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How to Stop Worrying and Love Business Valuations

Reference Material*

(1) Minimum information checklist, (2) Common queries in valuations for family law matters,
(3) Valuation method selection flowchart

Family Law Practitioners' Assoc. of Qld

Early Career Practitioners' Workshop

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Minimum Information Required for Valuation of Businesses, Shares & Other Equity in Family Law Matters*

The following summarises the *minimum* information required for valuations of businesses, shares and other equity including notional property and financial resources categorised into relevant information for all entities, additional information if there is a business and additional information specific to the type of entity being valued.

All entities

1. Financial statements for last 3 years[a]
2. Management accounts for year to date[b]
3. Income tax returns for last 3 years[c]

Businesses

1. Brief history of business (when commenced, by whom & so on)
2. Business name(s), location(s), market/operation area, relevant industry
3. Nature and extent of involvement of husband, wife & other family
4. Key people in business (family or otherwise)
5. Current market or agreed valuations of any real property

Companies

1. Constitution or Memorandum & Articles of Association (if any)
2. Current shareholder's agreement (if any)
3. Current & historical company extract

Trusts (incl. super funds)

1. Trust deed (and any amendments)
2. Current & historical company extract of corporate trustee (if applicable)
3. Member statements (super fund only)

Partnerships

1. Current partnership agreement (if any)

a. Detailed profit & loss statement, balance sheet, director's report, accountant's compilation report and notes to accounts as prepared by external accountant. May also include trading or rental statements.
b. Detailed profit & loss statement and balance sheet prepared by owner/management. Will not include director’s report, accountant's compilation report or notes to accounts.
c. Including the parties to the proceeding.

Common Queries in Valuations of Businesses, Shares & Other Equity for Family Law Matters*

There are a number of queries common to valuations of businesses, shares & other equity for family law matters. Most arise from the absence of accounting controls, lack of separation of owners and management, and limited accounting resources typical of smaller closely held enterprises. It is unlikely all are relevant to a particular case.

General

1. What entities are relevant to the valuation and on what basis (e.g. financial resource)?
2. Is there real property? If so, separate valuation?
3. Is there specific intellectual property (e.g. patents)? If so, separate valuation?
4. Substantial plant, equipment and/or motor vehicles? If so, separate valuation?
5. Are there significant borrowings? What are the terms including security?
6. Is it necessary to take in to account income tax? If yes, is this a matter for the valuer?
7. What valuation method(s) seem relevant (see attached flowchart)?

Businesses

1. What does the business do (location, market, customers, employees, industry)?
2. How did the business come about (purchase, inheritance, bootstrap)?
3. How long has the business traded?
4. Who are the key people in the business (family or otherwise)?
5. Who in the family works in the business and what do they do?
6. Is the business likely to continue trading for the foreseeable future?
7. Is it a cash business? Is there unrecorded cash income or expenses?
8. Has performance declined significantly since separation? Should valuation address?
9. What direct and indirect financial benefits are received by the parties?[a] On what basis?
10. Are the above financial benefits more or less than the commercial value of their labour?
11. Should there be work-in-progress (e.g. professional services, construction)? How much?
12. Are there related party dealings (e.g. premises lease, equip. lease, loans, customer or supplier)?
13. Are leave entitlements reported (e.g. long service leave)? If not, is there a liability?
14. Is goodwill recorded on the balance sheet? If so, what is the basis for the balance?
15. Have there been any recent offers for the business? If so, what was offered?

a. Consider salary, wages, superannuation, director fees, management fees, consultant fees, private expenses (e.g. telephone, home internet, travel, insurance), credit cards (incl. points), motor vehicle, low or no interest loans. Further, if business is in a partnership consider drawings, if a trust consider entitlement accounts and if in a company consider dividends).

Companies

1. Are there any limitations or preclusions under the constitution or articles?
2. What are the rights and powers of directors and shareholders?
3. Are there classes of shareholders? If so, what are the differential rights?
4. How could control be exercised and in what circumstances?
5. Are there limitations on share dealing (e.g. pre -emptive rights)?
6. What shares have been issued, who owns those shares and in what capacity?
7. Have there ever been any share dealings at value?
8. Is there a history of dividend payments? If so, how much and how often?
9. Are there currently franking credits? If so, what plans are there in respect of them.
10. Who has rights to remaining capital in event of winding up or liquidation?

Trusts

1. Is it a fixed/unit or discretionary trust? Who can be beneficiaries?
2. What is the vesting date? On what terms could the trust vest earlier?
3. Who has ultimate control under the trust deed? How could that control be exercised?
4. What are the trustee powers? Are there limitations or significant omissions?
5. What rights or interests do beneficiaries have to income and capital?
6. Who has historically received distributions and are there currently unpaid distributions?
7. Who actually received any cash distributions?

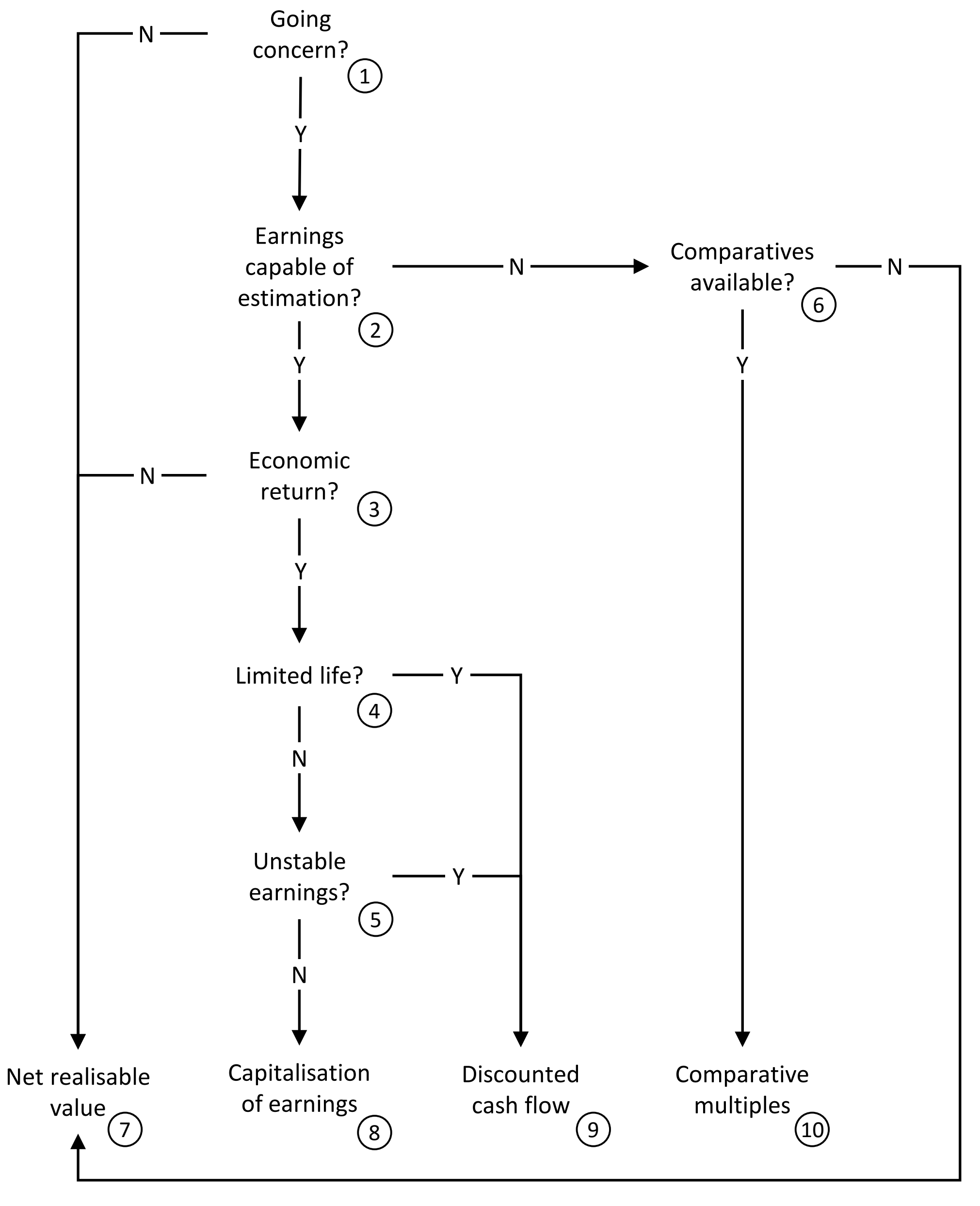
Partnerships

1. What are the rights and powers of partners?
2. How is the partnership administered including dispute resolution?
3. Who has control over the partnership and on what terms?
4. What are the restraints in the event a partner leaves?
5. What is the process and terms for payment to a partner on leaving?
6. Is it a ‘no goodwill’ partnership? How should valuation address this?

Sole traders

1. Are there separate accounts or only tax returns?
2. If there are accounts, are they prepared on a cash basis?
3. If only tax returns are they prepared under simplification rules?
4. If yes to (2) or (3) above, are there unrecorded debtors and creditors?
5. Are all assets required to operate the business reported?
6. Are there any liabilities of the business not reported (e.g. credit cards)?

Valuation Method Selection Flowchart*



Notes to Valuation Method Selection Flowchart

It is important to note that more than one valuation method may be appropriate in a particular case and a number of different methods may be required to infer a value. Moreover, there are a large number of valuation methods in practice whereas the flowchart only deals with the most common methods. Those other methods may be more appropriate in a given set of circumstances.

1. Going concern means the ability to pay debts as and when they fall due and continue operations for at least the next 12 months. If an entity is not a going concern it is generally better off realising its assets than to continue trading.
2. If earnings (or cash flows) are not capable of estimation (e.g. start-up with unique business and no trading history) then comparable assets may provide guidance.
3. If the rate of return on invested capital is less than the risk free rate in the economy then the owner is generally better off realising the assets and investing those funds elsewhere.
4. Expressed in terms of economic or commercial life which may be different to the time an asset is expected to exist and may be measured in terms other than time (e.g. rate of use). Assets with a limited life include patents, copyright, mines, quarries and, in some cases, leasehold businesses.
5. Earnings which are highly variable or increasing/declining significantly (e.g. start -up business in growth phase).
6. Comparable assets are those that are sufficient substitutes for the asset being valued. The comparative does not have to be identical (e.g. substitute for a toothbrush is not another toothbrush but something that cleans teeth).
7. Method of valuation where assets and liabilities are adjusted to their fair market value. Specific realisation period and realisation costs may be ignored if a going concern. Otherwise, method generally takes into account realisation period (e.g. distressed or orderly sale) and realisation costs.
8. Method of valuation where earnings for a representative single period are converted to a value using a capitalisation rate or multiple. The most common valuation method for small businesses with maintainable earnings.
9. Method of valuation where present value of future expected economic benefits is calculated using a discount rate. Method is capable of dealing with changes in level of earnings and risk over time as well as assets with effectively unlimited useful life.
10. Method of valuation where value is inferred from relative measures derived from comparable assets (e.g. share price to sales ratio for loss-making technology firms). May also be applicable to certain industries where firms generally trade on ‘rules of thumb’.

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