THE IMPORTANCE OF PERFORMING A BUSINESS ENTER

PRISE VALUATION

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WHEN THE COMPONENTS OF A BUSINESS ARE BEING SEPARATELY VALUED, A BUSINESS ENTERPRISE VALUATION CAN SIGNAL POTENTIAL ERRORS OR ODDITIES THAT DESERVE CLOSER SCRUTINY.

PERFORMING VALUATIONS FOR FINANCIAL REPORTING PURPOSES RELATED TO A BUSINESS COMBINATION REQUIRES A MULTI-DISCIPLINARY TEAM EFFORT.

Typically the team includes valuers who appraise the plant and equipment (i.e., machinery, equipment, and real estate), identifiable intangible assets and, increasingly, inventory. All of these values interact and come together as part of the value of the business as an operating entity.

The values opined on by each of the disciplines intertwine and may affect the values of the other disciplines, potentially more so than in any other valuation project. Valuations performed for financial reporting purposes cannot simply be performed in a vacuum with each discipline performing their portion of the valuation and the client adding up each to arrive at the overall fair value of their business. It is not that simple, as the actual fair value of a business may be more than or less than the sum of these parts.

Potential Insights from BEVs

If the fair value of the business is greater than the sum of its parts, there is goodwill; if the fair value of the business is less than the sum of its parts, there may be negative goodwill, and the acquirer may have received a bargain purchase. Quantifying goodwill or identifying a bargain purchase (and the gain associated with the bargain purchase) is essentially impossible without a properly performed economic overlay or business enterprise valuation (BEV).

Also, as is discussed below, a realistic review of the cash flows can assist in quantifying economic obsolescence; a form of obsolescence that is often ignored by tangible asset appraisers but that is extremely important to quantify, especially in today's sporadic economic environment.

Another reason for performing a detailed BEV is that, with respect to a bargain purchase, one of the first considerations of the audit team is whether the tangible assets were valued properly and all of the appropriate forms of obsolescence considered. In the audit world, this is referred to as a potential "measurement error." If measurement error is suspected, the assumptions and data used by the tangible asset appraisers will get increased scrutiny and testing. A properly performed and documented BEV may alleviate some of the potential questions.

In the process of teaching courses and seminars, the present author continually stresses the need for a BEV to be performed with every valuation for financial reporting purposes. This thought is often echoed in various seminars and webinars taught by others. After all, the main purpose of such valuations is to provide users of financial statements (i.e., present and potential investors, creditors, and others) with information that is useful in making investment, credit, and similar decisions. This is the first objective of financial reporting in Financial Accounting Standards Board (FASB) Concepts Statement No. 1 *Objectives of Financial Reporting by Business Enter-*

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prises. How better to do that than to perform a detailed analysis of the (hopefully realistic) projected cash flows?

Many tangible asset valuations performed for financial reporting purposes are done either without completing a BEV or with the results of that BEV not communicated to (or ignored by) the tangible asset appraiser. In addition, economic obsolescence is often dismissed, outright ignored, or not properly addressed.

These reports often contain a statement similar to the following:

> ABC Valuation Company has not investigated any financial data pertaining to the present or prospective earning capacity of the operations in which the Subject Assets are used. We have assumed that the prospective earnings would provide a fair return on the value of the Subject Assets.

This may be applicable for a financing appraisal, insurance appraisal, tax appeal appraisal, or any number of other intended uses. It is not appropriate, however, for a valuation performed for financial reporting purposes.

Paragraph 805-10-10 of FASB Accounting Standards Codification (ASC) 805: *Business Combinations* states that the objective of ASC 805 is "...to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects."

As stated above, a business can be worth more (or less) than the sum of its (identifiable tangible and intangible) parts. The only way to measure the true overall value of a business is to perform a BEV that captures all of the business' various tangible and intangible attributes.

When comparing companies or deciding which companies to invest in, analysts and others review the entire balance sheet (which includes data on the tangible assets) and other financial information and reports. Yet, they spend the most time analyzing the past and future forecast cash flows in order to decide if a company is stable and, ultimately, whether to invest in the company. While some review is done of the process used and the tangible assets (long-lived assets as they are called by FASB in the United States and the International Accounting Standards Board (IASB) in other parts of the world) used to produce the income, cash flows are the main source of data used to value a company.

Likewise, a typical market participant looking to purchase a business will perform certain due diligence regarding the long lived assets but will typically base the initial offering price and negotiate the ultimate selling price based mainly on the value of the potential cash flows. Because the valuer is supposed to look at the transaction (and the fair value) from the perspective of a typical market participant, the cash flows (and overall BEV resulting from those cash flows) must be considered and analyzed.

FASB Accounting Standards Codification Topic 820 (ASC 820), *Fair Value Measurements and Disclosures* states that, when concluding fair value, the business needs to record the assets acquired and the liabilities assumed at their "exit price" and not their "entry price." As this is the case, the valuer is required to value the assets from the exit price perspective.

Purchase Price. The purchase price is considered an entry price and thus, may or may not represent the actual fair value of the entire business. Additional analysis is required to verify whether the purchase price is equal to the fair value (and thus the exit price) of the business as a whole. An exit price would consider the potential future earnings of the company and thus, a properly performed BEV will represent the potential exit price of the entity and not the entry price.

Depending on the level at which the BEV is performed (in total or at the reporting unit level) it may also assist in the determination as to whether the subject long lived assets should be valued under the premise of in use or in exchange as defined in ASC 820-10-35-10. The level of economic support evidenced by the BEV may be an indicator as to whether or not the reporting unit (or specific assets within that reporting unit) should be valued under the premise of value in use or that of value in exchange.

Use of Typical Valuation Techniques. ASC 820 allows for the use of all three typical valuation techniques (cost approach, market/sale comparison approach, and income approach). Long-

lived assets are typically valued using a combination of the cost approach and market/sale comparison approach techniques. In using the cost approach, one of the components of depreciation which is often overlooked (for a variety of reasons including the difficulty in measuring its impact) is economic obsolescence. A correctly performed BEV might assist the tangible asset appraiser in quantifying economic obsolescence when combined with other knowledge and factors.

The next few sections delve deeper into the subject matter touched on above and into why a correctly performed BEV makes sense and should *always* be performed in conjunction with a valuation performed for financial reporting purposes.

Bargain Purchases and Fair Value

One of the areas where a BEV is critical, and where the transaction price may be significantly different than the fair value, is in the area of a bargain purchase. According to paragraph 805-30-25-2 of ASC 805, a bargain purchase occurs when the net value of the identifiable tangible and intangible assets and liabilities assumed is greater than the purchase price. Typically this would occur in a business combination in which the seller is forced or otherwise compelled to sell the business but may occur in other situations as well. The amount recorded above the purchase price is to be recognized and recorded as a gain in earnings as of the acquisition date (or measurement date).

According to a variety of data, the economy is supposedly improving, however, a steady stream of what appear on the surface to be bargain purchases continues—especially in a variety of process industries such as paper production, chemical production, steel production etc. Bargain purchases may be the new normal for processes with significant capital expenditures and high costs of entry. Not all of these transactions are forced or compelled sales. In some cases, the pool of potential buyers is limited, which reduces the number of competitive bids. In other instances, equity firms that purchased the assets, hoping to turn them for a quick profit, are shedding non-core investments.

ASC 820 outlines other situations where the transaction price may be significantly different than the fair value:

- When the transaction is between related parties.
- Where the sale was under a duress situation or if the seller is forced to accept the price in the transaction (such as a bankruptcy).
- Where the unit of account represented by the transaction price is not the same as the unit of account measured at fair value (e.g., if only one portion of the assets transferred in a transaction is valued).
- The market in which the transaction occurs is different from the market in which the reporting entity would typically sell the asset or transfer the liability (i.e., if an asset is transferred in other than an arm's-length transaction or if the reporting entity is a dealer etc.).

Key Terms and Definitions. *Long-lived assets* include the following:

- Individual long-lived depreciable and amortizable assets (such as machinery, personal property, and real estate).
- Capital leases of lessees.
- Long-lived assets of lessors subject to operating leases.
- Proved oil and gas properties accounted for using successful-efforts method of accounting.
- Long-term prepaid assets.

Market participants are buyers and sellers in the principal (or most advantageous) market for the asset or liability who:

- Are independent of and are not related to the entity (or assets) being valued.
- Are knowledgeable of and have a reasonable level of understanding about the assets or liabilities and the transaction based on all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- Have the ability to transact the asset or liability.
- Are willing to transact for the asset or liability (i.e., are motivated but not forced or otherwise compelled to do so).

Exit price is the price that would be received to sell an asset or paid to transfer a liability.

Entry price is the price to acquire an asset or received to assume a liability in exchange transaction.

A *reporting unit* is an operating segment or a unit one level below an operating segment (referred to as a component). A component of an operating segment is a reporting unit if the component is a business for which discrete financial information is available and segment management regularly reviews the operating results of that component.

The *highest and best use* of the asset is its "in use value" if the asset would provide maximum value to market participants principally through its use in combination with other assets as a group (installed or otherwise configured for use). The highest and best use of the asset is "in exchange," however, if the asset would provide maximum value to market participants principally on a standalone basis.

Economic obsolescence (as defined by the American Society of Appraisers) is a form of depreciation where the loss in value or usefulness of a property is caused by factors external to the property. These may include such things as the economics of the industry; availability of financing; loss of material or labor sources; passage of new legislation; changes in ordinances; increased cost of raw materials, labor, or utilities (without an offsetting increase in product price); reduced demand for the product; increased competition; inflation or high interest rates; or similar factors.

The *measurement date* is the date of the transaction or the date at which the impairment (or other measurement) is measured.

An *active market* for an asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Carrying value is the amount the company has on its books for that asset. For tangible assets, the carrying value is the same as the net book value (NBV) of the asset. Because goodwill (and other indefinite intangible assets) are not amortized, it is the value recorded during the latest valuation.

Contingent considerations are usually obligations of the acquirer to transfer additional assets or equity interests to the former owners of an acquired entity, as part of the exchange for control of the acquired entity if specified future events occur or conditions are met.

Orderly piecemeal disposition. Under ASC 820 and ASC 360, the lowest value is fair value in exchange. The value cannot, however, be a distressed or a forced liquidation sale. There has been significant discussion within the tangible asset valuation discipline (primarily within the property, plant, and equipment discipline) as to what the lowest value can be under this premise. A reasonable assumption is that the value can go no lower than what the American Society of Appraisers defines as the asset's orderly liquidation value.

The *orderly liquidation value* is an opinion of the gross amount, expressed in terms of money, that typically could be realized from a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis, as of a specific date. However, under no circumstances should the term "orderly liquidation value" be used in a valuation report performed for financial reporting. The terminology used in the report should be "fair value in exchange."

Level of Industry Activity

There is also the potential for the purchase price to not equal the fair value if the particular assets or industry are not currently in an active market or if there has been a significant decrease in the volume and level of activity (for the particular assets or industry) as outlined in ASC 820.

In order to determine whether there has been a significant decrease in volume and level of activity when compared to a "normal market," ASC 820 states that the reporting entity is to evaluate the following:

- If there are few recent transactions.
- If the price quotations are not based on current information.
- If the price quotations vary substantially either over time or among market makers.
- If the indexes that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair values.
- If there is a significant increase in implied liquidity risk premiums, yields or performance indicators for observed transactions or quoted prices when compared with the reporting entity's estimate of expected cash flows, considering all available market data about credit and other nonperformance risk for the asset or liability (primarily for financial instruments).
- If there is a wide bid-ask spread or significant increase in the bid-ask spread (primarily for financial instruments).
- If there is a significant decline or absence of a market for new issuances for the asset or liability.
- If little information is released publicly.

Other Red Flags. ASC 820 outlines that other circumstances that *may* indicate that a transaction is not orderly (and, as such, the purchase price may not equal the fair value) include:

- There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary.
- There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- The seller was required to sell to meet regulatory or legal requirements (that is forced to sell).
- The transaction price is an outlier when compared with other recent transactions for the same or similar assets and liabilities.

If the evidence indicates that a transaction is not orderly, the reporting entity should place little to no weight on the transaction price when estimating fair value.

The valuation team is not necessarily privy to all of the details of a transaction or how the purchase price was determined. As such, the valuer may not know *why* there is a potential for a bargain purchase; he or she may just be informed that the potential for a bargain purchase exists—or have to ascertain the potential for a bargain purchase on his or her own. The only real way to do this is by performing a BEV.

The purchase price *may* be an indicator, but the valuer cannot simply con-

clude the presence of a bargain purchase by reviewing the purchase price alone.

Early Detection. One way to determine early whether there is a potential for a bargain purchase is to compare the carrying value of the overall business or reporting unit to the purchase price (including all contingent considerations) but removing financial assets (such as cash, accounts receivables, etc.). If the purchase price is relatively close to the overall carrying value (less financial assets) or between the cost basis and the carrying value, then there is a good possibility of a bargain purchase. If the purchase price is significantly higher than the cost basis or carrying value of the business, a bargain purchase is unlikely.

For example, assume that the cost basis for a particular business is $400 million and the carrying value is $100 million. If the business has $50 million of financial assets and the purchase price is $200 million, a bargain purchase may potentially exist. However, if the purchase price is $750 million, a bargain purchase probably does not exist.

Prior to getting into any valuation for the purposes of a business combination, it is good to do a quick "back of the envelope" analysis such as the above (or a more detailed analysis) in order to figure out if there is a potential for a bargain purchase. From a long-lived asset standpoint, a bargain purchase may require additional analysis and gathering additional data for each asset valued. As stated earlier, the only way to tell for sure if there is a potential for a bargain purchase is to perform a full BEV.

Value of Assets in Bargain Purchases

If there is a bargain purchase, the fair value of the long-lived (tangible) assets may be at the level of "in use," "in exchange," or "orderly piecemeal disposition" or anywhere between. As such, the valuer may have to investigate and gather multiple data points for each subject asset prior to concluding on a value (based on the level of economic support).

Why is a bargain purchase (or other situation where the purchase price is different than the fair value) an issue from a valuation perspective? Because

the fair value of the business may not have any bearing on the purchase price and the valuation may come under tougher scrutiny by the company's audit firm and potentially the Public Company Accounting Oversight Board (PCAOB). Also, as stated above, additional research, analysis, and review time may be incurred by the valuer.

After recognizing the potential for a bargain purchase, the acquirer must reassess whether it has correctly identified all of the assets acquired and liabilities assumed. In addition, the acquirer is also required to reassess and review the process used to measure the amounts (i.e., the process used to value the assets and liabilities assumed at their fair value).

The process used to measure the amounts requires that the valuer review his or her work and conclude whether measurements stated (i.e., fair values opined on) reflect consideration of all available information available as of the acquisition (measurement) date. This includes a re-review of all the assumptions used to quantify the depreciation and obsolescence factors applied (or not applied) and the rationale associated with the application (or dismissing) of any adjustments.

Push Down Method. Previous to the issuance in 2006 of Statement of Financial Accounting Standards (SFAS) 157: *Fair Value Measurement*, any bargain purchases (accounted for under SFAS 141: *Business Combinations* (issued in June 2001)) were handled by the use of a push-down method (see Exhibit 1) that, simply put, reduced the fair value the business recorded on its financial statements pro-rata, based on the ratio of the fair value of the specific category to the overall negative goodwill (implied by the bargain purchase price).

The issue that came up eventually was that these were not truly indicative of the fair values of the various assets in the various categories, but were rather accounting-adjusted fair values which, in some cases, were significantly different from the appraised fair values. This was the case where an acquirer made a significant bargain purchase and assets were adjusted down by factors over 50% (which did occur). The present author personally worked on one project where the adjustment was over 70%.

Such significant adjustments often reduced the asset values below the long-lived assets' selling price in the in-exchange open marketplace, and went contrary to the FASB and IASB intent

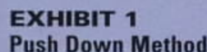

EXHIBIT 1
Push Down Method

The following is an overly simplistic example:
Assume that the purchase price for a business was $9 million and that the fair values of the various categories were stated as follows (based on accepted valuation techniques and following the guidance at the time)

Total purchase price	$9,000,000
Net working capital	$1,000,000
Intangible assets (fair value)	4,000,000
Real estate (fair value)	3,500,000
Personal property assets (fair value)	2,500,000
Total fair value of assets (fair value)	$11,000,000
Implied (negative) goodwill	$2,000,000

Net working capital cannot be adjusted, so the goal was to develop a pro-rata adjustment that is applicable to those categories that *can* be adjusted (i.e., intangible assets, real estate, and personal property). The sum of these categories is: $4,000,000 + $3,500,000 + $2,500,000 = $10,000,000. Thus, the pro-rata adjustment = 1-(($2,000,000/$10,000,000)) = 80%.
Applying this to the data represented above, produces the following result:

Adjusted net working capital ($1,000,000 x 1.0)	$1,000,000
Adjusted intangible assets ($4,000,000 x 0.80)	3,200,000
Adjusted real estate ($3,500,000 x 0.80)	2,800,000
Adjusted personal property ($2,500,000 x 0.80)	2,000,000
Total fair value of assets	$9,000,000

The adjusted values were then allocated to the various line items in each category and were recorded by the business on their financial statements as fair value.

of valuing assets at their realistic sales price (either under an in-use or in-exchange premise based on the highest and best use). The intent of the standards was to provide a realistic measurement of the values of the various tangible and intangible assets, and such pro-rata adjustments were not doing that.

The methodology suggested above was originally developed prior to the most recent recession period. The standards apparently did not contemplate such an economic downturn, nor did they take into account the need for very significant adjustments.

Current Process. After the FASB and IASB realized that this process was not providing their intended users with the appropriate information, they redefined the process as it exists today. The revised process presumably provides a more realistic picture of the financial situation of the business and the values of the underlying assets.

Under the current standards (ASC 805 and ASC 820) the purchase price may, but is not necessarily considered to, equal the fair value. In order to define a realistic fair value for the business, an accurate and reliable BEV has to be completed. The goal of the analysis under the current standards is to reconcile to the overall real value of the business (as evidenced by the BEV) and not to the purchase price (as under previous standards). With a bargain purchase, the BEV is probably greater than the purchase price. In other cases, an acquirer may over pay in order to eliminate a competitor or to buy certain strategic technology.

Under either a bargain purchase or in reality any purchase, the only real way to calculate the actual fair value of a business is through a well-executed BEV. The current standards are very clear that economic support (or lack thereof) is demonstrated by the overall fair value of the business and not by the purchase price alone.

In a bargain purchase situation, the standards do not specifically state that the tangible asset valuer *has* to reconcile to the BEV if it is lower than the sum of the identifiable tangible and intangible assets. However, they do require a thorough review of the approaches taken, the assumptions made, and all of the data used to assure that no pertinent data was ignored, missed, or misinterpreted.

After the subsequent review, could the sum of the long-lived assets still be above the BEV? Yes, this is always a possibility. If all of the long-lived assets were valued using market inputs, are valued in exchange, and the value of the long-lived assets is still greater than the BEV, the valuer could successfully defend the opined values.

Rarely, however, are all of the long-lived assets valued using market inputs. In most cases, a combination of the market/sales comparison and cost approach techniques is used. As such, the additional data supplied by the BEV conclusions should be reviewed and the valuer should reconsider whether they have considered all of the appropriate obsolescence adjustments required.

Final Valuation

When contemplating the final valuation, the valuer must be realistic and consider all of the facts. It is doubtful that a seller would purposefully leave money on the table during a sale negotiation. If the purchase price is under the true fair value of the company (or the sum of the identifiable tangible and intangible assets), the sale may be under one or more of the situations stated previously. The acquirer may be able to produce more cash flows using the same or some of the same long-lived assets due to synergies with currently owned oper-

ations, different managing practices, expanded customer base, etc.

If the actual BEV is less than the sum of the long-lived assets and identifiable intangible assets, the implication is that the assets would be worth more sold on an in-exchange (stand-alone) basis than under an in-use (combined) basis. As such, a valuer who initially valued the long-lived assets under an in-use premise may have to adjust the values to remove some or all of the direct or indirect costs associated with purchasing, moving, installing, and configuring the long-lived assets under an in- use value premise. A BEV is critical to assisting the appraiser in deciding whether the long-lived assets (or various reporting units) should be valued under the premise of in use or in exchange.

If the cash flows indicate significant negative goodwill or the cash flows are negative, and there are no foreseeable improvements which will improve the situation, the values of the long -lived assets may need to be valued at their orderly piecemeal disposition. There is little to no guidance on the term "orderly piecemeal disposition." Some practitioners believe the term equates to the in-exchange premise. Other practitioners believe that the value can be lower than the in-exchange premise. However, in no case can the value be a forced liquidation or value as if sold under duress.

The following is an overly simplistic bargain purchase example:

Example. The purchase price for a business was $200 million. The only long-lived assets purchased were real estate, and property, plant, and equipment. No identifiable intangible assets, financial instruments acquired, or liabilities assumed were part of the transaction. Upon performing their analysis, the real estate appraiser (using a cost approach only) arrived at a fair value of $100 million, and the machinery and equipment appraiser (using a combination of the market/sales comparison and cost approaches) arrived at a fair value of $200 million.

As such, the total of the long-lived assets is $300 million ($100 million above the purchase price). If the BEV arrives at an overall value of $300 million or greater, there is no need to consider any adjustment. However, if the BEV arrives at a $220 million value, the real estate and machinery and equipment valuers would need to review their analysis and potentially adjust downward for moving to an in exchange premise of value or potentially accounting for unrecognized economic obsolescence.

Assume that, after adjusting to an in-exchange premise of value or adjusting for unrecognized economic obsolescence, the real estate has a fair value of $70 million and the machinery and equipment has a fair value of $160 million. This is a total of $230 million (still $10 million above the implied BEV and $30 million above the purchase price). If the real estate and machinery and equipment valuers are confident that they have properly, completely, and accurately considered all of the factors, then the implied capital gain for the acquirer is $30 million.

If the BEV arrives at a value of $180 million ($20 million less than the purchase price), the real estate and machinery and equipment valuers may want to consider further analysis to assure that the values concluded under the in-exchange premise would not be significantly different than that under an orderly disposition scenario.

The greater the use of the cost approach, the closer the valuer should look at and review their assumptions. Market based data (especially Level 1 and Level 2 data with minimal adjustments) are typically not adjusted except for the movement from an in use premise to an in exchange premise.

Since the results of the valuation of the identifiable tangible and intangible assets can result in a capital gain for the acquirer, it is critical that the analysis be completed correctly, and all relevant factors (including the overall fair value of the business and elements such as economic obsolescence) be considered and appropriately applied.

BEV Used in Valuations Other Than Bargain Purchases

Whenever a valuer performs a valuation for financial reporting purposes, the use of a BEV is critical to assisting the valuer in quantifying:

- Whether the purchase price is representative of fair value.

- Whether there is unrecognized economic obsolescence.
- Whether the long lived assets should be valued under the in use or in exchange premise.
- Quantifying potential goodwill or, alternately, a capital gain.

Properly quantifying the values at the initial measurement date is also important because the assets will be tested for impairment on a periodic basis. Typically, the first impairment test occurs one year after the initial measurement date. If the various tangible and intangible assets were not valued appropriately, and the goodwill (or gain) appropriately measured as of the initial measurement date, the acquirer may be subject to potential impairments to either the tangible or intangible assets, or both.

Impairments are always a possibility, even if the various assets were valued appropriately as of the initial measurement date. However, if there has been

sonnel the acquirer has assigned to performing the BEV. This is not preferred, but sometimes, this is the only data available. If this is the case, the tangible asset appraisers are still highly encouraged to review the conclusions.

If the acquirer performs the BEV internally, this should be noted in the report of the tangible asset valuers and noted that the data was represented as being reliable and credible by the acquirer. As long as the process and assumptions used pass the valuation audit review process, they can be relied on.

In the instances where a BEV is not completed (either internally or externally), the client should be made aware of the fact that the overall fair value of the business being acquired may not be the sum of the individual parts and that there may be issues in properly calculating goodwill or the potential gain in a bargain purchase situation. These issues may cause additional justification and scrutiny in the valuation review process performed by the acquirer's auditor. This additional justification and scrutiny may increase the cost of the review and valuation process.

no appreciable change to the cash flows, the business situation, or the forecasts and a subsequent test shows impairment, doubt will be cast by the investors and others that the company was valued properly in the first place. This does not look good for the business or for the appraiser who performed the initial valuation. As such, there should be very few instances where a BEV is not completed in association with a financial reporting valuation.

In some instances, the present author has heard of a firm, either internally, or externally, developing an internal rate of return (IRR) that justifies the purchase price. This is *not* a true BEV and may not provide enough justification for the auditors that the purchase price does equal fair value.

Managing Client Expectations

Since a properly performed BEV is so important to the conclusions of value for both the tangible and intangible valuation professionals, it is critical that the various appraisal team members be able to communicate throughout the process. As such, if the valuations are being performed by different companies, each valuation discipline must make the acquirer aware of the need to communicate with the other disciplines and open the lines of communication as early as practical in the assignment.

If the acquirer wants to control the communications, they will need to understand that certain data will need to be communicated to each valuation discipline throughout the process in order to provide them the most reliable and realistic valuation possible.

In certain cases, the acquirer may internally perform its own BEV prior to purchasing the business or as part of the acquisition process. The results of this BEV are only as good as the inputs and the sophistication of the per-

Conclusion

Performing a properly documented and reliable BEV is critical to arriving at credible results for all assets (both tangible and intangible) during the process of a valuation performed for financial reporting purposes.

A reliable BEV can assist the entire valuation team in estimating the following:

- Whether the purchase price is representative of fair value.
- Whether there is unrecognized economic obsolescence.
- Whether the long-lived assets should be valued under the in-use or in-exchange premise.
- Quantifying potential goodwill or, alternately, a capital gain.

Appropriately quantifying the points above will, in turn, benefit the acquirer in assuring that it has properly recorded realistic fair values for all of the assets, and may decrease the potential for an immediate impairment as long as the general economics of the business do not change appreciably. ●