a hypothetical deal structure, and that structure more often than not mirrors the actual deal structure, as that is what the market participants agreed to. For tax, litigation and other purposes, DCFs may or may not be used. In any event, one must look at the valuation on a case-by-case basis. And remember, when valuing a minority interest, it would be inappropriate to include an amortization benefit, since an underlying assumption is that a minority interest cannot force a sale of a business.

Answer by: Steve Hyden, CPA/ABV, ASA, The Financial Valuation Group (Tampa), coauthor of Valuation for Financial Reporting, Fair Value Measurements and Reporting, Intangible Assets, Goodwill and Impairment, 2nd edition, 2007, Wiley. shyden@fvgfl.com.