

Business Valuations-Action Plans for 2011-2012

There are currently two things happening in the business valuation world. The first, The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, provides some temporary (for 2011 and 2012) estate tax relief by increasing the gift and estate tax exemptions. **Most business owners tend to put off succession and estate planning but should consider acting to take advantage of the tax savings opportunities.** The Act substantially increases the combined lifetime gifts and bequests at death gift tax exemption from \$1 million to \$5 million and gifts, generation skipping transfers, and estates in excess of the \$5 million exemption are taxed at 35% (down from the 45% rate in 2009 and the 55% scheduled increase in 2013). Therefore, business owners should consider gifting ownership to their heirs in 2011 and 2012, not only to capitalize on the benefits above, but valuations of their business may also be lower currently due to the ongoing recession. In order to transfer ownership, a business valuation must be prepared by a business valuator.

A business valuation may value a business based on future or historical earnings. The recession has dramatically affected the recent historical results and outlook for many businesses and therefore may result in lower values for gifting. In addition, business owners who used up their previously lifetime exemption of \$1 million may want to consider making additional gifts in 2011 and 2012. An updated valuation may be required, and in some cases, the change in value will have been significantly lower.

The second item in valuation news also affects business owners whose businesses have goodwill recorded on their books. Goodwill, an intangible asset, arises when one company purchases another company and the amount paid for the acquired company is over the value of the tangible net assets.” The Financial Accounting Standards Board (FASB) has approved changes that will simplify the rules for testing goodwill impairment for financial reporting purposes for some companies. Impairment can occur when the fair value of goodwill in a company’s reporting unit (from previous acquisitions of other businesses, etc.) declines to less than its book carrying value.

Previously, companies had to apply a two-step process on an annual basis that could be complex and costly. The first step was for an entity to calculate the fair value of the reporting unit and compare it to the carrying amount of the reporting unit. Fair value is calculated using any three commonly accepted valuation approaches: the asset approach (by adjusting the underlying assets to fair market value), the income approach (analyzing the earnings potential of the entity), and the market approach (analyzing comparable sales of business or similar public companies). If the fair value was less than the carrying value, then the second step was to measure the amount of the impairment. The new rules will allow an entity to **first** make a qualitative evaluation about the likelihood that goodwill may be impaired to determine whether it should calculate the fair value or not. If it is determined that goodwill is more than likely (greater than 50% probability) not impaired, then the entity has completed its evaluation. If it is determined that goodwill may be impaired, then an entity would proceed with the two-step process previously in place. Companies that are audited should be careful to document the “qualitative” factors it considered in its evaluation and be ready to support its arguments. Factors affecting the reporting unit such as economic, industry and market conditions, cash flows, rising prices, customer base changes, etc. should be considered. These changes are effective for fiscal years beginning after December 15, 2011 and early adoption is permitted.

For more information on these topics or to discuss your valuation needs, please contact Lynn A. Basconi, CPA, CFE or Charles M. Ciuni, CPA, CVA at 216-831-7171.