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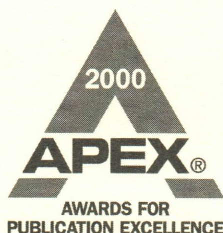

VALUATION ISSUES IN ALLIANCES, JOINT VENTURES AND PARTNERSHIPS

Part I: Recognizing the Issues

Mark L. Zyla, CPA/ABV, CFA, ASA

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"Four Airlines Form An International Alliance," "Barnes & Noble, Gemstar Form Alliance," "Converse Unit, Radware Form Broadband Joint Ventures." Almost daily these or similar headlines jump out at us from the business press. Businesses, it seems, are constantly announcing new alliances and joint ventures.

The amount of corporate partnering (alliances, joint ventures, and corporate partnerships) in fact rose dramatically over the last decade. The number of new joint venture announcements roughly equals the number of completed mergers and acquisitions.[1] The joint venture and the corporate alliance have become increasingly popular corporate business models because of their relative flexibility and specifically defined time frames. Whereas a merger or acquisition may be costly and is normally for an indefinite time period, a joint venture or strategic alliance can be structured to be flexible to meet the common goals of the parent companies for a defined time period at much less cost.

While alliances and joint ventures are becoming increasingly common business models, there are concerns about whether or not they actually achieve corporate goals. Key to alliances and joint ventures that are considered successful is a complete understanding of the valuation issues during the formation as well as the development of a plan for creating value from the alliances or joint ventures.

WHY BUSINESSES USE STRATEGIC ALLIANCES AND JOINT VENTURES

Corporate partnering such as joint ventures and strategic alliances take many forms, ranging from formation of a new corporate venture to a simple joint marketing agreement. One incentive for corporations to pursue a joint venture or other strategic alliance is that it is often much less costly than either internal development or acquisition of another company. Another benefit is that the flexible structures of corporate partnerships often allow each party to achieve its own corporate goals.

Recently Bertelsmann, the German media group, and Napster, the Internet-based music distributor, announced a strategic alliance to develop Internet file-sharing technologies. While Bertelsmann and Napster have very different corporate cultures and distinct business strategies (Bertelsmann is a 200-year-old European media giant and Napster is a California-based Internet startup), both companies believe that the strategic alliance will allow each to achieve individual corporate goals.

The proposed joint venture will develop a membership-based service, which will allow

[1] Reed, Stanley Foster, and Alexandra Reed Lajoux, *The Art of M&A: A Merger Acquisition Buyout Guide*, 3rd ed., page 825.

The uniqueness of structure of corporate alliances often creates issues related to valuation.

members to download music from the Internet for a fee. The service would then provide royalty payments to the holders of the music rights. Bertelsmann believes the alignment will allow them to jump to the forefront of the music industry while Napster believes they will benefit primarily by earning fees for the use of their technology without being pursued for copyright infringement. Both Bertelsmann and Napster believe this alliance will greatly benefit both companies at less cost than other types of structures.[2]

Joint ventures and strategic alliances are both common forms of corporate partnering. Because of their inherent flexibility, joint ventures and strategic alliances are sometimes difficult to differentiate. Both are a collaboration of two or more companies on a specific project. Often joint ventures are also referred to as strategic alliances. Joint ventures, however, are sometimes differentiated from strategic alliances in that they often require the establishment of a separate legal entity to form the relationship. Strategic alliances are more informal collaborations, often as simple as a joint marketing agreement.

One example of a strategic alliance is found in the airline industry where, in addition to code-sharing arrangements, there are often joint marketing agreements. Delta Airlines, Air France, Air Mexico, and Korean Air recently announced an alliance dedicated to "customer benefits." The new alliance, known as SkyTeam, provides code-sharing arrangements as well as joint advertising campaigns.

Participants enter into a joint venture or strategic alliance in order to achieve one or more of the following goals:

▲ Enhance competitiveness both domestically and globally.

▲ Develop new products more quickly and at a lower cost.

▲ Improve overall cost reductions.

▲ Share technologies and organizational skills.

▲ Enter a new line of business by utilizing another company's financial or technical resources.

▲ Improve distribution channels.

While a company may be able to achieve these same goals through a merger or acquisition, a strategic alliance or joint venture often provides the same results in a less costly manner with a more flexible operating structure. Each of these goals has a distinct valuation component.

HOW JOINT VENTURES AND OTHER STRATEGIC ALLIANCES CREATE VALUE

Joint ventures and strategic alliances create value through two key concepts: 1) maximize strategic advantages, and 2) minimize risk. The valuation issues are often related to the particular format of the venture or alliance.

Joint ventures often fall under one of three formats related to common strategic reasons for entering into an arrangement:

1. Two partners of a joint venture combine their technological efforts to create a new product. For example, Texas Instruments and Hitachi Ltd., both semi-conductor chip manufacturers, entered into an agreement to build jointly a $500 million plant near Dallas, Texas, using the technological advantages of both companies to manufacture memory chips.[3]

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[2] "Bertelsmann and Napster Form Strategic Alliance," *www.FT.com*, published October 31, 2000.

[3] Reed, Stanley Foster, and Alexandra Reed Lajoux, *The Art of M&A: A Merger Acquisition Buyout Guide*, 3rd ed., page 825.

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2. One partner with a technology product enters into a joint venture arrangement or other strategic alliance with a partner who may have a strong distribution capability within a given market or geographic region. Phillips NV of the Netherlands and John Fluke Manufacturing of the U.S., for example, have set up a regional distribution network agreement for each company's testing and measurement equipment products in both the U.S. and Europe.[4]

3. A startup company in the process of developing a new technology requiring additional capital seeks a relationship with an existing firm in a larger more established company in the same industry. The startup benefits from the capital investment and possibly the management expertise of the larger established company while the established company gains access to new technology at a much lower cost than through either an acquisition or internal development. IBM is an example of a company that has developed a program to invest in startup technology companies that need financing for promising technologies.[5]

VALUATION ISSUES

The uniqueness of structure of such corporate alliances often creates issues related to valuation. In the case of a joint venture formed to develop a new product, the joint venture partners typically contribute the working capital, management, and technology to the newly formed venture. These assets can be contributed by one or both parties. The first valuation issue that typically arises is determining the relative value of each asset contributed by the participants to the joint venture, particularly in relation to structuring the relative ownership interests.

One possible solution is to value independently each asset contributed by each party to the joint venture. Standard valuation methodologies can be used to estimate the relative value of the assets including the technology to be contributed, the management team, and the fixed assets as well as any other assets, including intangible assets, contributed to the joint venture.

A second valuation issue in a joint venture is the relative value of the ownership interests. After the total net worth is determined, the relative value of the ownership can also be determined, which may or may not be the same as the relative value of the assets contributed. In analyzing the relative values of the ownership structure, the valuer would have to consider the rights and privileges attached to the ownership interest.

Often an established technology company will provide funding to a startup entity in exchange for rights to use the technology. The relationship can be more beneficial for both parties than typical venture capital financing. For the startup, the rate of return required on the investment by a corporate sponsor is often less than that required by a venture capital fund. Consequently, the cost of funding is cheaper. Additionally, the corporate sponsor often may provide managerial expertise. For the corporate sponsor, the investment is beneficial in that it receives the use of a certain technology for less cost than internal development or an acquisition.

Valuation issues arise in determining the percentage of the equity that the corporate sponsor should receive for the investment. Careful thought should be given to the value of the investment in relation to the rights received in exchange. Issues to be considered that have an impact on the valuation in this area are:

- Size of the equity interest.
- *De jure* or *de facto* control of the company.
- Liquidity of the investment.
- Exit strategy.
- Preference rights.
- Liquidation rights.
- Conversion rights of refinance.
- Rights to use the technology.

One common corporate partnering arrangement is either a manufacturing or distribution alliance with another organization. In these alliances, a technology company, for example, will "subcontract" the manufacture of a product with another organization. The first organization may have developed the technology initially but forms a relationship with another company to produce the product. Similarly, an organization may enter into a marketing or distribution alliance. The valuation issues related to these types of alliances often concern the value of aligning

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[4] *The Mergers & Acquisition Handbook*, 2nd ed., McGraw-Hill, Inc., 1994, page 90.

[5] *Ibid.*, page 89.

Consulting Services Opportunities Arising from Assisting in Forming Joint Ventures and Strategic Alliances

The valuation issues that arise in the formation of joint ventures and strategic alliances also create opportunities for valuation professionals to provide valuable consulting services. These services can include assisting in estimating the value of the assets contributed to the joint venture, particularly the intellectual property. Valuation professionals can also provide consultative services in estimating the relative values of the equity interests in the joint venture. Finally, valuation professionals can estimate the value added to their clients by entering into a strategic alliance with another entity.

with another organization versus the cost of developing an internal marketing or distribution system.

RISK REDUCTION

Another way to increase value is to reduce risk. A common benefit of corporate alliances is that they can be structured to focus the relative strengths or competitive advantages each partner brings to the alliance. A second risk reduction benefit is that the alliances can be structured for a limited purpose or a defined time frame.

By focusing on competitive advantages, a properly structured alliance can reduce risk. Toshiba and Siemens recently announced an alliance to "jointly research, produce, and market high-speed" mobile phone handsets capable of sending and receiving video images. Siemens is the third largest mobile phone manufacturer in Europe. Toshiba is a leader in imaging technology. The two companies are expected to share an estimated $370 million in research and development costs as well as production facilities and distribution networks under the alliance.[6]

The alliance should allow Toshiba and Siemens to focus on each organization's own competitive advantages, which should reduce the risk of the project. The alliance also reduces the risk by sharing costs of development, manufacturing, and distribution of the new technology.

A key part of a successful corporate alliance or joint venture is understanding the valuation issues that arise and the potential value results whether they are associated with the expected synergies, the relative values of technology or other assets contributed to the joint venture or of the ownership structure of the venture, or the value of an investment partner in a startup entity. CE

In an upcoming issue of CPA Expert, *Mark Zyla will discuss ways to address specific valuation issues that arise in joint ventures and other strategic alliances. The genesis of this article is a paper presented recently to a State Bar of Georgia's ICLE Seminar on Alliances, Joint Ventures, and Partnerships.*

[6] "Mobile Images Spark Alliances," *www.FT.com*, published November 3, 2000.

THE VALUER'S ROLE AND OPPORTUNITIES WITH THE BUSINESS STARTUP TEAM

Rosanne T. Schwartz, CPA/ABV, CVA, AM, and John R. Gilbert, CPA/ABV, CVA

The recent economic boom is not just about large companies backed by significant amounts of capital. Rather, it is also about millions of startup companies offering products and services that are changing our lives. These startup companies need advisers to help them with all aspects of their business. They will require the assistance of a CPA in many areas, including compliance work, preparation of a business plan and, ultimately, implementation of the business plan. It is essential to the startup's success that its team of advisers includes an expert in corporate finance and valuation as well. The CPA valuation adviser with knowledge and experience in these areas is a perfect fit. The new economy offers great opportunities for the CPA valuer, but first you need to understand the game.

THE DREAM TEAM

Successful startups historically have had access to a team of internal and external advisers with both technical and business expertise. Many startups have struggled or

failed because they were led by individuals with only technical expertise. Although the makeup of startup teams differs based on the business's market segment and may change as the company matures, it is essential that the team includes members with a solid technical understanding of the startup's business and target market, as well as members who understand what it takes to raise capital, those who understand valuation issues, and those with strong networks of lenders and various investors (for example, venture capital, private equity firms). Using outside consultants and advisers is an excellent way for startups to leverage their expertise and finances, and an important way for CPA valuers to be involved.

It is critical that the startup engage a law firm with experience in working with startups. Experienced legal counsel can help with properly issuing the founders' stock, drafting stock-option plans, and, if necessary, protecting the startup's intellectual property. Help your client look for a firm with experience in dealing with various types of investors, as well as expertise in drafting private-placement offering memorandums if your startup expects to raise equity capital.

CPA valuers can play a key role by assisting startups with preparing business plans and financial projections. The business plan provides a route for management to follow, as well as a benchmark by which to measure the company's progress. It is crucial that financial projections err on the side of conservatism. An experienced business valuation adviser can serve to keep management from becoming overly optimistic in its revenue projections. An outside valuation adviser brings objectivity to the planning process. Most of us have seen projections that clients consider conservative, but are, in fact, wildly optimistic. We need to ask entrepreneurs the hard questions they may avoid asking themselves.

While revenues for new companies can grow rapidly, operating costs tend to grow gradually. At various points, however, large increases in fixed operating costs may push up the breakeven point. Accurate revenue projections are the most critical and difficult component of the plan. Financial projections will be used in the valuation of the company during its initial funding efforts, as well as to estimate the startup's funding needs. The projections will also be used to prepare the company's budgets. Startups are likely to change dramatically in the initial stages, so expect to modify the projections frequently.

DEFINING AND TARGETING THE CUSTOMER

A startup company needs to define its customer in precise terms and the founders need to research where the startup fits in today's market. One of the biggest errors entrepreneurs make is not defining the size of the specific market. Often they define the global market without considering what segment of that market is truly available to the company. Beyond that, the expected market penetration of the startup is often grossly overstated.

Many other important questions must be answered as well before the startup is launched: Is there a need for the product or service being offered? Who is the customer? How do they reach them? Do they use the Internet, e-mail, traditional marketing sources, or a combination of all of them? A competent business valuation adviser will understand the startup's business and its market and know how to find and interpret the answers to these questions. Success depends not only on knowing where the startup fits in the market, but also on reaching that market before the competition.

MONEY IS HARDER TO COME BY

Since the second quarter of 2000 it has become more and more difficult to finance startup companies. Before that time, venture capitalists and investment bankers were eager to fund Internet and other high-tech startups. To do an IPO, an entrepreneur simply assembled a good team, funded a business model, did the IPO, and all of the risk shifted to public investors. This is no longer the case. The market correction since April 2000 has resulted in many recent high-flyers, including AOL, Amazon.com, Pets.com and Dell, among others, seeing their stock prices tumble despite sound business models and experienced management teams. This market adjustment has had a significant negative impact on capital markets and the desire of investors to fund startups in every industry.

Another option for financing a startup is a business loan. Compared with selling a portion of the business to investors, borrowing money has an obvious plus side: If the business succeeds and the owners pay back the

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Startups often miss important steps during their initial round of equity fund raising.

lender, they do not have to share the company's future profits. Nevertheless, a commercial lender will be unwilling to lend to a startup if it looks as if the money may not be repaid. To help keep the risk low, a lender will very likely ask for security for the loan, such as a mortgage on the owner's house, personal guarantees, or other collateral the lender can seize in the event of default on repayment of the loan. A distribution company, for instance, may own the real estate it occupies and use it as collateral to obtain debt financing for a new venture.

In addition, as the capital markets contract, there is a ripple effect throughout the entire economy resulting in more stringent terms of debt financing. A qualified business adviser can help management determine the most appropriate and likely method of financing the startup.

RAISING EQUITY CAPITAL

Funding a startup is often the most difficult part of the process. Entrepreneurs do best to move cautiously until they are certain they have locked in their initial financing. For most startups, the initial capital comes from the founders themselves, providing enough funding to allow the startup to formalize its plans, engage its external advisers, and develop materials needed for the first round of financing.

Typically, the first round of equity financing is with friends, family, employees, and anyone else willing to invest. It is essential that you work closely with the founders and their lawyers during this period to develop the appropriate private placement documents and be certain they comply with all federal, state, and securities laws. Although most startups will not progress beyond this level of equity financing, initial funding documentation must comply with all applicable securities laws because all subsequent funding rounds will rely on these documents as a foundation.

Shareholder litigation can destroy all chances for a company to raise additional equity financing, so the startup needs to be sure that this first round is done properly. There are disclosures to potential investors that must be made, as well as a determination as to whether the investors qualify to invest in a high-risk venture. Startups often miss these important steps during their initial round of equity fund raising. It is essential that the founders know how much money needs to be raised and at what valuation. This is where an outside adviser with experience in both corporate finance and business valuation is an invaluable asset to the company.

For the minority of startups that reach this stage, the second round of equity funding usually targets high-net-worth entrepreneurs, institutions, venture capital firms, and other more sophisticated investors and is, therefore, more formal. Often, this round involves preferred stock with conversion rights and will raise sufficient capital to take qualified startups to the IPO stage or a similar funding event. Again, much thought must go into the amount of funding needed at this round, as well as the valuation of the stock.

At each round of funding, the shares belonging to the founders and all previous investors are diluted, resulting in a loss of equity interest in the company for each. The expectation is that each round of funding results in an increase in company value that exceeds the loss of equity interest. This presents an interesting situation. Is it best to raise only enough money to increase the valuation of the company, or should the startup raise all the money it can at the lower equity value and accept the higher dilution? On the other hand, delays between rounds of financing expose the company to the whimsical changes in the capital markets. These issues must be considered carefully when deciding whether to pursue these levels of equity financing.

REAPING THE REWARDS

Aside from the dream of "building a better mouse trap," most owners create startups with the hope of building a valuable asset. One of your jobs will be to help the founders reap the rewards of a successful business. For example, with the decrease in successful IPOs in recent times, Internet and high-tech entrepreneurs have fewer options for getting a quick return on their investment. In addition, the consolidations that we have seen in a variety of industries in recent years are winding down as well, making the strategic sale of a business less likely. Also, fewer cash deals are available to stockholders in closely held companies involved in these consolidations, while more deals involve payment in publicly traded stock. Although this payment

offers the shareholder more liquidity than the exchange of closely held stock, it also exposes them to all the risk of the public market. Furthermore, the declining market has driven stock valuations to a significantly lower level than we have seen in recent years. Ultimately, it may be best for your client to build an enterprise that can be sustained and held during this market correction. A startup built on a solid business plan will survive a downturn in capital markets.

In any case, it is wise for the entrepreneur to consider a succession plan for the business. Alternatives to selling the entire business include offering employee stock ownership plans, allowing key employees to buy stock, and merging with other closely held companies. All of these options require sound business and legal advice, and a valuation of the company's stock that is independent, reliable, and prepared by a qualified expert.

ARE YOU UP TO THE CHALLENGE?

As you can see, in today's market, advising startups is a complicated business. In addition to understanding your startup client's business, you must also understand today's new economic environment, as well as the current lending environment, the capital markets, and the changing public market value paradigms. Most startups will not survive. However, a CPA valuation adviser with an understanding of accounting, tax, corporate finance, business valuation, and organizational structures is well suited to lead the team of advisers that will give these startups a chance. CE

MED/ VAL: AN ALTERNATIVE TO "THE BATTLE OF THE EXPERTS"

John L. Casalena CPA/PFS, BVAL, CDP, CFE

Many attorneys call me to ask for a "ballpark number" on the value of a small business or professional practice. After explaining that my professional ethics and standards do not allow me to give them such a number, I offer them an alternative solution for their smaller cases. If the parties are truly ready to settle the dispute, I facilitate a combination of mediation, teaching, and facilitated discussion that I call Med/Val™. It is an eight-hour program, which is an effective and inexpensive ($2,000 to $4,000) process that attorneys on both sides of a case may participate in. I never give parties a value opinion or even suggest one. The parties buy into the result because they arrive at the value number themselves.

In one eight-hour highly controlled session, the participants receive an elementary valuation tutorial, present their own ideas of value and are critiqued on them, complete a revealing luncheon assignment, and look at sales of comparable companies. In caucuses, they are individually probed for "their real underlying issue," and are made intimately aware of their FOOOL (Finest of Other Options Left) in the event no value is agreed to. Finally, they are cajoled and pressured to be in control of the outcome of likely the most important financial decision of their lives rather than letting a third party decide their fate. The result is compromise on their agreed value and the preparation of a binding memorandum.

Most lawyers are skeptical in the beginning, but I provide them with the names of their peers who have been a part of a Med/Val™, many of whom were initially "on the other side" when first exposed to the concept. I remind them that the less the parties spend on experts the more liquid assets will be available for their fees.

My most frequent question from counsel the day after a Med/Val™ session is "Where did the number come from?" I know then that I have a successful result that will stick, since it wasn't perceived as either party's number. Instead, it was truly a compromise—the essence of successful mediation.

I have used the Med/Val™ process primarily in dissolution matters when a family business or professional practice is a marital-asset subject to division. I also have used it in "but-for" damage cases as well as cases involving departing partners, members, or shareholders.

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Usually, some tacit issue, frequently involving a third person, keeps parties from compromise in dissolution matters.

Although I am certain many forms and sequences of elements of the process could be successful, after dozens of tries, here is what works well for me:

1. Conduct initial interviews (generally by telephone) separately with each party and counsel.
2. Coordinate parties' and counsels' schedules for one available full-day, allowing time for production of materials.
3. Prepare the engagement letter and materials request, assigning production dates and clear responsibility.
4. Collect the nonrefundable fee.
5. Review produced materials, visit the site, and request any additional necessary material.
6. Lock up the mediation site with two rooms available.

CONDUCTING THE SESSION

In each hour of the eight-hour sessions, I focus on particular activities or issues. In the first hour, I focus on the following three activities:

▲ Getting everyone comfortable and going out of the way to make the side who did not bring the mediator to the table believe that he or she is a neutral.

▲ Reviewing agreements—not rules (there is a difference)—on decorum and completing the process (for example, one person speaks at a time; body posture should suggest attentiveness; civility is maintained).

▲ Acknowledging that to maintain objectivity and avoid conflicts of interest, the mediator will not accept an engagement to appraise the business if the Med/Val™ fails.

In the second hour, I teach an elementary valuation tutorial covering the three approaches to business appraisal and, if necessary, the two approaches to a damage calculation. In hour three, I facilitate a discussion about the business, its earnings history, projections and prospects for the future, compensation and perquisite issues, entitlement issues if the subject entity was started prior to a marriage, and similar matters.

In the fourth hour, each side makes a short presentation of their idea of fair market value or damages, which is followed by questions and criticism from the mediator and the other side.

Participants receive lunch-hour assignments, which vary according to circumstances. For a business, there is a "shootout" in which each side picks a number at which they would buy or sell. For a professional practice, the parties are told, "Pick your *real* peer's earnings if you can" from compensation studies. For a damage case, the parties thoughtfully revise the pro formas and damage estimates, considering earlier questions and criticism.

GETTING TO CONCILIATION

Compromise usually comes into the picture during hours five and six and when debriefing of the lunch assignments begins. The debriefing is followed by reviewing the balance sheet and making adjustments for an orderly liquidation as a base value. In these hours, the process includes explaining how the expected rate of return is directly proportional to the risk of receiving that return. Using the T-bill rate, the S&P 500, the NYSE lower 10%, and the specific indicia of the subject's risk, rather than generic terms, we very slowly develop a discount rate and subtract the rate of growth to convert the discount rate to a capitalization rate; then we review the calculation to show how subjective it was and demonstrate how sensitive it is to judgment by slightly changing risk premiums and calculating values with both capitalization rates. I explain the very speculative nature of results achieved by using the capitalization of earnings method, especially without normalized and stabilized earnings, or the discount of future earnings method without a very solid pro forma.

If a business is being valued, we avoid using the excess-earnings method, a method designed to determine goodwill, demonstrating why that method will provide an egregious result when applied to value the entire business and therefore should be used only when no better method is available.

If a professional practice is being valued and the participants force me into an excess-earnings method calculation, I show that it requires something more than just a casual comparison with the average of other professionals' compensation. A careful analysis of the subject professional's hours

worked, responsibilities, and the number of positions the subject is truly being compensated for is mandatory because the true "peer" will very likely not be "Mr. Average." Lastly, I reemphasize that no matter how meticulous and careful we are in selecting a peer, the fair market value reached for the practice, using the excess-earnings method, will likely far exceed what the practice could be sold to a third party for, post-divorce, the result being that the party who is bought out will receive a windfall.

During hours five and six we also take time to normalize earnings, determine if the earnings are stabilized, look at pro formas, and apply discount or capitalization rates if necessary. Then I spend time revealing potential comparables, using "determining a selling price for your residence" as a metaphor, discussing and either distinguishing and eliminating them or accepting at least four and then applying price/sale and, if necessary, price/earnings ratios to the subject company. Presuming there are good comparables, this easy-to-understand "Direct-Market Data Method" always results in serious compromise (finally) and I call for a break for the parties to consider this method. This perfectly sets the table for the next step, one-on-one caucuses.

SEPARATE CAUCUSES

Hours seven and eight are devoted to caucuses in separate rooms. I meet with each party to promote the other side's strong points and emphasize this side's weak points. We explore for the "real underlying issue" that is resulting in an uncompromising position. Usually some tacit issue, frequently involving a third person, keeps parties from compromise in dissolution matters.

During the caucus, I have each side identify their FOOOL should the process fail (for example, the cost of two appraisals and counsel so a judge or jury may decide their fate). I never leave the caucus room without a compromise of some kind, even a small one. To get some movement toward conciliation, I tell the parties that time is expiring and their money may be wasted. Other ploys that help move them include raising tax issues that develop in the event of no resolution; urging them to get on with their lives; leaving them alone for an extended period; or asking why the spouse who is being bought out should receive any more than one-half of what comparables sold for.

I bring the parties back together when an agreement is reached or when 15 minutes are left, whichever occurs sooner. Most agreements are reached in the last 15 minutes. If there is no agreement at this point, I make certain each party fully appreciates their FOOOL and that I am unavailable to appraise the subject entity or determine the damage.

THE MEMORANDUM

If the parties are not represented, I prepare a simple bullet-point memo that includes very specifically what was valued and what issues, if any, were not settled, the agreed value, terms and signature lines for the parties. I provide a list of mediation-friendly attorneys and I instruct each party to engage counsel and provide them the memo. If they are represented, one of the lawyers does the memorandum and in either event the memo is executed by everyone attending the Med/Val™.

FACILITATING YOUR OWN MED/VAL™

If you have appraisal credentials, good interpersonal skills, are capable of leaving your opinions and ego behind for eight hours, are good at planting seeds, and are willing to get mediation training, the Med/Val™ process is something you could bring to your practice area.

Mediation training is available at your local American Arbitration Association office or many other training venues such as The Trillium Group in affiliation with Notre Dame Law School. A Web search of "mediation and training" will provide you with many other training sources. Be sure to check your jurisdiction for certification requirements, if any, and to identify which training is required for certification. CE

To read more about mediation and other dispute resolution approaches, see the following *CPA Expert* articles: "Alternative Dispute Resolution: The Pros and Cons," (Summer 1996); "As Use of ADR Expands, Opportunities for CPAs Grow" (Fall 1998); and "New Opportunities for CPA Neutrals and Experts" (Winter 1999).

RESOLVING BUSINESS DISPUTES: FACT-FINDING IN BUSINESS MEDIATION

Donald Lee Rome

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A typical impasse in a business mediation usually occurs when one party is demanding too much money, and the other is offering too little—or none at all. Furthermore, the impasse will generally not be broken if the mediator tries to "move" the parties in the direction of the traditional dollar-focused compromise settlement. This is because in many cases of an impasse in a business mediation, a resolution will only occur when mediator-assisted fact-finding is discussed with the parties as an option to help them reach a compromise settlement.

But some would say that fact finding is just what mediation is designed to avoid; that they are not trying to prove who is right and who is wrong; that they would rather not have discovery; and that they need to look to the future, not the past, for solutions. All of this is true. But for a large percentage of business disputes, when an impasse occurs or is likely, some degree of fact-finding is needed to enable the parties to break or avoid stalemate and to reach a fact- and situation-oriented business resolution of the dispute.

THE RAISON D'ÊTRE FOR FACT-ORIENTED RESOLUTIONS

When dealing with each other, business people are not in the habit of giving away money, or making other concessions, without some basis for doing so, especially when in the midst of trying to resolve a controversy. Resolution does not require absolute certainty as to who is right or wrong, but it does require something more than the assertion of a claim. There may be good business reasons to compromise—and also not to. A criticism of some mediators in impasse situations in business mediations is that they seek an offer and counteroffer before any serious exploration of important issues is made. This is similar to the business person's aversion to "split the baby" arbitration results. To compromise for the sake of compromise irritates many business people—and for good reason. Yet, many mediators and lawyers for the parties simply have not had enough involvement with business entities and business people—particularly in the corporate environment—to understand what exactly is needed to avoid or break an impasse in a business dispute.

COMPROMISE WITHOUT FACT-FINDING

Compromise only works to avoid or break an impasse in business disputes when each party, believing that the other is acting in good faith, decides voluntarily and without external pressure that good business relations require a speedy resolution of the dispute, even though the parties have not yet fully established the facts. A party-driven decision to compromise without fact-finding will in some cases be necessary to preserve a valuable business relationship. In other cases, it will be justified on business grounds simply to avoid losing money and time. Indeed, a skillful business mediator knows to explore this compromise option when the first signs of an impasse appear. But this must not be misunderstood as a push for compromise regardless of the facts. It must be presented to the parties as a business option.

Compromise without fact-finding usually requires understanding, as some form of "buy in," if not approval, by those back at the business ranch who have an interest and may be affected by the compromise outcome. They need to know the business objectives, the reasons for selecting compromise without regard to fault. That is not always easy. Internal departmental rivalry, chain of command decision making, internal allocations of the economic effects of a settlement are only some of the factors involved for many business entities in agreeing to a compromise that is not fact oriented. But mediators and lawyers must understand that before business people agree to compromise with-

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out regard to fault, they must believe it is a good business choice and can be justified. It must also be understood as a mediation option, and not a mediator's mandate. Compromise in business disputes is usually a complicated matter and must be treated carefully.

DIFFERENT GOALS

Business disputes are usually associated with some type of contractual agreement. Thus, breach of a contract in one form or another becomes the issue.

This is quite different from a typical "fall down" negligence case involving liability, damages, and an insurance carrier. This type of case generally does not raise issues of performance by the parties in relation to each other, and traditional compromise is an accepted norm. But if the defendant in an accident case does not believe the plaintiff did in fact fall down, then an impasse may result unless there can be some level of fact-finding. The plaintiff who really did fall down is not going to give up, and the company will not pay unless it is educated on the circumstances. Once the insurance company is given factual information to correct or create doubt as to the accuracy of the insurance carrier's information, settlement negotiations will follow.

The big difference between these two worlds is that in business cases, the contract creates a relationship between the parties, and the cause of the problem is not always readily apparent. Therefore, much more fact-finding—internal at each entity and jointly between them—may be needed before the parties are ready to negotiate for settlement.

THE DUAL TRACK

In many business disputes, there exists a dual track in the dispute resolution process. One track is a dispute that needs to be resolved. The other is a business problem that requires fact-finding and solution.

An example of a dual track in business disputes is product performance:

Scenario: A manufacturer sells a machine to a customer. The machine does not perform as the customer expected. Regardless of fault and liability as a court jury might determine, normal business practice indicates that the manufacturer will want to try to answer certain questions.

▲ Did the sales representative make a product-performance representation to the customer of a higher level of machine performance than was appropriate for the equipment?

▲ Is a component—purchased by the manufacturer from a supplier and installed by the manufacturer—in the machine defective?

▲ Did the customer fail to operate the machine in accordance with the manual supplied by the manufacturer?

▲ Does the manual contain specification or other errors in it that could have caused the problem if followed by the customer?

▲ Did the customer use the wrong products necessary for proper machine maintenance?

▲ Is there a basic design problem in the equipment?

▲ What other possibilities could cause the problem being experienced by the customer?

For the customer, in addition to some of the same issues of concern to the manufacturer, there are others:

▲ Did the employees of the buyer who were involved in the equipment purchase fail to give the proper specifications for performance to the manufacturer's sales representative?

▲ Did its employees improperly operate the equipment?

▲ Can the problem be corrected by the manufacturer or by changing operational methods?

▲ What information is available from its own people to identify exactly what may be causing the problem?

▲ Will it be necessary to replace this equipment?

▲ Is the manufacturer in a position to provide assistance in various business and financial issues caused by the problem, regardless of fault?

For both the manufacturer and the customer, none of these questions or business issues will be resolved through pre-trial discovery or trial. Yet, the parties have a mutual business interest in working together to find the cause of the problem, to see if it can be corrected, and to fairly allocate responsibility, economic and otherwise, for the problem.

The same mutual goals exist when a dispute arises from a letter of intent, a commit-

A business-oriented mediator can help the parties find out exactly what happened.

The Need to Restore Trust

The Acorn and Zebra companies are in serious negotiations for Acorn to buy Zebra. Both parties expect the transaction to happen. Suddenly Squirrel Inc. makes an overture to buy Acorn. Word of that leaks to Zebra. Zebra thinks Acorn will make a deal with Squirrel and back out of its deal with Zebra. Zebra now tells Acorn it will not continue, based upon its information about Acorn/Squirrel negotiations. Zebra thinks Acorn is using Zebra simply to get a higher price from Squirrel. But Acorn thinks Zebra has found another company and wants to back out. A dispute develops under the letter of intent that had been signed by Acorn and Zebra. In fact, Acorn did not initiate the Squirrel overture, and told Squirrel that it was not able to pursue discussions. Zebra doubts this. Good faith and trust—a critical element in a long pre-existing relationship between Acorn and Zebra—is now seriously damaged. Even if negotiations resume between Acorn and Zebra, a high level of mutual trust and good faith will be needed to consummate a very difficult deal. Fact-finding of some sort will be needed.

ment letter, a joint venture agreement, a license agreement, a business acquisition, or other similar agreements in which good-faith performance by the parties is essential. One party takes action based upon the belief that the other is in breach. Each then accuses the other of a failure to honor their agreement. Each thought it had the right to do what it did because of the perceived actions of the other party.

Yet, these actions and perceptions result from unclear and unknown facts. The result is misunderstandings by each party. Intent that is inconsistent with good faith may be assumed when in fact there may be acceptable reasons for certain actions—actions that unfortunately are unknown to the other party. This problem can be cleared up with some fact-finding. It is true that a court of law can decide the issue, but that will not necessarily resolve the business problem. It will not induce the parties to resume their working relationship.

The mediation challenge is to blend the two existing tracks into a single endeavor—the fact-finding that both parties really want, and the dispute resolution that is dependent on the fact-finding.

An impasse in negotiations will not be broken unless each party recognizes that some of the facts, circumstances, and assumptions on which their conclusions have been based may not be correct. Doubt and uncertainty usually will lead to risk analysis by the parties. Ideally they will ask themselves: What would the consequences be if we were wrong?

The mediator must help the parties come closer to understanding the root of the problem and to look at possibilities they may not have considered before entering mediation.

FACT-FINDING TO BREAK IMPASSE

A business-oriented mediator will be able to help the parties come closer to finding out what exactly happened, and how to assess responsibility. The critical ingredient for the parties, the mediator, and especially the lawyers is to recognize when the parties and their respective business organizations cannot justify a compromise settlement without a factual basis. Once this is realized, a mediator can be the facilitator for dispute resolution.

The immediate goal of the mediation should be to have candid discussion with the parties as to how they can:

- Share information.
- Jointly employ a neutral expert, if needed.
- Conduct internal interviews based upon information provided by the other side.
- Pursue joint fact-finding efforts on the basis that it is important for business relations.

These elements are needed when key facts and circumstances are not fully known or are misunderstood by the parties.

It should be noted that this process need not necessarily be geared to a proof-positive conclusion. Neither party may need that. One party or both will usually know when the time is ripe for settlement negotiations to start. Sometimes negotiations can last a day, and sometimes they can take much longer. There is room for the mediator to provide significant assistance in the process. However, the parties themselves should be the driving force to the settlement.

FACT-FINDING AND COMPROMISE AS BUSINESS CHOICES

The most important aspect of breaking an impasse in a business dispute is to understand the choice between (a) fact-finding before undertaking serious settlement

negotiations or (b) pursuing a negotiated compromise without fact-finding. The option chosen must be oriented to business goals and practices. These are not theoretical ADR concepts, nor are they mediator-driven precepts to be taken by the parties on faith. A skillful mediator with experience in business disputes can be enormously helpful in bringing parties to a point where they can identify business goals, experiences, and practices in the context of these two options—or a blend of both—to bring about the problem solving necessary to resolve the dispute at hand.

Unless the parties go through the exercise of choosing between compromise without fact-finding or some fact-finding, an impasse is likely to remain. The best mediation will be one in which this choice is outlined, explored, and discussed with all parties—together and in caucus. The essential ingredient is to identify good business reasons for the choice to be made, not generalized concepts of why compromise is good. This process will often lead to creative business solutions to resolve a dispute.

FACT-FINDING AS A FLEXIBLE PROCESS

A mediator should also point out the flexibility of the fact-finding process to the parties. He or she should show the parties that it is not an all-or-nothing process and that it is conducted in steps.

A party that is steadfast in its position, and driven to prove it is right, is likely to be receptive to fact-finding. After all, the mediator's argument to the no-compromise party will be that fact-finding will provide information that will help its position and let the mediator show the other party how reasonable the position is. That is the first step.

Then, once the mediator starts to explore the process of how this will be done—the cooperative effort needed, the sharing of information—the no-compromise party may begin to see the merits of leaning towards a compromise. In effect, the process becomes a subtle form of reality checking.

The next step is to provide a schedule of who will do what and when. For example, which employees need to be interviewed? What documents are needed? What inspections will be required? This part of the process will test the parties, again without pressure from the mediator, to settle. The discussion will help each party to decide how much fact-finding will be needed.

The more matters are discussed, the more it is likely the parties will re-evaluate their position. They are likely to resist, privately, any lawyer's effort to convert this mediation fact-finding into pre-trial discovery. The mediator is therefore in a special position to see what changes are developing in the attitudes of each party once the nitty gritty of fact-finding is explored.

Once the fact-finding process is set in motion, then it is critical for the mediator to be involved so that the process does not take on a life of its own. The mediator is needed to help the parties move from this step to negotiations to resolving the dispute. For a skillful mediator, it will not be hard to see when the parties have had enough. Tight time schedules for the various fact-finding steps involved, interlaced with meetings of the parties and the mediator, are needed to maintain momentum and to control the process. The mediator should work with the parties to follow the outline, to keep to the schedule, and to preserve the focus on the business objectives. At some point, negotiations for resolution will flow naturally, based on the information then available to the mediator and the parties.

BUSINESS CONSIDERATIONS IN A MEDIATION IMPASSE

What is it that business people want from mediation when dealing with disputes where one business entity does not believe it is liable to another, and yet the claimant is equally certain that liability exists? This polarized posture of the parties and the impasse it creates cannot be dismissed on the basis that such polarity is always true at the start of mediation.

Lawyers for the parties and the mediator should explore the following questions with the business people involved.

▲ Why is fact-finding so important in business mediation?

▲ What questions and considerations can a mediator raise that will influence business thinking about dispute resolution, that will (a) influence how business people react to an impasse, (b) affect the willingness or

The great opportunity in fact-finding is that business people can take the lead on business issues, opportunities, and problems.

A great opportunity exists for mediators who understand how business works to help business people break an impasse.

resistance to compromise, and (c) will create fact-finding as an option in mediation where an impasse may be the alternative?

▲ What is the principal reason for the impasse?

▲ What are the credibility issues?

▲ What are the different views of "what happened?"

▲ What are the conflicting assumptions?

▲ Is there good business reason to compromise, regardless of fault and liability? If so, will the other party have the same view?

▲ If compromise without fact-finding, without a fact orientation to justify the result, and sooner rather than later is desirable, can the other party be convinced of this without a modest level of fact-finding?

▲ Is fact-finding important to the parties for business reasons?

▲ Will fact-finding help to restore trust where good faith behavior is in question? A typical business acquisition scenario provides an excellent example of how trust can be restored (see "The Need to Restore Trust" on page 12).

▲ Will fact-finding help the parties work together to solve a business problem, not simply the dispute at hand?

▲ Will fact-finding lead to awareness that more uncertainties exist than either party initially recognized?

▲ Will fact-finding cause tension among the parties or internally?

▲ Where preservation of relationship is important, will some fact-finding help or harm that goal?

▲ Where relationship is not an issue, will some fact-finding be helpful to move the parties out of the impasse?

▲ Will some fact-finding be helpful with the other parties and internally? If so, can it be done in a cooperative environment, with the other parties and internally?

▲ How can the mediator be helpful in the process?

▲ What are the business goals to be advanced through some fact-finding?

▲ If fact-finding really will not work to advance business goals and allocate responsibility, then why the impasse?

▲ Will a judge or jury fare any better?

▲ Does anyone have complete confidence in ascertaining all the facts and a just result in litigation?

▲ Given the foregoing, what will it take to break the impasse without fact-finding? What are the barriers?

With mediator assistance, business people will begin to see the business issues in a new context. Hopefully these questions will highlight the key issues and decisions to be made to deal with the impasse in the negotiations.

BUSINESS LAWYERS AND IMPASSE

Business lawyers, whether outside counsel or in-house, usually know their client's business, the industry, and the people in it. They can be very helpful in dealing with business disputes that can give rise to an impasse as described in this article. Working with mediation counsel—usually trial lawyers—the business lawyer can assist the business client in the process. This should be encouraged.

FACT-FINDING: OPPORTUNITIES AND PITFALLS

The great opportunity in fact-finding is that business people can take the lead on business issues, objectives, and problems. The significant pitfall is that it can become a preparation for trial rather than mediation.

To explore what happened for the purpose of reaching a mediated resolution is not the same as trial preparation to reach a verdict. The trial lawyers involved in the process will need help from business clients and business lawyers, when appropriate, to provide assistance in a fact-finding process that is geared to mediation. It may not come naturally to trial lawyers. Some companies have employed settlement counsel as well as trial counsel, each performing its respective functions, in order to separate the mediation effort from the necessary pre-trial activity.

Let us take a look at fact-finding in litigation, and compare it to fact-finding in mediation. The judicial process is not geared to fact-finding in a methodical, organized, and objective manner when it comes to determining cause and effect in any situation. "Proof" is offered by competing interests to enable a third party—judge or jury—to reach a verdict. It is not a flexible process. Strict rules of presentation govern. Clients lack any control over the process. The court's rules and proce-

dures are beyond the control of the participants.

What manufacturer of a product would rely on the verdict of a jury in a product liability case to determine whether a product was in fact faulty? For example, what governmental agency would rely on an adversarial judicial process to determine the cause of a fire or an airplane accident? Far more scientific methods are available if the goal is to ascertain whether a particular product malfunctioned, how and why an accident happened, and what the uncertainties were that might preclude a clear and certain identification of all relevant facts and circumstances.

CONCLUSION

A great opportunity exists for mediators who understand how business works, how business goals and objectives are important, and how to help business people break an impasse. Business lawyers can and should help trial lawyers and mediators understand the issues business people face in dealing with dispute resolution. When the business people see that the "professionals" care about their problems, understand the barriers to settlement, and respect their input, and are flexible to meet client needs, the whole character of a mediation can change and lead to a successful resolution. It can offer a wonderful opportunity for all involved. CE

AICPA VALUATION STANDARDS: A CONVERGENCE OF ISSUES THAT DEFINE THE NEED

Steven E. Sacks, CPA

The landscape of the business valuation discipline has changed rapidly over the past decade. Even within the last several years since the advent of the Accredited in Business Valuation (ABV) designation program there have been marked changes. In 1996, AICPA Council charged the Business Valuations Subcommittee with the responsibility to build the ABV credential. Through our many business valuation-related initiatives (for example, education, conferences, and newsletters), we have created a strong brand presence in the marketplace in just four short years. The commitment of the past and present members of the BV Subcommittee has resulted in a program whose success and visibility have grown with each passing year. More and more members are answering our clarion call for volunteers for the many initiatives underway.

Valuation educational offerings have undergone continuous improvement since being purchased from the Illinois CPA Society in the early 1990s. Formerly part of the Certificate of Educational Achievement group study series, the valuation education program has been transformed into two three-day modules, making it much more accessible and convenient for those who want to develop a practice niche or who need a road map for earning the ABV credential.

The ABV brand itself has become more familiar in the marketplace particularly in the legal community. The challenging requirements to earn the designation along with an effective communications program have positioned the ABV to be the credential of choice, from the perspective not only of AICPA members, but also judges, attorneys, and other interested parties.

How to account for this enthusiasm? It should come as no surprise that the AICPA always had the wherewithal to play in a market space that is tailored for its members' skill sets. A national business valuation conference that had 250 attendees in 1995, its inaugural year, attracted nearly 800 attendees in each of the past two years. Both CPAs and non-CPAs alike consider the conference the place to be and be seen.

There is consensus that we need to continue the momentum for growing the credential and educating the interested parties about the valuation discipline, especially if the objective of offering AICPA credentials to non-CPAs becomes a reality. The next logical step in reaching the long-term goal of being the industry leader in this practice niche is

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Appraisal theory diverges from accounting theory in several areas.

the creation of a set of valuation standards that serve as the authoritative guidance for all appraisal organizations and regulatory agencies.

BUSINESS VALUATION STANDARDS

Despite all the successes resulting from various business valuation activities, the lack of AICPA business valuation standards continues to put CPAs at a considerable disadvantage, particularly when testifying in a court of law. This lack of AICPA-promulgated authoritative business valuation standards has confused the marketplace for judges and attorneys, as well as for CPAs. What AICPA guidance exists to ensure quality performance of valuation work? Other than Rule 201 of the Professional Code of Conduct—the cornerstone of all CPA activities—and the Statement on Standards for Consulting Services No. 1, which speaks to consulting services in only the broadest of terms, our members have no CPA-centric performance or behavioral guidance to follow in doing business valuations.

GUIDANCE AVAILABLE TODAY

The importance of ensuring that appraisals are based upon established industry standards that are not subject to the influence of any interest group was illustrated by the savings and loan failures resulting from overvalued real estate. In response to the difficulties and losses experienced by many lending institutions, the Appraisal Foundation, a quasi-governmental agency, developed the Uniform Standards of Professional Appraisal Practice (USPAP) in 1989.

With the passing of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), the Appraisal Foundation created the Appraisal Standards Board (ASB), which established the rules for developing an appraisal and reporting its results. The ASB also promotes the use, understanding, and enforcement of USPAP.

Several appraisal sponsors, such as the American Society of Appraisers, have adopted USPAP in large part. Portions of USPAP have also been extracted and combined with other organizations' own standards, such as those of the Institute of Business Appraisers. Major deficiencies still exist, however, that render USPAP unusable from the CPA's standpoint. The deficiencies include the absence of the recognition and treatment of GAAP in a valuation context, intangible assets, and the critically important concept of fair market value.

CONFLICT AMONG STANDARDS

Appraisal theory diverges from accounting theory in several areas, and this divergence can place CPAs at a competitive disadvantage. Within USPAP Advisory Opinion No. 8, for example, there exists a conflict with GAAP in that Opinion 8 states:

> *Fair value is an accounting term and market value is an appraisal term. The auditor can generally relate the definition of fair value in the accounting literature to the appraisers' definition of market value. It is clear from the accounting literature that the accountant looks to the appraisal concept of market value in establishing fair value. Informed appraisers and accountants should understand the relationship between the accounting term fair value and the appraisal term market value and be in a position to clarify the use of these terms for their common clients.*

USPAP's original purpose was to establish a means for real estate valuation, which is the only area over which it has regulatory authority. The Appraisal Foundation expects its member organizations to adhere to USPAP when providing a business valuation.

A number of APB, FASB, GASB and IAS standards contain elements of valuation in their pronouncements. There is, however, no cohesive or consistent pattern of definitions or applications of GAAP. Further, there is no foundation for qualifications and standards for addressing valuation issues associated with GAAP.

The GAAP guidelines are set through pronouncements, but there is no underlying foundation for the valuation conclusions in any of the pronouncements. So when the concepts of *value, fair value,* or *fair market value* are to be used, these terms are partially defined, thereby limiting the effectiveness of the definition that can have equal weight within both an accounting and valuation context. This may allow other organizations or regulatory agencies to take up the mantle and define for the profession much of what is steeped in accounting theory, thus precluding the AICPA from controlling the technical accuracy of the content.

The Internal Revenue Service has a keen interest in the valuation arena, particularly as it relates to the bases for conclusions in estate and gift tax filings. The AICPA has perhaps the largest group of tax professionals in the country, and it has a vested interest in the needs of taxpayers and the tax compliance system. IRS leaders have indicated that the Service will set its own guidelines for valuation standards. The IRS has a good working relationship with the AICPA and has sought input from our representatives over the years on various tax matters. We hope that the AICPA's development of valuation standards will include input and mutual cooperation from the Service as well as from other regulatory agencies and appraisal organizations.

THE ROAD AHEAD

With the daily events of simultaneous business startups and business failures dotting today's landscape, the need for communicating value in a more timely and reliable manner will be greater. Consider the widely fluctuating values of companies that react to new economic, geopolitical, or litigious events. Whether it is a large institutional investor in pension funds or the smallest individual investor with 10 shares of Disney, volatile swings in stock value will be the key drivers of both parties taking action to protect their interests. Their actions will have either a positive or negative impact on the confidence in our capital markets.

In recognition of the minute-by-minute changes in the financial markets, the future may see real-time reporting models, and with it, real-time changes in value. The old model of financial results disseminated 60 to 90 days after year-end diminishes its utility for investing decisions, since valuation is a prognostication of the future that employs historical results as a "source document."

Some of the greatest impact will be on auditors, who—if the movement toward real-time reporting becomes a reality—will have greater responsibility and accountability for disclosures. To avoid the impact of negative speculation, companies will be driven to report earlier and more frequently. What impact will this have on valuation is still too early to tell, but we can be sure that information for decision making will land equally hard on the auditor and the business valuer. Alan Greenspan recognized this in a speech one year ago when he said: "Information is critical to the evaluation of risk. The less that is known about the current state of a market or venture, the less the ability to project future outcomes and hence, the more those potential outcomes will be discounted."

The nature of the valuation discipline is undergoing the same rapid shifts as the rest of the marketplace. We believe the establishment of a set of cohesive standards will enable CPAs in whatever role—auditor, CFO, tax practitioner, financial planner, or valuation consultant—to provide a more competent and higher value-added service that responds better to both today's and tomorrow's business environment.

BRIDGING GAPS

The convergence of accounting and valuation issues has become quite evident in the past year. The AICPA's Accounting Standards Team has engaged in several studies having valuation implications, including in-process research and development, cheap stock issuance, business combinations and customer acquisition costs. As the marketplace becomes more complex, additional valuation issues within an accounting and reporting context such as those we've discussed will arise.

The AICPA has an opportunity to bridge the gaps that exist within the community of valuation standards issued by all the appraisal organizations. The chance to create a set of valuation standards not only will serve to enhance the reputation and credibility of the AICPA in bringing definitional consistency to previously promulgated accounting standards that have elements of valuation theory, but also will serve to be the standards of choice by the SEC, FASB, and other governmental, regulatory, and commercial entities.

We view an inclusive approach to be a win-win for all organizations. From the perspective of the AICPA, internal cross-functional cooperation will ensure consistency in applying accounting principles in a valuation or tax setting. From an external standpoint, the cooperative effort with other agencies and organizations will result in a widely accepted set of valuation standards that can enjoy wide acceptance in the courts and be employed for various purposes and functions. CE

IRS leaders have indicated that the Service will set its own guidelines for valuation standards.

ABV REACCREDITATION FOR CLASS OF 1997

December 31, 2001 is the due date for submission of the forms demonstrating the appropriate requirements to be reaccredited as an Accredited in Business Valuation (ABV) credential holder. This date is for those who passed the November 15, 1997 exam. Each ABV holder must pay an annual administration fee of $150 and recertify his or her accreditation every three years. If reaccreditation requirements are not met, accreditation ceases and all initial requirements, including examination, must again be met to regain accreditation. A requirements waiver may be requested and will be granted if, in the sole judgment of the ABV Credential Committee, there is justification because of extreme hardship or extraordinary circumstances. To recertify, an ABV holder must:

▲ Be a member in good standing of the AICPA.

▲ Have a valid and unrevoked CPA certificate or license issued by a legally constituted state authority.

▲ Submit documentation demonstrating substantial involvement in five business valuation engagements/projects at the conclusion of every three-year period. For the credential holder to have *substantial involvement,* he or she must be *responsible* for:

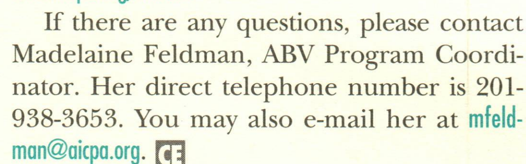
- Defining the engagement/project objectives.
- Planning the specific procedures appropriate to the engagement/project.
- Developing a basis for a conclusion.
- Documenting a conclusion.

▲ Complete at least 60 hours of related CPE during the same three-year period. Self-study courses, published articles, classes taught or lectures given are limited to 20 hours.

"Related" CPE are those courses that assist practitioners to expand or deepen their knowledge of business valuation. An excellent way to obtain BV CPE is to attend the AICPA Business Valuation National Conference. Attending AICPA courses in business valuation and other qualifying courses will also fulfill CPE requirements.

As for the "substantial experience" criteria, the point mentioned above is straightforward and self explanatory as are the forms for submitting the experience requirements, which are available on the AICPA Web page at www.aicpa.org/abvinfo.

If there are any questions, please contact Madelaine Feldman, ABV Program Coordinator. Her direct telephone number is 201-938-3653. You may also e-mail her at mfeldman@aicpa.org. CE



ABV Holders: Do We Have the Right Address?

If you became Accredited in Business Valuation (ABV) before this year and have not been receiving the monthly electronic newsletter for ABV holders, AICPA *ABV E-VALUATION ALERT,* contact Madelaine Feldman, ABV Program Coordinator, mfeldman@aicpa.org.

If you change your e-mail address, please let Ms. Feldman know, so we can keep the list up to date.

FYI...

AICPA LITIGATION AND DISPUTE RESOLUTION SERVICES SUBCOMMITTEE RISES AGAIN

Reinstated as a subcommittee from task force status, the AICPA Litigation Services and Dispute Resolution Subcommittee formed a special task force to make CPA expert witnesses aware of their obligation to comply with professional standards. Their initial effort will be to produce an article reminding practitioners of this obligation. They are also considering issuing a more formal document such as a statement of responsibilities.

Other subcommittee projects include a practice aid on business valuations in bankruptcy cases, a fraud academy, and bodies of knowledge for family law and for economic damages.

REDUCING LIABILITY RISK IN BUSINESS VALUATIONS

Business valuation malpractice claims occur most often when a tax planning or consulting client requests that you add a business valua-

tion to an ongoing engagement. Guidance on minimizing the liability risk in business valuation engagements is offered in the February 2001 issue of *The Journal of Accountancy*, "A Nice Niche if You Minimize Liability Risk."

BUSINESS VALUATION SUBCOMMITTEE CHAIR REVIEWS THE COMMITTEE YEAR

During his luncheon address at the AICPA National BV Conference, BV Subcommittee Chairman Butch Williams of Dixon Odom, Birmingham, Alabama, listed many accomplishments of the committee and dedicated volunteers during 2000. They included:

1. A complete revamping of the Fundamentals in Business Valuation courses, led by Jim Alerding and assisted by Ron Seigneur, Jim Hitchner, Shannon Pratt, and others.
2. Development and presentation of valuation training to the Federal Bureau of Investigation, led by Barry Sziklay and Mark Zyla and assisted by Ron Durkin and Elliott Leary.
3. Continued development of valuation training for the federal judiciary, led by Barry Sziklay and Ralph Ostermueller.
4. Continued work with other business valuation organizations to improve the profession, including work on the International Glossary of Business Valuation Terms (Mitch Hoffman and Mark Zyla) and The Appraisal Foundation (Chris Rosenthal and Mike Mard).
5. Administering the 4th annual ABV Review Course and ABV Exam (Bob Gray, Art Brueggeman, and many others). About 360 candidates sat for the 2000 exam.
6. Working with the AICPA's National Accreditation Commission regarding their desire to move all AICPA credentials to a points system for accreditation (Steve Sacks and Ron Dimattia).

Looking forward to 2001, Butch defined the top three priorities of the Subcommittee as development of the following:

1. *Theory & Practice Panel*—A largely academic group of thought leaders providing guidance and leadership for the business valuation profession. This effort will be led by BV Subcommittee member Bill Kennedy.
2. *On-line Business Valuation Center*—The BV Subcommittee will work closely with the AICPA portal CPA2BIZ to become the primary first resource/gateway for all business valuation professionals. This task force is being led by BV Subcommittee member Ron Seigneur.
3. *Development of Business Valuation Standards*—The BV Subcommittee recently requested and was granted authorization to proceed with the development of business valuation standards. This will be a cross-functional effort within the AICPA and will address valuation issues that have an impact on all CPAs. The goal also is to provide an inclusive, comprehensive set of standards that will serve the entire business valuation profession.

—Contributed by Harold Martin, Keiter, Stephens, Hurst, Gary & Shreaves, P.C., Glen Allen, Virginia, Editor, AICPA *ABV E-VALUATION ALERT*.

AWARDS AND HONORS

In recognition of ABVs who have made significant contributions to the valuation profession over the course of their careers, the AICPA awarded four ABV "Hall of Fame" awards. The inductees for 2000 included Art Brueggeman, Jim Hitchner, Mike Mard, and Jim Rigby.

The AICPA also recognized six ABVs for their efforts on BV Subcommittee initiatives this past year. Recipients of the "Volunteer of the Year Award" included Jim Alerding (development of Fundamentals in Business Valuation courses), Bob Gray (ABV Exam), Mitch Hoffman (development of the International Glossary of Business Valuation Terms), Harold Martin (Editor of the *ABV EVALUATION ALERT* electronic newsletter), Barry Sziklay (development of valuation training for the federal judiciary and Federal Bureau of Investigation), and Mark Zyla (development of training program for the Federal Bureau of Investigation and development of the International Glossary of Business Valuation Terms).

—Contributed by Harold Martin, Keiter, Stephens, Hurst, Gary & Shreaves, P.C., Glen Allen, Virginia, Editor, AICPA *ABV E-VALUATION ALERT*.

ARBITRATION GROUP DEVELOPS B2B ADR GUIDELINES

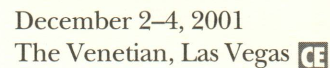
To help online marketplaces resolve conflicts that may arise between buyers and sellers, the American Arbitration Association developed a set of guidelines for dispute management protocol, which can be found at its Web site (www.adr.org). Twenty companies including Microsoft, AT&T, PepsiCo, and FedEx Corp were involved in developing the guidelines. The AAA also offered recommendations for companies to use in attempting to resolve disputes and in the next few months will provide specific guidelines to implement the recommendations. The recommendations include guidance on drafting clauses describing clear dispute policies. In addition, in the spring, the AAA plans to release dispute resolution applications that will allow companies to use the Internet to automatically resolve problems.

MARK YOUR CALENDARS!!!

AICPA NATIONAL CONFERENCE ON FRAUD
October 25–26, 2001
Fairmont, Dallas

AICPA ADVANCED LITIGATION SERVICES CONFERENCE
October 25–26, 2001
Fairmont, Dallas

AICPA NATIONAL BUSINESS VALUATION CONFERENCE
December 2–4, 2001
The Venetian, Las Vegas



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