

Valuation Services

Common Valuation Pitfalls

Details

The use of proper, acceptable valuation techniques and analysis is critical for accounting and tax reporting purposes. Valuation errors that impact financial reporting can cause audit issues and delays, as the company's audit firm may ask the valuation analyst to make corrections or revise conclusions. When valuations are not done correctly the first time, it can require additional time and attention from a company's management team, cause audits to be more expensive, and could push back the timing of completed audited financials which can create covenant compliance issues for leveraged businesses. Additionally, valuation errors for tax reporting purposes can have even more dire consequences, such as tax penalties.

Examples of Common Valuation Errors

➤ Incorrectly Calculating the Partial Period for Present Value Factors

- When using a discounted cash flow ("DCF") method of the income approach, it is generally accepted in the valuation community to use the mid-period convention when present valuing cash flows. Theoretically, this practice assumes cash flows are collected at the mid-point of the year, rather than year-end. A common mistake is to add 0.5 to the first year's present value factor, thus under-discounting cash flows, and overvaluing the enterprise.

➤ Incorrectly Discounting the Terminal Year

- Typically, in a multi-year DCF, the terminal year is valued utilizing the Gordon growth model – a widely accepted valuation practice. Often times the terminal year value is discounted using the wrong rate; the valuation analyst will extend the present value discounting factor an extra

year, rather than correctly using the last discrete year's present value factor. This error deflates the value of the enterprise.

➤ Employee Stock Options Issued In The Money

- When private companies issue employee stock compensation without the help of a valuation analyst they must determine fair market value, per Internal Revenue Code 409a ("IRC 409a"). Without determining fair market value in accordance with IRC 409a, employee stock options may be incidentally granted in the money, thus triggering a tax penalty to the employee that is awarded the option. In addition to the potential tax liability for the employee, improperly valuing stock options can be uncovered during audit process, as the audit firm reviews how the company expensed the stock option award as part of ASC 718. This can ultimately lead to increased audit fees for the employer issuing the employee stock options. Private company executives often simply select a strike price for the option using their gut feel, or do not adequately use proper valuation techniques to conclude fair market value.

➤ Models that are not Dynamic

- A non-dynamic or hard coded model refers to the practice of embedding data or an assumption directly into a model or calculation. For some valuation firms, it is not uncommon to roll forward prior analyses and models when working with the same client for a new engagement, or to leverage a model from a different engagement entirely, as this saves time and can lower fees. The pitfall arises when hard coded numbers are not updated, and then stale or errant inputs or assumptions are incorporated into the analysis. This pitfall culminates in a flawed conclusion of value and will often time require rework.

How Centri Can Help

Using seasoned valuation professionals, such as those at Centri Business Consulting, will avoid these common pitfalls, and ensure the correct conclusion is reached the first time. Partnering with Centri's Valuation Services practice will save you time and money, and can prevent tax and compliance nuisances so that you can focus on running your company.

Centri is dedicated to providing the highest quality valuation consulting services by being reliable and responsive to your needs. We select the right client service team to match your specific objectives. This allows us to offer a tailored solution to help you measure, analyze and report on a broad range of valuation issues. Centri specializes in valuations for companies of various sizes, business stages and industries. Our professionals use their analytical skills, business acumen and experience with best practices to determine the appropriate model sophistication. Whether the need is best met by utilizing a more complex methodology, like a Monte-Carlo or Decision-Tree analysis, or a more traditional approach, such as a Discounted Cash-Flow or Direct Capitalization analysis, we work to ensure the results meet your objectives and are appropriately interpreted, recorded and disclosed within your financial statements.

Our Valuation Services include:

- Sell-side advisory and valuation services
- Embedded Derivatives or Bifurcation of Convertible Securities (ASC 815)
- Equity-Based Compensation (IRC 409A/ASC 718)
- Fair Value Measurements (ASC 820)
- Financial Assets & Liabilities
- Fresh Start Accounting
- Gift and Estate Tax
- Goodwill & Other Intangibles Impairment Analysis (ASC 350)
- Purchase Price Allocations Related to Business Combinations (ASC 805)
- Private Equity Portfolios
- Variable Interest Entities
- Credit Valuations

Centri Business Consulting provides the highest quality finance and accounting consulting services to its clients by being reliable and responsive to their needs. Centri provides companies with the expertise they need to meet their reporting demands. Centri specializes in financial reporting, internal controls, technical accounting research, valuation, and CFO advisory services for companies of various sizes and industries. From complex technical accounting transactions to monthly financial reporting, our professionals can offer any organization the specialized expertise and multilayered skill sets to ensure the project is completed timely and accurately.

For more information, please visit www.CentriConsulting.com