



BUSINESS VALUATIONS FOR FORENSIC ACCOUNTANTS - A CHECKLIST

BACKGROUND

Members of ICAEW's Forensic & Expert Witness Community may often be called upon to value a business in a contentious situation. The most common are family matters (where one spouse will be taking the business out of the marriage), partnership disputes (where one partner may be leaving the business) or private company shareholder disputes under Section 994 of the Companies Act (a prayer for relief by the Court where a shareholder contends they are unfairly prejudiced by the actions of the directors).

This practical perspective cannot be a textbook on valuation; it merely provides a checklist of matters to be considered. If you need a full treatise, a couple of useful textbooks are Tolley's Practical Share and Business Valuation by David Bowes from LexisNexis, ISBN 13: 978 0 7545 3536 2 or Practical Share Valuation (7th Ed.) by Nigel Eastaway & others from Bloomsbury Professional, ISBN 9781526505088.

COMPETENCE

Assess your own competence before accepting a valuation assignment. Are you relying on your general accounting skills, perhaps acquired long ago in professional examinations, or are you up to date with current developments in business valuations? Do not risk your own reputation, or that of your profession, by accepting an assignment you are not competent to undertake.

THE FUNDAMENTALS

Consider first the forum you are addressing. In a contentious situation a report is required, so ascertain to whom the report is to be addressed; generally the Court, but which court? There are differences in the Expert's Declaration for the different courts.

Then think about the legal status of the business being valued. If it is a partnership, get a copy of the partnership agreement. If it is a limited company, consider the rights attached to the shares to be valued. Or is this limited company merely the vehicle by which effectively a partnership is conducted? In a quasi- partnership each shareholder owns a fixed amount of the company, with no mark-up for control and no discount for a minority holding.

Understand the business. At some point (and not necessarily before your basic fact-find) it is valuable to 'walk the course' – visit the factory, walk the shopfloor, chat to the workers, get a feel for the business. But be careful of your status as an expert; for instance, it would not be right for a Single Joint Expert (SJE) to be shown around the business without a representative of each side being present. Anything learned at such visits should be recorded, and such notes are disclosable. Consider exhibiting any such notes to your report.

THE HYPOTHETICAL PURCHASER

To value a company or a shareholding, you should generally imagine that you are the potential purchaser, and obtain the information to which that purchaser would be entitled, although this is not always the case (for example in litigation where only disclosed or public documents would be available). For a majority holding where that shareholder has the power to appoint directors, all relevant information would be available to you; for a minority holding, only a limited amount.

INFORMATION GATHERING

To value a majority holding you will need to consider obtaining the information below as applicable to your valuation assignment:

- full financial statements including detailed profit and loss accounts for at least the past three years;
- details of any changes in accounting policy or deviations from UK GAAP;
- management accounts for the period from the last full financial statements to the latest possible date;
- projections, budgets, business plans and financial forecasts;
- fixed or intangible assets schedules, with any professional valuations;
- description of the financial systems and controls;
- details of bank facilities and security, and renewal date;
- aged debtor and creditor analysis;
- details of related party balances and charges;
- stock listings;
- explanations of any major items in the profit and loss account or balance sheet, especially those items in the profit and loss account unlikely to recur or of an exceptional nature;
- details of significant contracts or agreements with customers or suppliers including agency and distribution agreements;
- list of major customers, and turnover with each;
- list of major competitors;
- details of company pension schemes; for final salary schemes, actuarial valuations and details of surpluses or deficits;
- details of planned expansions or other significant changes in the business including envisaged flotations, takeovers, part sales, mergers etc;
- analysis of promotion and advertising expenditure and copies of brochures (remember to review the website);
- details of directors' hours of work, duties and responsibilities, remuneration including bonus schemes, loan accounts. Copies of directors' service contracts;
- copies of any newspaper or media articles relating to the business or the sector in which it operates;
- details of any businesses considered to be comparable;
- organisation chart;
- dates of birth, length of service and rates of pay for each employee;
- identification of key employees and copies of their service contracts;
- details of any staff bonus incentive or profit related pay schemes;
- details of remuneration (including salaries, bonuses and benefits) provided to all directors, shareholder employees and relatives or connected parties employed by the business;

- details of any share sales or allotments;
- history of dividend payments;
- corporate or other tax returns;
- a copy of the Memorandum and Articles of Association for the company and any relevant shareholders' agreements, or partnership agreement;
- details of any recent business acquisitions or sales, including details of any offers by third parties to acquire the business;
- details of any capital commitments and any contingent liabilities including those under assigned leases;
- list of trading premises including, for each, any professional valuations of rental and capital values and estimates of any potential claims for dilapidations;
- details of any current, pending or threatened litigation or legal proceedings by or against the company;
- details of any surplus assets;
- confirmation that the business does not face any problems with taxation (tax investigations, VAT arrears etc); and
- anything else of particular relevance to this valuation.

MATTERS TO CONSIDER BEFORE REACHING AN OPINION OF VALUE

- Commercial dynamics:
 - product mix;
 - client mix;
 - nature and size of contracts, if any;
 - security over client or supplier base;
 - innovation of the produce or processes;
 - competition;
 - the product life cycle;
 - dependency on external factors;
 - adequacy or obsolescence of production facilities;
 - competitive advantages;
 - intellectual property rights; and
 - competitive threats.
- Personnel matters:
 - skill base and level;
 - key employees;
 - family involvement; and
 - available labour source.
- Financial performance:
 - trend analysis (turnover/GP/profit/labour costs/overheads/interest or financing costs etc);
 - non-recurring exceptional items;
 - private expenses; subsidies; and
 - dividend or drawings policies.

- Balance sheet:
 - redundant assets;
 - surplus assets and funds;
 - adequacy of depreciation policies;
 - obsolescence;
 - key ratios;
 - contingent assets and liabilities; and
 - leasehold details.

- Financing:
 - proprietorial retention;
 - bank facilities (adequacy and longevity);
 - cash generation and working capital management;
 - capital asset replacement, past and future; and
 - calls on collateral, guarantees etc.

- Marketability:
 - security of customer base and turnover;
 - ability to hold margins;
 - dependency on the proprietor or other key person;
 - relative competitive position; and
 - succession of management.

- Ratios.
 - Perform the usual ratio calculations: breakeven turnover, profit margins, interest cover, liquidity ratios, balance sheet gearing, return on capital employed and return on shareholder funds.
 - To analyse trends in the financial data, consider expressing every figure in the profit and loss account as a percentage of turnover and every figure in the balance sheet as a percentage of gross assets.

CONSIDER INCLUDING THESE MATTERS IN THE REPORT

- Purpose/basis of valuation.
- A description of the share structure and ownership.
- An explanation of the trading dynamics such as what the business does, its marketplace, its regulatory framework, location, economic and industry outlook etc.
- Summary of historic performance; commentary; explanation of changes.
- Balance sheet review.
- SWOT analysis.
- Basis of valuation (open market, fair value, fiscal etc); also the implicit assumptions (going concern, willing buyer and seller etc); share of partnership, majority/minority discount, quasi-partnership).
- Explanation of valuation methods (dividend yield, asset or earnings basis, EBIT, EBITDA, PBT multipliers, DCF); reason for using one basis, and reasons for not using the others.
- Key assumptions made in deriving the valuation and any limiting factors.
- If applicable, express a range of values, and say within the range where one's opinion lies.

- Consider the application of minority discounts. Do not express an opinion on quasi-partnership; such matters are for lawyers and the Court.
- Consider any latent tax in shares or assets.

CONCLUSION

To repeat, this is not a treatise on how to perform business valuations; it merely provides a checklist for the experienced valuer.

ETHICAL ADVICE

If you are ever in doubt as to whether or not your conduct is ethical, you should step back from the situation and analyse it. It often helps if you put your thoughts down on paper or take a second opinion. Section 100 of the Code of Ethics (paragraphs 100.16 – 100.20) includes a framework for ethical conflict resolution. This outlines a series of steps that can help you not only to identify the problem but also to resolve the ethical conflict. In resolving such ethical conflicts it is important that you make a file note to explain the rationale for your position. This will help if your conduct is later challenged.

ICAEW members, affiliates, ICAEW students and staff in eligible firms with member firm access can discuss their specific situation confidentially with the Ethics Advisory Service on +44 (0)1908 248 250, via webchat or via e-mail ethics@icaew.com.

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