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Introduction

It was an exciting year for the business valuation profession in 2019! Some of the developments include important court rulings on tax affecting pass-through entities, a possible upending to the goodwill model, a new cost of capital platform gaining traction, and advances in fair value for financial reporting. For 25 years, *Business Valuation Update* has chronicled these developments as well as the latest thinking in methodologies as well as changes in regulations and professional standards, new and updated resources, and practice-building ideas. Here are some of the notable happenings of 2019, which were covered within the pages of *BVU*.

Tax affecting. Since the *Gross* case in 1999, valuation experts have been unable to convince the Tax Court of the need to tax affect the earnings of a pass-through entity when doing the valuation. In subsequent cases, the IRS continued to win on its stance of “no tax affecting.” Two major court decisions emerged in 2019 that may be a lasting victory for tax affecting. First, the *Kress* case was the game changer in that both the taxpayer and the government tax affected the earnings of the subject S corp.¹ But the decision was from a federal court, not a U.S. Tax Court memo or a decision from a U.S. Court of Appeals, so there was a question about its precedential value.

Then came a U.S. Tax Court ruling in an Oregon gift tax dispute, accepting the taxpayers’ tax-affected valuations of a PTE without overturning *Gross*. The court recognized there are tax consequences to PTE owners that valuation experts must address by quantifying the burden and benefit related to flow-through status. That case is *Estate of Aaron Jones v. Commissioner*, T.C. Memo. 2019-101 (Aug. 19, 2019),² which provides further support for the use of tax affecting. Another case (which is still pending) is *Cecil et al. v. Commissioner of Internal Revenue*, and it involves a gift of shares in the Biltmore Co., which operates the famous Biltmore estate that is now a tourist attraction. When that case is decided, more clarity may be given to S corp valuations.

Revisiting goodwill. A very important issue reared its head in 2019 with the FASB revisiting the idea of annual impairment testing versus amortization of goodwill. The group issued an

¹ “Kress and S Corp Valuations: Be a Little Cautious,” Daniel R. Van Vleet, ASA (*BVU*, June 2019).

² Available at *BVLaw* (bvresources.com/products/bvlaw).

Invitation to Comment (ITC) on how to account for certain identifiable intangible assets acquired in a business combination. Private companies and not-for-profit organizations got relief from the rules after struggling with the burden of annual testing. In preliminary outreach with public-company stakeholders, the FASB received mixed feedback “indicating that the benefit of certain intangible asset and goodwill impairment information might not justify the cost of preparing and auditing that information,” according to the 34-page ITC.

The FASB received almost 100 comment letters on the ITC.³ Also, a roundtable discussion was held at FASB headquarters in November with a mix of stakeholders. Members of the valuation profession expressed serious concerns over going back to a model that treats goodwill as a wasting asset. Also, the point was made that the acquisition of a business assumes a going-concern premise, so the concept of goodwill amortization is not compatible with this premise.

The FASB has done an excellent job of laying out the issues and soliciting comments from a wide variety of stakeholders. But this is just the first step. Next, the comments will be processed, and a presentation will be made to the FASB board, which will decide on what action to take. Typically, an exposure draft would be issued and go through one or more revisions before rules are finalized. This entire process can take up to several years to complete.

Cost of capital. 2019 was the first full year of operation for an online platform, the Cost of Capital Professional, launched by Business Valuation Resources.⁴ This is an independent, transparent, and less complex resource rooted in academics that is affordable to all, not just the big firms. How does this platform stack up against the Duff & Phelps Cost of Capital Navigator? During a conference session, Jim Hitchner (Financial Valuation Advisors Inc.) put both platforms through their paces using a hypothetical subject company using various input options –and the results were similar. The result was a cost of equity range of from 15% to 17% from both platforms for the buildup method and 15% to 16% for the modified CAPM, which is “not that much different,” he said.⁵

In the audience were users of each platform, so they both clearly have a place in the valuer’s toolbox. The BVR Cost of Capital Professional is not the massive system that the Duff & Phelps Navigator is, but in its simplicity lies its appeal to some users. In fact, some users have both platforms and compare the results, which is certainly a welcome option in this very challenging process.

Size effect. At several conferences during 2019, a show of hands revealed that almost every valuation practitioner applies a size effect when estimating the cost of capital. While it seems

3 “FASB Gets an Earful Regarding Goodwill Amortization vs. Impairment” (BVU, “News and Trends,” December 2019).

4 “BVR’s New Cost of Capital Platform Makes Its Public Debut” (BVU, January 2019).

5 “BVR and Duff & Phelps Cost of Capital Platforms Go Head-to-Head at VSCPA” (BVU, November 2019).

to be a settled matter with experts, that's not the case with academics. Most empirical studies find that the size effect has diminished or disappeared since the early 1980s when Rolf Banz first documented it. In 2019, a number of new research papers were released that largely support this finding. One of these papers presented the first meta-analysis of the size premium, and it provides an estimate that is smaller than what many people believe.⁶ Meta-analysis is a quantitative research method designed to aggregate and synthesize past findings and explain differences in earlier studies. It is particularly useful when earlier studies have conflicting results. However, it seems that the size effect debate among business valuation practitioners will continue.⁷

The upshot of all this research is that practitioners should not automatically use a size premium but should take a fresh look at the issue and consider other factors, such as firm quality.⁸ Also, as academic research points out, the size premium differs depending on the historical time frame of the data. Therefore, the valuation expert must consider the historical time frame that is most relevant to the firm being valued. The size premium in listed firms, if there is one, varies over time positively and negatively. Sometimes, smaller listed firms outperform larger listed firms, and, sometimes, the opposite occurs. No formula or black box should decide this for you—it's a matter for your professional judgment.

Fair value for financial reporting. *Business Valuation Update* attended the RICS Business Valuation Symposium in New York City, and one session chronicled the events and developments in fair value for financial reporting that strikingly illustrated the advances the profession has made in enhancing the public trust.⁹ What regulators once viewed as a “fractured” profession has pulled together to respond to criticisms over a perceived lack of unified qualifications, standards, and enforcement in this area. Anthony V. Aaron, formerly with EY and now an adjunct professor at the University of Southern California (Leventhal School of Accounting), and Jay E. Fishman, managing director at Financial Research Associates, conducted the session. Both of these individuals—along with other speakers and attendees in the room—have been personally responsible for much of the progress the profession has made.

In 2019, the AICPA launched its new credential, the Certified in the Valuation of Financial Instruments (CVFI), with an accompanying performance framework.¹⁰ This new credential is not just for CPAs but for any valuation professional who performs fair value measurements of financial instruments for financial reporting purposes. The CVFI can be considered a companion of sorts to the Certified in Entity and Intangible Valuations (CEIV), which was developed jointly

6 “New Meta-Analysis Study Reveals Diminished Size Premium” (*BVU*, December 2019).

7 “No End in Sight to Size Effect Debate,” Dr. Michael A. Crain, CPA/ABV, CFA, CFE (*BVU*, May 2019).

8 “Two Articles Addressing Firm Quality and Its Impact on the Size Effect,” Roger J. Grabowski, FASA, and Anas Aboulamer (*BVU*, May 2019).

9 “Timeline Reveals Advances in Building Trust in Fair Value for Financial Reporting” (*BVU*, August 2019).

10 “Update on the AICPA's New CVFI Credential” (*BVU*, February 2019) and “AICPA Launches CVFI Credential” (*BVU*, “News and Trends,” June 2019).

by the AICPA, ASA, and RICS. But, unlike the CEIV, this new credential was not developed in collaboration with other valuation professional organizations (VPOs).

Also of note, the Public Company Accounting Oversight Board issued four documents that provide guidance on the new requirements for auditing accounting estimates and the auditor's use of a specialist, which includes valuation experts. The new requirements are effective for audits of financial statements for fiscal years ending on or after Dec. 15, 2020.¹¹

Methodology. A highlight of 2019 was in the area of healthcare—groundbreaking research and data analytics that challenge commonly held beliefs about survey data, physician compensation, and fair market value. Mark O. Dietrich (Mark O. Dietrich, CPA, PC) wrote a peer-reviewed article, which *BVU* was allowed to reprint from the journal of the Healthcare Financial Management Association (HFMA). In the article, Dietrich makes the case for the entire healthcare industry to rethink its approach to the fair market value of physician compensation. He advises that the use of surveys should be limited to rough benchmarking and the focus should rather be on localized relative value unit (RVU) data that reflect actual local-market conditions.¹²

A few other articles of note concerning methodology:

- A method to adjust enterprise values that were calculated using pre-TCJA M&A multiples¹³;
- Determining and applying an appropriate market rate in the valuation of privately held promissory notes¹⁴;
- How an appraiser looks to the private capital market to estimate cost of capital for private-company valuations¹⁵;
- The application of option pricing model techniques to the valuation of interests in early-stage enterprises based on a new AICPA accounting and valuation guide¹⁶; and
- A testifying expert explains how to value a financial advisor's book of business.¹⁷

Also, in 2019, *BVU* started a series of articles called "Tales From the Trenches," designed to present valuable lessons based on the experiences of seasoned valuation experts. While you

11 "PCAOB Issues New Guidance on Fair Value" (*BVU*, "News and Trends," October 2019).

12 "Physician Distribution, Mobility, Fair Market Value, and Compensation Surveys," Mark O. Dietrich, CPA/ABV (*BVU*, March 2019).

13 "Enterprise Value Adjustment Multiple for Post-Tax Reform Valuations," Daniel R. Van Vleet, ASA (*BVU*, March 2019).

14 "Determining the FMV of Small Privately Held Promissory Notes," Bruce A. Johnson, ASA (*BVU*, July 2019).

15 "Appraiser Shuns Public Data for Private Cost of Capital" (*BVU*, May 2019).

16 "Calibration With OPM in Early-Stage Enterprises: A Fair Value Update," Neil J. Beaton, CPA/ABV, CFA, ASA; Andreas Dal Santo, CFA, ARPM; and Antonella Puca, CFA, CPA/ABV, CEIV, CVA (*BVU*, March 2019).

17 "Valuing a Financial Advisor's Book of Business," Howard A. Buchler, J.D. (*BVU*, December 2019).

may be able to find some of this advice in books, only real-life experiences can highlight the nuances that can only be found in the minds of the experts who have lived through many engagements. Veteran appraiser Robert Kleeman kicked off this series,¹⁸ and Jim Alerding also contributed.¹⁹ *BVU* looks forward to carrying more of these articles.

Conferences. *BVU* attends major U.S and global business valuation conferences and many smaller, specialty conferences and provides coverage of major takeaways from these events. Here are the events we covered in 2019:

- ASA Fair Value Conference (New York City)²⁰;
- New York State Society of CPAs BV Conference (New York City)²¹;
- AAML/BVR National Divorce Conference (Las Vegas)²²;
- RICS Business Valuation Symposium (New York City)²³;
- NACVA 2019 Annual Consultants Conference (Salt Lake City)²⁴;
- 2019 CBV Institute Congress (Canada)²⁵;
- ASA Fair Value Conference (Los Angeles)²⁶;
- ASA Joint 2019 Advanced Business Valuation and International Appraisers Conference (New York City)²⁷;
- Virginia Society of CPAs BV, Fraud and Litigation Services Conference²⁸;
- ICPME, IVSC, IACVS, ICAEW (various locations)²⁹; and
- NACVA Connecticut Chapter BV and Litigation Seminar (New Haven, Conn.).³⁰

18 “Company Research: The Internet May Be Right, But It May Also Be Wrong!” Robert E. Kleeman Jr., CPA/ABV, ASA, CVA (*BVU*, August 2019).

19 “How to Successfully Use Statistics—Without Being a Data Guru,” R. James Alerding, CPA/ABV, ASA (*BVU*, September 2019).

20 “Hot Topics Abound at ASA Fair Value Conference in New York City” (*BVU*, June 2019).

21 “Front-Burner Issues Presented at This Year’s NYSSCPA BV Conference” (*BVU*, July 2019).

22 “Attorneys and Valuers Strengthen Ties at AAML/BVR Divorce Confab” (*BVU*, July 2019).

23 “Timeline Reveals Advances in Building Trustin Fair Value for Financial Reporting” (*BVU*, August 2019).

24 “10 Things to Know From the NACVA 2019 Conference” (*BVU*, September 2019).

25 “2019 CBV Institute Congress—Fantastique!” (*BVU*, “Global News and Trends,” August 2019).

26 “Possible Change to Goodwill Model Generates Buzz at ASA Fair Value Conference” (*BVU*, September 2019).

27 “Gems From the ASA Advanced BV Conference in New York City” (*BVU*, October 2019).

28 “BVR and Duff & Phelps Cost of Capital Platforms Go Head-to-Head at VSCPA” (*BVU*, November 2019).

29 “Reports From Global BV Conferences: ICPME, IVSC, IACVS, ICAEW” (*BVU*, December 2019).

30 “Calculations Headline NACVA Connecticut Chapter Conference” (*BVU*, “News and Trends,” November 2019).

Also, BVR provided the livestreaming for two ASA conferences: the ASA Fair Value Conference (Los Angeles)³¹ and the Energy Valuation Conference, which was presented by the ASA's Houston Chapter.³²

*Note: In 2019, BVR took over the co-sponsorship role from the AICPA for the American Academy of Matrimonial Lawyers (AAML) National Divorce Conference, which has been held every two years (in the even-numbered years). However, a year was skipped, and there will be a conference in the fall of 2020 to get back on track. The conference will be held Sept. 10-12, 2020, at the Venetian in Las Vegas.*³³

Practice management. In 2019, BVR released its survey-based *Firm Economics & Best Practices Guide*, which provides business valuation, forensic, and litigation support (BVFLS) professionals with the largest and most thorough analysis of best practices in financial management, marketing, human resources, compensation, and professional and ownership standards. *BVU* covered some key findings from the report, including preferred research sources,³⁴ how BV firms win new business,³⁵ and best ways to manage staff.³⁶

New books and resources. During 2019, *BVU* provided insights and reviews of several new books and resource tools, such as:

- Synergyflow, a workflow platform that allows users to create, acquire, manage, and deploy the knowledge capital utilized in the valuation process³⁷;
- Vertical IQ, an industry research service that focuses on the financial aspects of how firms operate in a particular industry³⁸;
- RCReports, a cloud-based software application designed to quickly calculate accurate and defensible reasonable compensation for closely held business owners³⁹;
- The new edition of the *Business Reference Guide*⁴⁰;
- BVR's new Valuation Benchmarking Platform, which provides direct access to documents that reveal the valuation analyses behind M&A transactions⁴¹;

31 Video available at sub.bvresources.com/trainingeventpast.asp?WebinarID=711.

32 Handouts available at sub.bvresources.com/trainingeventpast.asp?WebinarID=698.

33 bvresources.com/events/national-divorce-conference-2020.

34 "New Study Reveals BV Research Sources of Choice" (*BVU*, April 2019).

35 "Survey Uncovers the Most Effective Ways to Get More BV Business" (*BVU*, May 2019).

36 "BVFLS Firms Disclose Their Best Management Practices" (*BVU*, June 2019).

37 "Synergyflow: A New System Designed to Add Intelligent Workflow to the BV Process" (*BVU*, January 2019).

38 "Vertical IQ: Very Smart Industry Research," Stuart Weiss, CPA/ABV (*BVU*, March 2019).

39 "Determining Reasonable Compensation Using RCReports Data," KC Conrad, ASA, BCA, CMEA, and Marsha Conrad, BCA, CMEA, CSBA (*BVU*, September 2019).

40 "Rules of Thumb Highlight the 2019 *Business Reference Guide*," (*BVU*, October 2019).

41 "Using Industry Benchmarks to Establish Secure Negotiating Positions for M&A Purposes," Casey Karlsen, Seth Webber, CFA, ASA, CEPA, CBA, CVA (*BVU*, December 2019).

- An update to DealStats, the leading database of transactions in the private and public sectors⁴²; and
- The *2019 FactSet Mergerstat Review—UK Edition*, a new resource that delivers 20 years of data and statistics on M&A transactions that involve UK companies.⁴³

We've just touched on some of what happened in the BV world in 2019, so we invite you to journey back through the pages of *BVU* for much more. And we will continue to keep you fully informed during 2020.

42 "DealStats Adds 35 New Fields of Data, Other Enhancements," (*BVU*, "News and Trends," December 2019).

43 "Control Premium in UK Is 30%, Per New Study," (*BVU*, "Global News and Trends," August 2019).

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- ktMINE Royalty Rate Data & License Agreements
- First Research Industry, State & Province Profiles
- BizMiner Industry Financial Reports
- Mergerstat Review & Mergerstat Review Monthly
- Butler Pinkerton Calculator – Total Cost of Equity and Public Company Specific Risk Calculator
- Vertical IQ - U.S. and Canada Industry Profiles

News & Research

- BVResearch Pro
- Business Valuation Update
- BVLaw
- Economic Outlook Update
- Business Reference Guide Online

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