Unedited transcript of

# Understanding the Engagement Including Standard of Value and Valuation Date

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>>: So without further ado, the first part is when you're working with a client and there is a business valuation that needs to be conducted - you know, the first thing we take for granted is why are we conducting a business valuation? Well, one of your clients, maybe it might be the client's estate, had an ownership interest in a private business and the value of that ownership is not known or not commonly known. For the most part, I should say. If you deal with a client who wants to sell their business and they want to know what it's worth - well, how do you get there? And the first step is understanding this 30,000-foot concept that there are going to be logical steps needed to build or put together a process which ultimately will arrive at a conclusion to determine what that ownership interest is in the private business. And this process here is really a bottom-to-top approach. And we've broken it out essentially into five logical steps that most business appraisers are going to follow in order to arrive at the top of the pyramid here. Those steps include the first one, understanding the engagement. And again, this is the foundation. Why is this on the bottom? - is because this, understanding the engagement, is going to allow you as an attorney and your client to start with the factors that are going to be needed to be defined in order to value the company. In our second step, this is really - you know, we'll call this our fact-gathering step, but you're looking at the financial information of the company, looking at outside factors such as the economic and industry factors that could go into affecting the appraisal. Building onto the third step, the - is where

approaches are selected into how the valuation is going to be derived. What are the methods used by the business valuator to get to a value? And we'll go through the common approaches there. We're going to talk about the application of discounts and premiums. When they apply, when they might not apply, and how to apply them. And then finally putting together the work product that's necessary for the type of engagement, such as what type of report can you expect if you're doing gift and estate, if you're in a litigation matter, family law or civil, talking with interrogatories, the type of expert report to be produced or in an M&A type scenario, the type of consulting work product that might be there. So these five steps represent the most common process in order to arrive at a business valuation of a privately held company. So with that being said, let's jump into the foundation, understanding the engagement. As we build this foundation - this is the initial step when a client calls you and says, I'd like to make a gift for a certain - to my children in a privately held company I own. I am dealing with a divorce matter and one of the parties has an ownership interest. This starts with - all these understanding what I'm talking about starts with the purpose of the valuation. We're going to get into - from a purpose leading into what standards and premise that might follow and then selecting the valuation date. And what we'll see is that valuation date becomes critical based on the factors that a business valuation expert can consider in conducting their analysis. And the final foundation piece here is the level of value, and that really ties to the ownership or the amount of control an individual will have over the company. So with these five factors, now we're going to dive into what are they all about? And Jesse, with that, why don't you start in with - you know, let's start in with purpose a little bit.

>>: Marc, that sounds great. Thank you for that awesome introduction, by the way. Yes, purpose does matter. And we wanted to talk about this in a couple of different ways, you know, starting with, really, what type of transaction are we even looking at? Is it real or is it hypothetical? And you know, so you look at the top half of this slide, you've got, you know, some sample of actual transactions. So if you're selling the business, for example, you know, so we're in an M&A environment, you know, you could have, say, strategic buyers involved, you know, and that's things like, you know, a competitor comes and buys you, or you're buying a competitor or

vendors, customers. You know, issues where, you know, there might be some sort of a strategic motivation or, say, an investment thesis in doing the transaction. You know, and then you move over to things like, you know, purely financial buyers. So, you know, investment funds, private equity, venture capital, things of that nature. You know, sometimes high net worth individuals that are just looking to sort of build a legacy, if you will, and accumulate a bunch of businesses. You know, then you have - your other example here on the actual end of things would be, you know, employee stock-related transactions. So this would be - like, think of this as, like, a tech company, you know, hiring somebody to come work and well, they're cash-strapped, and probably part of the employment agreement is we're going to give you some stock options or some restricted stock, you know, as part of the package. And, you know, while this might be quite risky, there's also some promise involved. But essentially, you've got to give something of value in this actual sort of exchange. Then there's the hypothetical side, and Marc, what on earth is the hypothetical side of this thing?

>>: So I think, Jesse, the - when you start talking the hypothetical side is when there's not going to be an actual transaction or trading of shares of stock. So when you think of hypothetical valuations, the first two that usually come to mind are when you're talking gifting and estate purposes. You know, someone has an ownership in a privately held company and you start to do estate planning and there's going to be gifts made. And with gifting, there is no actual buyer or seller who's going to be out there actually buying these shares from you. You're actually just transferring them. Similar to the estate side of things. If some - if a business owner passes, the estate needs to put a value on those shares, they may not necessarily be selling them. They're going to transfer it to someone. So in this hypothetical scenario, a business valuation expert is going to lean on certain criteria to develop what they would say is a valuation of those shares without an actual transaction at the end of the line, a real buyer for them. Also similar in a divorce situation. Hypothetically, one person is giving up their ownership in a business. You have to put a value on the ownership interest that the parties have, or one party has, in this company. But again, at the end of the divorce, usually one spouse is going to retain interest in a business. So these hypothetical transactions create a specific

fact pattern that leads into the next steps of the appraisal. And when you say, how do you take these different purposes and then tie it to what one can expect from a business valuation, that translates really into our standards, because a standard of value creates this roadmap in a way. You know, if you think about, Jesse, the actual transactions that you talked about, you're going to come in and you're going to say, look, I might be representing a seller. If I'm representing a seller, I'm going to outlie certain factors that I'm going to demonstrate where I think my company has value. You might represent a buyer doing due diligence for them, and you might have a different outline of what a company could be valued. Well, then you move to those hypothetical scenarios I talk about, and because you don't have buyer seller negotiating on different ends of the spectrum, the appraiser's really considered that neutral person - right? - and I always like - it's the analogy of the appraiser has to beat themselves up because they're going to use whether it's revenue rulings, judicial holdings from prior court decisions, and what's defined in valuation textbooks as to what steps are going to be needed and followed, right? And, you know, when you think about the standard of value and how it ties to purpose, the first thing that is important for attorneys to remember is - what I'm going to say is the - kind of the most authoritative, most common referent standard always begins with fair market value. And Jesse, why don't you kind of take everything - everyone through defining it in the importance of what fair market value really is?

>>: Yeah. Sure. And before that, I just want to make one comment on your - the fact that we beat ourselves up, but - you know, it's - interesting headspace to get into. We're both - and this sort of dovetails into this definition, we are both buyers and sellers in our heads, hypothetically, at the same time is probably the right mindset to have. All right. So fair market value. Fair market value - in a way, everything flows from this, and so the IRS back in the day initially defined fair market value under revenue ruling 59-60 - and I won't read this to you verbatim, but essentially what it provides is the idea that you have two hypothetical parties. Everybody's willing and able to come to the table and do this transaction, albeit hypothetical. And basically, you know, everything that needs to be known, you know, to consummate this transaction is sort of out in the open. You know, we've got all of our relevant facts lined up. And importantly, nobody

has to actually transact, right? You know, there's no compulsion. There's no, you know, premise of, oh, we're going out of business, now there's a forced sale. You know, this is just sort of a free and open transaction at the end of the day. And of course, Marc, in his infinite wisdom, he's recommending on this slide that you go and download a copy somewhere online of revenue ruling 59-60 which should be freely available. Now, next, really, we get into building the house here. We're going to get into about eight fundamental factors that help us to put a value, you know, typically on a privately held business or an interest related to it. And we have to go through all these fundamental factors, of course, because, you know, there's not necessarily useful market data to tell us how to value, you know, what we're looking at. You know, or whereas, you know, this - the language on this slide here suggests that, you know, even if there is market data, you know, it's not necessarily the greatest of market data, and so you still need some help sort of crunching the numbers. So now, if we can go to the next slide, we'll jump into what those factors are. The first couple items, A and B, on this slide is really getting into sort of the background of what we're looking at, OK? Things like history, the nature of the business, you know, understanding, you know, kind of how it makes money at the end of the day. And - now that said, I just referenced money, but a lot of it's getting into the qualitative understanding of the business at the end of the day and building the proper story of what we're looking at. And when I say the proper story, I don't mean, like, we're just making it up. I really do mean, like, building - you know, this is - we're coming up with the true and correct story of everything that's relevant here. Then you move on, you look at items C through E here on the slide, and really, we start to get into the financial side of things. And so that's going to include things like looking at the finances of the business from a few different perspectives. You know, from a historical side, you know, maybe it's the last 3 to 5 years, you know, certainly understanding the current state of finances and then also bridging the gap. You know, what's going to happen in the future or what's a reasonable expectation of what's going to happen in the future as we don't exactly have a perfect crystal ball, and nobody does. Now, you - some important things here. You know, item C, book value of the stock and financial condition of the business. You know, that's almost like a stake in the ground. You know, it could be a point of fallback. You know, if we don't have a healthy situation, what's left at the end of the day? And certainly, it goes a lot farther than that, and my hope is we get into more of those topics as we move along in this presentation. You know, above and beyond, issues like book value have the ability to understand, you know, how much can we earn, right? And, you know, there's a range of earnings, and by the way, your earnings are not necessarily what we can get out of the business - right? - and so that's why you have - you go from D on this slide to E - dividend paying capacity. You know, that's a little bit closer to what you might actually get in - if you're, say, an investor or an owner, what are you actually going to get at the end of the day, because it might not be everything that you earn. Now, unless Marc, you have any comments on this slide, I'd like to move on to the next one.

>>: I think I - you know, Jesse, just to add to, one, kind of complement what you're saying and just going back to the importance of this revenue rule, right? It - the revenue ruling itself has been around since 1959, and when you think of the overview of the process that we talked about, you know, getting into A through E here, you know, really sets the building block for an appraisal. You know, and for everyone out there kind of listening today, you know, this is going to set the standard that we're going to repeat when we get to our second step. You know, information that's going to be requested from the company. Information that's going to be analyzed about the company and factors. So it truly is impressive that going back to 1959, setting the foundation of encompassing steps needed to understand to value privately held companies. And Jesse, I thought you did, you know, really hit on all those factors that build into those stages, so just taking one second to see - you know, being around as long as this has, the fundamentals have not changed and they're important. And then it kinda leads into, I think, where are you going to go next into the final three factors that are outlined within 59-60?

>>: Yeah. So, continuing with this - perhaps it's a terrible house analogy, right? We've built the foundation. We've understood all the wiring and the diagrams and all the stuff in between. Now, you know, we have to figure out how to see the big picture of valuation, OK? And so, you - we've highlighted here, item F, the question of whether or not the business has goodwill, or sort of this idea of value that's above and beyond sort of the easy stuff that you can touch and feel and put a quick value on. You know,

and are we imputing from our analysis that things are worth above and beyond, and it's a healthy, you know, prosperous situation here. And, you know, so you get into things like this through - you - we'll talk later about things like approaches to value and you - this probably speaks to a couple of different things, both in income sort of methodology or a market methodology so it doesn't say the income aspect directly. But, you know, here you get into - in G and H, it actually does directly refer to sort of the market side of things. So, you know, item G, for example, is - when it talks about the sales stock, you know, and the size of the block of stock to be valued, you'd almost think, like, an internal transaction, so you have a business - it might not - you know, it's probably not public, you know, if we're talking about valuation issues here. And, you know, it very well could be that you actually have internal transactions in stock in the past, right? And, you know, whether that was, you know, one share out of a thousand transacted last year or you have, say, 20% of the business turned over - you know, might have a different impact on how we look at, you know, what we're actually trying to value at the end of the day. The other item that's listed here, you know, is more of an external framework, so item H, market price of stocks of corporations that are essentially, you know, comparable enough to make a useful reference point for valuation. You know, it's nice that some things actually have a traded market and can make - help us make inferences about what, in the alternative, you know, something privately held might be worth at the end of the day. And that's - you - that's basically a wrap on some of these - this kind of, like, overarching, you know, 30,000-foot view from the revenue ruling that I think we wanted to cover.

>>: And I think, you know, just as we can, you know, start laying foundations and providing background and understanding here, you know, when you talk about purpose and then purpose dictates standard - you know, this fair market value concept and the, as Jesse went through revenue ruling 59, the factors that are embedded in there really start creating the foundation for then when standards get modified to purposes. So for instance, when you move from fair market value to what's known as a fair value standard. So if you think about purpose - and I'll start with gift and estate hypothetically, that's typically the fair market value standard where an appraiser, as Jesse said, is going to look at a hypothetical willing

buyer, willing seller without compulsion. Well, you now change the purpose a little. And let's say you're in a litigation matter, whether it's civil or a divorce matter, and the fair market value standard might just be changed a little bit. You know, so the factors change and you might get into what's known as fair value during a shareholder dispute. And fair value itself comes into play in a litigation, a civil litigation matter like a shareholder dispute because typically one shareholder has been damaged. And when a damage occurs, what kind of judicial precedent sets is they want to know the value of the business that would fairly represent someone's ownership, not taking into account discounts. Not saying that recognizing there could be marketability or minority factors that could impact this because in these type of disputes, potentially, someone was unfairly or was harmed and the value of their ownership should not be reduced by commonly accepted discounts on that fair market value standard. Now, it should be noted that the definition of fair value could vary state to state, and it could also vary depending on what agreements talk about. You know, if you get into looking at a shareholder's operating agreement or a partnership agreement, are there remedies if a shareholder or partner wants to get bought out? Are there specific definitions that the owners have agreed to? And, you know, Jesse, we've seen it when we talk with attorneys getting involved in civil matters. You know, that's the first question. Should there or should not there be discounting based on the nature of the claim? That's built in.

>>: Yeah. And sometimes, you know, it's interesting. Sometimes you see both built in, although, you know, in my own experience it's somewhat rare, but you can almost see, like, two opinions and sort of a hedging. And, you know, also, you know, there's often disagreement, you know, between the parties. Is this a fair value case or is this in fact a fair market value case? And, you know, then sometimes is interesting. You know, we had an instance where we saw draft somehow crept into the word papers in recent history where someone's fair value opinion actually had a fair market value in the background. So it's not always cut and dry, right? It's not always obvious, and we absolutely have to be - you know, typically we're not deferential to legal counsel, but here's an area where we really can use some help sometimes.

>>: And also too, and speaking of that Jesse, sometimes you might ask the expert to have both opinions because it is ambiguous as to whether the dispute itself represents on a non-marketable minority basis for a shareholder or whether it's, as you get into levels of value later, before discounts. A second example of, you know, modifying from fair market value to fair value comes in Massachusetts divorces where, going back to 2007 - prior to 2007 when we were valuing companies for divorce, we always looked at fair market value and it was not uncommon to see discounts. Well, in 2007 through the present, the Massachusetts divorce standard has really shifted based on this Bernier decision where the SJC came out - and it's a very famous quote - that the judge must take particular care to treat parties not at arm's length, hypothetical willing buyer willing seller in a theoretical open market, but really as fiduciaries entitled to equitable distribution. And business appraisers and attorneys over the years have, you know, adopted this into, essentially, looking at what does a business look like as of the date of divorce? How does it operate? Does the business itself have value beyond an owner? And regardless of the ownership interest, it doesn't look to accepting discounts unless there are extraordinary situations. And this is how, you know, a fair market value standard can get changed over to a fair value standard. And again, just because I like to tie things back, again, purpose can lead to standard. You know, if you have gift and estate on the hypothetical side, you are at, most likely, the fair market value standard, whereas if you are in a litigation setting, you could be at a fair value standard, and in a massachusetts divorce, more likely than not, you're at fair value. And then we can always now bring it back where, on purpose, Jesse was talking about actual transactions, and that leads into some other standards that impact these actual transactions, right Jesse? Like...

>>: Yeah. Absolutely. So look, we've covered the source - right? - we've covered fair market value, bridged it to fair value. There's still more than what we've covered so far. I think, truth be told, it's - at least in our world, it's a little bit less typical to see this stuff day to day, but - OK, so you have this thing called investment value, right? And so in investment value, you've got a specific buyer, you're almost, like, looking at a specific transaction, not a hypothetical transaction - excuse me - where - OK, I run a business - right? - and I want to go - and I want to buy my customer for

some strategic purpose - or I want to buy a competitor - right? - for some specific motivations that I might have in mind, and whatever they might be - you know, often it's like a question of, you know, is one plus one not equal two? Does it equal three? Right? Because of these specific motivations, you know, the strategic aspects. The potential for synergies. And - but again, this is not necessarily something you typically see. Like, the interesting aspect of this is you get involved in a transaction, you know, and oftentimes, you're not asked to look at investment value. You, oftentimes - you're asked to look at sort of the - you know, what's the base of value, right? What's the fair market value of this thing? And, you know, oftentimes the aspect of investment value that goes above and beyond, it's - you're somewhat of, like, a theoretical exercise until you see it actually pan out. You know, there's probably ways to measure it. They're probably not super accurate at the end of the day, but it can certainly be done. Next, you get into intrinsic value, and this is - look, it's interesting because this is actually - it's not really common in appraisal world, but it's definitely common if you think about the public market. So you get the guys and gals at the investment banks or the research firms, and, you know, they're putting out all sorts of research reports. You're scouring all the available information publicly. You're attending earnings calls, asking questions. You're reading all the investor materials. You know, to say, all right, well, that price of ABC Corp on this public market might be ten bucks today, but we actually think it's 15 because we ran all our models. We did our diligence. Its intrinsic value is something different. You know, hey guys, go buy it now. The other thing - and perhaps we should've covered this a little bit earlier is - because the term fair value is used again, fair value for financial reporting is actually incredibly common, OK? But it's definitely different from some of the stuff Marc covered earlier from, say, you know, a judicial sort of case law state by state idea of fair value. You think - thinking in terms of valuations that might impact, you know, gap financial statements, you know, purchase allocations in the instance of a transaction, you know, testing the goodwill that might be sitting on a company's books. It's things like that at the end of the day, and, you know, the interesting thing is fair value in a financial reporting context - you know, it often has some fair market value style considerations in it as well, right? You can get into discounts. You know, it's just a little bit different context, different words. But there are some similarities for sure. And then, you know, I think, unless we uncover anything else here, Marc, that probably puts a nail in standard of value at this point.

>>: But as we did have one question, Jesse, that comes into play. And the question that came into play is, you know, who ultimately defines the standard of value?

>>: That - you know, that's interesting. So I'm going to assume that means from the standpoint of defining it for the assignment, and you - it's interesting. It's like that foundation we talked about in understanding the engagement in things like purpose. You know, the who, what, when, where and why of valuation. It sort of leads you to the right answer at the end of the day. I hope that's not taken as a copout, right? But you find out you're doing a divorce in Massachusetts. You know, hopefully the appraiser and the attorneys are kind of, like, in agreement at that point. This is a fair value case for Massachusetts divorce or, you know, you pick up, as you said earlier, you know, somebody is trying to do a family gifting transaction - you know, well, that's sort of something that could get scrutinized by the tax authorities, and then you're going back to that IRS, you know, derived fair market value world.

>>: And I think it's kind of - I always look at it as a team effort in knowledge. You know, I know Jesse, we take pride in making sure any assignment that we take on with a specific purpose, we try and know, is there case law precedent? Is there judicial precedent? Is there IRS rulings that could impact the purpose? And then also going back to the attorney, have they seen anything that identifies what could impact or define this standard of value? But, you know, it - with who defines it, it's - you know, working with the appraiser to know the purpose, and then are there underlying factors? You know, I think finally with standards, you know, be aware that the Internal Revenue Service, when it comes to gift and estates, defines specifically what constitutes a qualified appraisal, how it's going to get done, and who qualifies as a qualified appraiser. And then I think the last thing that I wanted to bring up, too, is I always recommend for attorneys to kind of build a valuation library if they like and do a lot of business valuation work. You know, there are publication or there is a publication out there called Standard of Value. I think it's in its second

edition now. And then in addition to, you know, downloading revenue ruling 59-60, you should be aware of, like, revenue ruling 68-609 that talks about an excess earnings method. There's also revenue ruling, I think it's 77-208, which - 77-207 is another revenue ruling that impacts standard of value. So, you know, having these downloaded and having a reference section for valuation is important. I think we've covered it on standard. Let's keep building moving forward with our foundation and what we mean, Jesse, with just the premises quickly.

>>: Yeah. And Marc, I think you're going to have a - get a lot of calls on helping people build their library. But - I think too many building references today.

>>: Right. You need a library card, though, if you're going to call us.

>>: Yes. Of course. So premise of value. So this is another, you know, sort of critical 30,000-foot concept to drive what we do when we do an appraisal, OK? And so it's interesting. I want to take this slide and, like, kind of flip the order for a second and start with going concern value that's on the bottom. And in many instances - OK? - we're going to start from this particular premise which means that the business - essentially, it's going to continue, OK? And so we're going to have - same as today, tomorrow we're going to have the same assemblage of assets in place, right? The same management team, you know, the same plant equipment, you know, workforce that's in place making that assumption that things are sort of continuing into the foreseeable future. And you know, the hope at the end of the day is there is almost that implication of if it's going to continue. We're probably kicking off the healthy values when we're recognizing things like that as opposed to sort of more of a dire situation getting into things like liquidation - the top half of this slide. You know, you might get into the idea that it's not really worth it to keep the business operational, right? Let's take all the money out of the cash registers, lock the door, go home and figure out what to do with it 'cause we're not coming back to work tomorrow, OK? And, you know, you might have issues where you were looking at liquidation from the standpoint of getting bought out and emerging from bankruptcy, you know, making a deal on the court steps, you know, of bankruptcy court to kind of move on and get a new, better,

healthier buyer to kind of get back on track. And you know, I want to - look, we've got some methodology issues, some approaches mentioned under each duties on the side. You know, the fact of the matter is, we're going to get into this stuff in greater detail, probably closer to the second half of this presentation. And we can't wait to get there. All right. So now, here, we have another cornerstone, is level of value. OK? And you it's interesting 'cause things like level of value and standard of value are somewhat linked at the end of the day. And it's my hope that by the end of this, like, that becomes abundantly clear. Essentially, level of value describes, you know, where we are on the yardstick - right? - or rather which yardstick we're using to measure value at the end of the day. You know, and while this is driven by things like purpose, standard, the nature of the interest, right? So, you know, you can start to make analogies - right? - where we have at the top of this, you know, strategic control value. We were talking earlier about, you know, that idea of investment value is a standard of value. And one plus one doesn't equal two. It might equal three - right? - if there's some specific motivation that's really kind of putting a premium on value, you know, certainly above and beyond a hypothetical transaction. OK. And then you go down from there. You know, financial control value - you know, it's sort of like what's a reasonable value to put on usually an entire business at the end of the day or a proportionate piece of an entire business where, you know, from reasonable reference points of rates of return and, you know, ability to say - you know, put at least some reasonable leverage into buying a whole company will typically land you on the concept of financial control value. Now you start to notice, you know, there's - this chart effectively starts to introduce the concept of valuation discounts, which is sort of a tough, you know, grey area to get into, but we're looking forward to getting into it. You see there's some indications here on the left-hand side in some areas that say FCP. You know, that's financial control premium. And by the way, there's an inverse of that, and it's on the right-hand side of this chart. It's MID - minority interest discount. You know, is it worth less at the end of the day to be at a minority, you know, noncontrolling level of value than a financial control value? You know, sometimes these two things are - you know, could be conceptually pretty close. Sometimes they're pretty far apart. It's going to depend on the facts and circumstances of things. Now, you know, the interesting thing from an appraisal standpoint, marketable minority value is - in a way, it's almost like a reference to the public market, right? We're marketable. We don't own the whole thing, but we can still go and sell it, right? It's like owning a share of Apple stock or Home Depot or something like that. Of course, somebody will come back and correct me and tell me one of those is private. But you go down further from there, right? You know, in most instances, we're actually - if it's applicable, we're going to go all the way from financial control down two steps to nonmarketable minority value, you know, if things like discounts are relevant to the assignment we're getting into, right? And so then you have to think about, well, look, we're not marketable. There's some kind of a deduction baked in for not being marketable. You know, and typically, nonmarketable minority value gets you to, you know, gifted estate - right? - if we're not looking at - you know, if we're looking at a few shares in a company as opposed to something sort of controlling or majority, right? And, you know, financial control value might be analogous to, well, look, we're going to appraise a whole company because we're thinking about putting it on the market. You know, we're not necessarily thinking about synergies. Or we might be looking at it from, like, a fair value standard, for example, of, well, we're certainly not thinking of discounts. If we've got, you know, a 10% interest here, you know, it's 10% of the whole thing. You know, it's not 10%, you know, and then lopping off huge discounts. So that's my quick spiel on level of value at this stage, and...

>>: And Jesse, if I can just kind of to compliment that one more time, too, is this chart kind of talks - it shows inherently risks that are involved with valuing privately held company - right? - is, you know, if you think about someone who comes in to buy a company with strategic control, that's probably a win-win in both parties' mind - buyer and seller. You know, a seller is willing to pay a premium to take on additional risk because they think they can add value, right? And the seller would jump all over that because the company is worth more than as they run it today with that financial control. And then finally, risk inherent with minority shareholders who don't have a lot of decision power. You know, there's discounts taken there to reflect their inability to get out of the stock if the company gets into trouble. So there's - you know, this chart really does a nice job also of showing how values can change as there is an increase or decrease of risk from an owner's perspective. The last - I think the last piece in our

understanding that's important is the valuation date. And when we get into a valuation date, the starting point here is that everyone needs to understand the biggest factor in determining a valuation date is what can a valuator consider? And the most common term you're going to hear is this known or knowable standard? I'm going to kind of walk through the AICPA's standards when it comes to subsequent events because the valuation date is going to trigger for a business valuation. All the information that is known and available or should be known and available to an appraiser as of that date is going to be something that can impact the value. However, if there's any factors that could not have been expected affect the value that happened during appraiser's work because all the work is done always after the appraisal date. And appraisers shouldn't be able to factor those events into play. And on that second bullet point verse the last bullet point, there's - looking at factors that affect the value verse anything that can provide an indication to the ownership in a privately held company. So, for example, if you went back and you were at the end of December 31, 2019, for instance, companies are running pretty well at this point. COVID was not a factor that was known or knowable as of that valuation date. It wasn't until February, March of 2020 that COVID in the U. S. started impacting businesses. If there is a fire or a natural disaster or a stock market crash, these are factors that could affect a business valuation. But if these events were not known prior to your valuation date, you're not going to be able to consider it. Whereas an indication of value, something where shares of the privately held company have transacted post-valuation date, then an appraiser, if they have not issued their report, although cannot, in theory, take it into consideration may need to reference that to support their hypothetical value. And a perfect example is there was an older case called the Estate of Helen Noble. And basically, for estate purposes in a lot of the legal battles here dealt with the fact post-death, there were transaction of shares of company stock and whether or not those transactions provided a more appropriate value under the fair market value standard then what was known as the date of divorce - date of the estate or date of death. So this valuation date and the known and knowable criteria is absolutely critical when you're deciding on what is the valuation date.

>>: Can I add a couple of sort of, I guess, examples that I think we see

commonly where you had things like COVID and a fire or stock market crash listed? Is it somewhat typical that - or maybe not - typical is not the right word. But in, like, small and mid-sized businesses, sometimes you have enormous customers, right? So you run a business, and customer X might make up like 40% of the business, right? And so it's a frequent subsequent event. You know, you get out past that valuation date. And sometimes the client calls and says, jeez, guys. I'm talking to this client right now. He's substantial to the business. I think it is a possibility we're going to lose this client, right? Or an actual loss happens. And so that'll come up time and again or, you know, even getting out past - what was it? - like, late February or early March of '20 and COVID, you know, even valuation dates after that. Well, then you get into issues like the, you know, when supply shortages really started to hit, right? So we'd have like a late, you know, let's call it, like, a third-quarter 2020 valuation date. And of course, you're in 2021 trying to do this thing and wrap it up. And, you know, the clients tell you, oh, we can no longer get this building material, you know, unless we're willing to buy, you know, 90 days' worth at a time at, you know, a 20% increase. You know, what's that going to do to your valuation, you know? Of course, unless we're moving the date. We're glad we know about this, but it's like there's not much you can do sometimes.

>>: And Jesse, that's a really good final point, I think, here on valuation date. You know, what should the appropriate valuation date be? We know for estate purposes, it's either date of death or six month later. For gifting, you have some flexibility as to the date you want to make the gift. When it comes to divorce, it tends to be as close to valuation date - I mean, as date of divorce as you can get to select the valuation date. And finally, in civil litigation, you know, that valuation date might be the date of the damage where there might be two dates depending on when someone thinks they were - actually left the company or harmed. Or do they potentially still have an ownership and they want to move the date? Given the interest of time, I was going to go through - what the next few slides will do is talks about this subsequent event standard because from an education standpoint, this - the AICPA has valuation standards. Their Valuation Services-Subsequent Events Section 100 lists out criteria of what's known and knowable. And what I want to point out here, instead of going through all these factors that are really here for, you know, material for you in the future, is, look, the

third bullet point - any event that could affect the value may occur subsequent to the valuation date will be known as a subsequent event. And then subsequent event are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent. Now, it doesn't mean that an expert isn't going to disclose in a report that subsequent to my valuation date, this happened and it was not factored in. Going back to my illustrative example of if we're valuing a company at 12-31-2019 and we're here in 2022, the company could be materially different because of COVID, because of inflation and maybe, as Jesse said, an issue with a key customer that's happened that needs to be disclosed. But it's also noted that it probably cannot impact the indication of value used in a hypothetical appraisal. Following along in the same section, just a few more bullet points that talks about disclosures under the subsequent event standard. And I think I've talked about - and again, I'm going fast through these because these are just bullet points reiterating what Jesse and I talked about as the known or knowable. But here's an example that's actually within the standard. For illustrative purposes, consider whether an agreement executed shortly after the valuation date with a new major customer would likely have been known or knowable, OK? We get this all the time. We're working on an appraisal. The valuation date is December 31 2021. We were engaged last month and, all of a sudden, there's a major contract coming up for renewal. Well, what's - what would have been known or likely known as of that valuation date versus what's happening today? And let's see. I think finally to round this out is although, again, not required to disclose in a valuation report what that subsequent event was. In most valuation reports, we do see subsequent events being disclosed just in case something material has happened that could not be considered. So rounding out, you know, when you think about the valuation date, a couple key takeaways. You know, sometimes the valuation date is going to be fixed and triggered by a certain event. Other times, the valuation might be flexible given the nature of circumstances. Be aware of this subsequent event standard. Have the AICPA standards available to you. Know what the expert is going to be able to consider and can't consider. You know, it's going to go into, one, either helping your expert build their report. It can also be helpful in critiquing another expert's report. And then finally, when it comes to subsequent events - how and when they can be disclosed. Final point here is - and if you have the ability

- potentially changing the valuation date. So Jesse, with that, I think rounding out our understanding of engagement, just to touch on two valuation concepts.

>>: Yeah, I'd love to. And Marc, thank you so much. I'm going to playfully make fun of you for a second. I enjoyed that Windows 95 clip art included on the slide. So, OK. I think we briefly highlighted earlier the concept of goodwill. But now I want to talk about this from a couple of different reference points, whether we're looking at personal goodwill or whether we're looking at business goodwill, and you know, sometimes maybe there's some murky situations. But we are typically not aiming to put a value on a specific person, right? You know, and typically, this is in the context of, like, a key individual to running the business. You know, oftentimes, this could be someone who is both in ownership and sort of overall management of the firm. You know, of course, sometimes you can have employment agreements that sort of tie an individual down. And yeah, certainly that might be sort of useful and positive to the business under review. But most of the time, we're valuing a business, not a person again. So whether a business itself has goodwill, the enterprise has goodwill or if we're just looking at, you know, personal value, it's sort of an issue that - you know, I've always liked to look at this on a spectrum - and I think maybe Marc does, too, but I wouldn't speak for him - you think about it is on one end of the spectrum, you've got a business that's a guy with a computer in a basement - right? - just serving some clients - right? - and there's really not much more to it, right? What are the odds there's a ton of business goodwill involved there? And obviously, we'd have to expand upon that example. But I think you could take a good guess. In many instances, there's really not much of a business there, right? And then you go to the opposite end of the spectrum. And again, this is somewhat selective opposite end of the spectrum just for the illustration. You know, when you have, you know, a business with, you know, two or three manufacturing plants, you know, in different regions of the country - and by the way, they've got international distribution and 500 employees - like, you start to get the sense of separation, you know, certainly on opposite ends of business value versus personal value. And certainly there's - you know, sometimes we just have to sort through the weeds to try to make sure that we're only grabbing and putting into value, you know, what is intended to

be there at the end of the day. Marc, I don't know if you wanted to add anything else around this particular concept.

>>: No, I think the only thing that I might add is when you come to personal verse enterprise goodwill and again Revenue Ruling 59-60 is there are going to be attributes of individuals that can affect value. And we typically shave that out of the appraisal before we arrive at the value of the business. So you know, those attributes that relate to an owner's education and specialized skill set and active involvement, you tend to carve those out so they're not implied in what is the remaining equity value of a business.

>>: I think this concept - would you agree? - is typically pretty important. And it's somewhat of a state-by-state issue, but like, particular to divorce, for example.

>>: Yeah.

>>: And then sometimes in, like, a transaction context as to - you know, from a tax perspective - this particular issue.

>>: You also see it a lot not only in divorce but in gift and estate. And I think it was Boss Trucking was another example of - in an estate case where the business owner had a lot of personal attributes that reduced the value at the end of the day. So I think it's in those type of cases. And it might also impact on the M&A side, you know, if an owner is going to stay on and the type of agreements that you might find if there's going to be an earnout over time or an employment agreement that carves out some of that value.

>>: Absolutely. All right. So now - oh, go ahead.

>>: Oh, I was just going to say, I think, you know, as we get into here, you know, we've - that covers our first - the groundbreaking foundation of our house. And Jesse, you're going to move us into stage two.