CPAs can help owners without successors decide to sell or liquidate.

Businesses in Transition

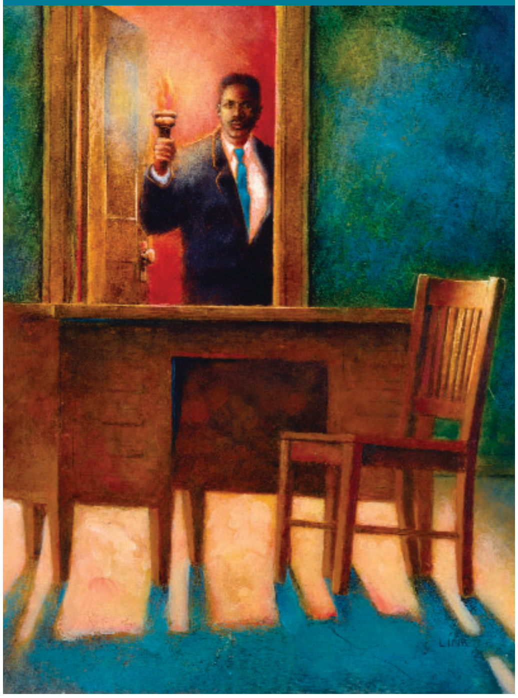
BY VICTORIA M. ZUNITCH

Successful business owners who are ready to move on sometimes find they have no one to pass the baton to. Those who thought they'd have traditional succession options upon their retirement such as transferring ownership to family members, partners or employees, for example, may discover their plans fail to materialize when a candidate balks. As trusted advisers with intimate knowledge of clients' operations, CPAs can assist owners facing this problem with choosing between the options of selling or liquidating. This article will describe how a practitioner can help the client to value and sell a business or liquidate it and handle the accompanying tax effects.

Next in Line

An 80% majority of executives who were polled about succession planning said it is "very valuable" to identify and groom the next generation of management.

Source: RHI Management Resources, 2001, **www.rhimr.com**.



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DECISION TIME

Business valuation experts say it's not too difficult to objectively determine whether a business will bring more if it's sold as a going concern rather than dismantled in an orderly liquidation. Thomas E. Hilton, CPA/ABV and chairman of the valuation and litigation services group at St. Louis-based Anders Minkler & Diehl, says, "Generally, a company is worth more as a going concern" than it will be if it is liquidated. The other CPAs interviewed for this article agree.

However, in unusual—but not rare—cases, an adviser may recommend liquidation as the preferred course of action. "Sometimes selling the business does not add value," and the owner can get as much or more by liquidating, says Woody Levitan, CPA and a partner in Levitan Yegidis & Goldstein LLP in Middletown, New York. Such cases include businesses that

- Are in extremely competitive fields. (The computer software and telecommunications industries experience constant changes that render businesses obsolete very quickly, for example.)
- Need to save time more than get top dollar. (Estate, health, divorce or partnership-dispute situations belong to this group.)
- Have severe financial problems that require an owner to liquidate assets to avoid bankruptcy.

To analyze a business to determine whether to sell or liquidate it, Genevia Gee Fulbright, CPA, vice-president and marketing director for Fulbright & Fulbright, Durham, North Carolina, recommends an organization follow this process:

■ Interview the owner(s) and top managers to figure out who really pulls the strings, which is not always the day-to-day "partner in charge." For example, a nonoperating spouse can have a lot of influence in a family, closely held or microbusiness (which has five or fewer employees, was created with a small initial operating investment and uses simple equipment, perhaps from a base in the owner's home). It's important to identify and defuse resistance to liquidating or selling from people close to the business who can cause significant problems later on. (For more information see "Offer Family-Business Solutions," *JofA*, Jul.02, page 55.)

■ Determine whether the business has a marketable product or service that doesn't require the hands-on participation of the owner. For example, is the business a sole-practitioner skincare salon or a full-service day spa with a staff of estheticians? Is your client a motivational speaker or the owner of a consulting group that employs many motivational speakers? The answer should be obvious: The second category of client is working "on" the business—that is, enhancing its viability—rather than working "in" it. Such businesses are attractive for sale because they're ripe for a smooth transition of ownership.

■ Identify the business's marketable intangibles. Does it have trade names, patents, copyrights, trademarks or other intellectual rights, subscription renewals or royalties? If there are cutting-edge assets, competitors or new entrants to the market might be willing to pay a premium.

Thomas E. Hilton, CPA/ABV, says owners generally do better when they sell rather than liquidate.

■ Evaluate the company's market position. Review the client's competition or market study—or help develop one if none is available—to determine whether the business is in the most-marketable tier of similar businesses. The top competitors in a particular niche are more attractive sale candidates than also-rans.

■ Ask the owner if there has been any expression of interest in purchasing the whole business or parts of it. If so, for how much? If necessary, the practitioner and/or client should speak with business brokers, competitors, suppliers and other industry players to get perspective on these offers. Are the amounts less than what could be obtained if the business were to be sold as separate divisions or liquidated?

■ Assess whether or not the business has strong documentation, which is important to prospective buyers. This means not only thorough financial and tax records, but also written policies and procedures for all aspects of the business, such as training, marketing, personnel, computer usage and security.

■ Analyze the business for significant assets that can be liquidated. Research their value (ask brokers or check local listings or on the Web). A lot depends on the type of business and its network of suppliers and customers. A small printer with die-cutting equipment might find that its re-

EXECUTIVE SUMMARY

■ **CPAs CAN HELP BUSINESS OWNERS** who are ready to move on but find they have no one to pass the baton to. As trusted advisers with intimate knowledge of clients' operations, CPAs can advise them on choosing between the options of selling or liquidating.

■ **A BUSINESS USUALLY WILL** bring more if it's sold as a going concern rather than dismantled in a liquidation. In unusual cases, however, selling the business does not add value. Such cases include companies in extremely competitive fields, those that need to move quickly and those with severe financial problems.

■ **TO DETERMINE WHETHER TO SELL** or liquidate, figure out who's in charge of a business; determine whether it has a marketable product or service that doesn't require the owner's participation; identify intangibles such as trade names, patents, copyrights, trademarks or other intellectual rights; and evaluate the company's market position.

■ **IN A SALE, THE CPA SHOULD WORK** with a business valuator to determine value, create a pitch book and review potential offers. CPAs can help clients interview prospective BV specialists to learn about fees, credentials and experience and whether the valuator will provide personal consultation and guidance as well as a comprehensive written report.

■ **IN A LIQUIDATION, CPAs PROJECT** a scenario for clients, including tax results, to help them understand the consequences of the decision. To liquidate, list the assets, estimate their expected price, decide whether to close or operate the business during liquidation, have the client work with legal counsel to notify creditors and use appropriate brokers to market the assets.

■ **EVEN WHEN A CHANGE** in ownership isn't imminent, CPAs' help with careful analysis and planning may enhance business value by revealing opportunities or problems.

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pair person knows a potential buyer, for example. After you round up figures, add up how much the sale of the assets will bring.

Evaluate all the information that's been gathered to determine whether liquidating will bring more than a sale of the business—either in parts or as a whole—will bring. CPAs with experience in sales and liquidation say the answer nearly always is clear. If it isn't, however, the CPA may need to conduct additional research on what prices the sale of similar businesses in the client's market have brought, or he or she may advise the client to obtain a written opinion from a valuation specialist.

Genevia Gee Fulbright, CPA, says disarm resistance to a sale from whoever sees to day-to-day management.

TO PREPARE FOR A SALE

Clients usually get the most—financially and emotionally—when they sell their business as a going concern. "If planned correctly, cashing out eliminates a lot of risk and adds a lot of wealth," says Steve Comeau, an attorney and certified business appraiser with Meyners & Co. in Albuquerque, New Mexico.

To help clients sell their enterprise, Comeau and other experienced advisers say practitioners should call in credentialed business valuation (BV) specialists (see "Resources," page 47). Loxahatchee, Florida, sole practitioner Laura Tindall, a CPA and business administration PhD who holds MCBA, CBA and ABV credentials, suggests that CPAs help clients interview prospective BV specialists before hiring one.

The interview should disclose the valuator's fees, professional designations and certifications, how much experience he or she has (not just in years but also in the number of valuations prepared for clients) and how much experience the valuator has in analyzing businesses in the client's niche. Ask whether the valuator will visit the business site or sites and provide personal consultation and guidance as well as a comprehensive written report (the answers should be "yes").

The CPA works with the client to help lay the groundwork for selling, first by assisting him or her in building value throughout the life of the entity and then by preparing the business for sale, preferably three to five years in advance. "It's similar to what individuals do when selling a residence," Hilton says. "We can tell you where to put in your time and money so the buyer will be willing to pay you for the value added." *Note:* While the buyer is preparing to sell, he or she should keep the potential sale a secret from competitors, customers, suppliers, employees and others.

Bill Hanlin, CPA, told a client liquidating a small knitting factory to use the Internet to sell equipment.

To prepare a business for sale, the CPA will help the client

■ ***Put the financial statements in order.*** "The more reliable the information the buyer gets, the easier it is to sell the business," says Judy Wagner, CPA/ABV at Meyners & Co.

■ ***List discretionary costs that can be eliminated.*** Many businesses regularly incur extra expense for conveniences or owner luxuries that aren't necessary for business operations. The CPA can flag those items to make it easy for prospective buyers to see ways to trim costs and improve efficiency. For example, if a business owner's leased car is a luxury model that's flagged as discretionary, a prospective owner might recognize an opportunity to save money by switching to a less expensive car. Common discretionary costs are large charitable contributions, lavish employee benefits and travel and entertainment allowances.

■ ***Ensure the business owner has proper professional legal, financial and insurance advice.*** No matter how experienced a client is, prospective buyers will want to see that the owner has been relying on the advice of professionals in these highly specialized areas.

■ ***Identify and minimize risks of all stripes.*** For example, Comeau says a window installer might depend heavily on a strong personal relationship with a certain supplier. "A purchaser might not have access to the preferred brand of windows," he says. Prospective buyers will be reassured if the owner formalizes the supplier relationship in a contract.

■ ***Analyze the business against industry standards.*** Buyers will compare every aspect of a business with the industry standard—capital structure, financial ratios and lease terms, for example—so find out what's typical, determine where the client's business deviates from the norm and justify differences that represent more risk than the industry standard.

■ ***Prepare a complete list of assets.*** Bill Hanlin, CPA, of Hanlin Moss in Seattle, says buyers of a retail furniture franchise he helped to sell wanted a listing in minutia of what they would get: inventory, fixtures, leases, lease assignments, computer files, contact lists and software lists. If the price is more than the value of the fixed assets, for the purposes of FASB Statement no. 141, *Accounting for Business Combinations*, the valuator will need to assign fair value to intangibles, he notes.

■ ***Review the client's business plan.*** If there is none, help him or her prepare one. (For more information see "Strategic Planners Lead the Pack," *JofA*, Dec.01, page 27.)

■ ***Debrief the owner about potential buyers.*** Wagner suggests that the CPA ask the client about the competitors, suppliers or others who might be interested buyers.

■ ***Walk through the due diligence process to make sure all relevant information and documentation are on hand.*** The CPA and client will have prepared sale price estimates for the business in the process of deciding whether to sell or liquidate, and the CPA should retain all those records and documents. The business valuator will need complete documentation later and again during actual due diligence, and having those records will save time and money. (If a full-service valuation firm is hired, Wagner says, it will have the resources to generate documentation for due diligence.)

WORK WITH A VALUATOR

Once the business and its tax and other records are in shape, the BV specialist can begin work. He or she determines what value the company or its components would have to a buyer and models potential sale scenarios, something the CPA can assist with. That value is arrived at in the context of the relevant market, which depends on the size of the business, its industry, location and other factors.

The CPA's role is to guide the client in finding and hiring an appropriate valuation specialist—who may or may not also be a CPA—and to ensure the client gets quality work from him or her. The CPA should expect the valuation to follow one or more of three standard approaches, Tindall says. They are the market approach (what other people have paid for similar businesses), the asset-based approach (the identifiable value of the assets—particularly for equipment-heavy entities such as manufacturers) and the income approach (how much money a buyer can make from the business).

The CPA and client also might engage a BV specialist to compare the value of any offers received, analyze prospective buyers' qualifications to fulfill the financial obligations of a deal or to help structure a deal as an asset sale (the buyer takes on the assets of the business without the liabilities) or a stock sale (the liabilities go along with the assets).

Finally, before approaching potential buyers, the CPA should prepare a pitch book (see "What Goes in a Pitch Book," below) that shows what the business has to offer based on the work that has been done so far. Now the client's team should be ready to market the business with confidence.

The right way to approach potential buyers will depend on the nature of the prospect and what the business is, Comeau says. He recommends using the client's lawyer, or hiring one with experience in mergers and acquisitions, to make the initial contact. This ensures the client's competitive and legal positions are protected. However, if the potential buyers are consolidators or competitors, he says it's a good idea to analyze the relationships involved to determine whether the client or someone on the client's team has an "in" with the prospect. "It may be no more than advising (the client) to 'take the lady to lunch and see what she's got to say,' " he says.

CONDUCT AN ORDERLY LIQUIDATION

Some clients have to obtain the highest possible price (those in estate, divorce or other situations involving the courts). Others, such as clients who are about to retire, can dispose of a business as they wish and may want to sell even when liquidation likely will yield more. The CPA should help a client understand the financial consequences of making an emotional decision. If the CPA and client

What Goes in a Pitch Book

Once negotiations to sell a client's business get under way, it helps to have an information packet available for prospective buyers. The CPA may prepare this document or, if the client prefers, provide the necessary information to a business broker, investment banker, lawyer or other professional who will prepare it. Investment bankers refer to such packages as "pitch books" because they help sellers make their pitch. It should include

■ A sales proposal.

■ Financial statements for three to five years, depending on the business's circumstances. Prospective buyers need recent, not ancient, history. For example, a restaurant that added a lunch to its dinner business three years ago would provide three years of statements to show the business that currently exists (the combination lunch/dinner restaurant, not the previous dinner-only restaurant).

■ Tax returns for three to five years.

■ Leases.

■ Corporate documents.

■ Business plan information, minus performance forecasts.

"You need to be careful about sharing your projections with a potential buyer," says Steve Comeau of Meyners & Co. There is an important difference between a pitch book and a financing package, he says. Buyers may view forecasts as a representation of how the business will perform in the future, something that cannot be guaranteed. A pitch book is meant to share sufficient information with prospective buyers to allow them to do their own analysis and make their own projections about the future.

agree the business isn't likely to attract a buyer, or the liquidation of the business will bring a higher price than a sale, the CPA must then lead the client through the liquidation process.

To liquidate, Levitan recommends that owners take the following steps:

■ ***List the assets using the entity's business records.*** This includes real property, accounts receivable, inventory, equipment, leases, trademarks and other intangibles.

■ ***With the client, estimate the expected price of the assets.*** Usually, owners can do this, but if an operating spouse has died and the family hasn't been involved in the business, it may be necessary to consult with employees familiar with the operation and/or appraisers, brokers, equipment dealers, auctioneers, inventory liquidators, competitors and suppliers. The CPA may have the expertise to place a value on the customer list or mailing list. If not, that's a job for a business valuator or appraiser with expertise in the industry.

■ ***Decide whether to close immediately or operate the business during liquidation.*** Base the decision on practical considerations and the likelihood of getting additional revenues from continued operation. CPAs note that retail businesses usually experience a huge jump in sales to customers looking for bargains once word gets out that a business is liquidating. On the other hand, a manufacturing business might not be able to continue selling and producing products once its employees, customers and suppliers know that its days are numbered.

If the business will continue operating, schedule assets needed for operations—such as cash registers or display shelves owned by a retail business—for sale after closing. Have the client inform creditors. If the business has a bank loan with a security agreement the client needs to talk to the bank at an early stage—but not too early. "You don't want to go to the bank saying, 'I don't know what I'm going to do yet (about the debt) but I'm planning to liquidate (in the near future).' Have the estimates ready beforehand," Levitan says.

The client must be prepared to verbally reassure the lender the debt will be paid, either during or after liquidation. Levitan suggests such notification not be in writing unless it becomes necessary in the course of events, and then only with the advice of an attorney.

(continued on page 48)

Resources

MARKET INFORMATION

■ *The Almanac of Business & Industrial Financial Ratios* by Leo Troy, Prentice-Hall Trade, 1989, recently has been updated.

■ The Risk Management Association (RMA) publishes financial ratios and industry norms by business classification.
www.rmahq.com

■ *First Research* provides industry information on a subscription basis for going concerns or for entities in preparation for sale.
www.1stresearch.com

■ Institute of Business Appraisers provides market data on the sale of businesses by size.
www.instbusapp.org

BUSINESS VALUATION

The following organizations offer CPAs training and business valuation (BV) certification. They provide searchable lists of their certified members on their Web sites.

■ AICPA
1211 Avenue of the Americas
New York, NY 10036
Jfeldman@aicpa.org
www.aicpa.org
Requires achievement of 100 program points, including an exam, hands-on involvement in 10 valuation engagements or projects, course work and other substantial "lifelong learning" activities. It's possible for CPAs who have some experience to complete the BV requirements in as little as a year.

■ American Society of Appraisers (ASA)
555 Herndon Parkway
Suite 125
Herndon, Virginia 20170
www.appraisers.org
ASA offers eight training courses in BV services. CPAs with two years of appraisal experience and 1½ years of BV experience can earn the Accredited Member designation. Practitioners with five years of appraisal experience and three years of BV experience can earn the Accredited Senior Appraiser designation through a combination of training, testing and submission of past BV reports.

■ Institute of Business Appraisers (IBA)
P.O. Box 17410
Plantation, Florida 33318
www.instbusapp.org
The IBA is a membership organization providing training and assistance to practitioners specializing in the appraisal of closely held businesses. IBA offers seminars, workshops, publications and practice aids. Well-known valuator Shannon Pratt teaches some of the courses.

■ National Association of Certified Valuation Analysts (NACVA)
1111 E. Brickyard Road
Suite 200
Salt Lake City, Utah 84105
www.nacva.com
CPAs can earn the Certified Valuation Analyst (CVA) designation by completing a five-day training course, passing a four-hour examination and preparing an extensive case study.

■ Appraisal Foundation
1029 Vermont Avenue, NW
Suite 900
Washington, D.C. 20005
www.appraisalfoundation.org
The foundation promulgated the appraisal standards known as the Uniform Standards of Professional Appraisal Practice (USPAP). Federal regulatory agencies require that BV reports provided to them comply with USPAP.

■ ***Market the assets.*** For help with this, use real estate brokers for buildings; have equipment dealers buy, auction or sell equipment; contact parties who were approached about buying the business as a going concern; read and place ads in trade publications; and hire industry-specific liquidators. When a client of Hanlin's lost her lease and decided to sell her small knitting factory, she knew her equipment wasn't worth very much. But on Hanlin's advice, she ran ads for it in *The Wall Street Journal* and on the Internet. "She got many inquiries and more than salvage value," he says.

■ ***File all necessary legal papers.*** Coordinate with the client's attorney to ensure that the business and its owner do this. For example, the CPA and attorney may need to help the client to file estate papers, and some states require notification of certain types of bulk sales for tax purposes.

■ ***Clean up loose ends.*** Cancel or redeem unexpired insurance policies and repay or otherwise resolve outstanding debt including bonds, posted letters of credit and any other residual debt.

■ ***Keep pertinent tax records and file the necessary returns.*** Make the required payments of federal and state, payroll, sales and, in some states, intangible and other taxes.

Projecting the tax consequences of liquidation involves standard tax expertise, Levitan says. First, the CPA should list the tax basis for every asset, which will be on file or, if he or she is not the client's tax practitioner, obtain them. Next, he or she should estimate each item's disposal value, which is its expected selling price. Then the CPA should run a tax plan and calculate the tax for each type of gain (capital or ordinary) using the entity's tax rate. *Note:* Because the liquidation of a business often results in a loss to the owner, "the tax ramifications very well could be positive"—a refund of previously paid taxes, Levitan says.

WHEN THERE'S STILL TIME

Sometimes CPAs need to help a business weather a change of ownership before an exit strategy or succession plan has been developed, but it's preferable to encourage a client to make one well in advance. Throughout the CPA's association with an organization he or she should remind the owner of the inevitability of a need for a transition plan and the benefits of having one, say practitioners and business valuation specialists.

But even when it comes down to the wire, CPAs still can help clients build value. Whatever the owner's succession options, the careful analysis transition planning requires can enhance business value by highlighting current opportunities or problems. Walking through the steps involved in a theoretical sale or liquidation lets CPAs focus a client's attention on where the business may be heading and how that affects its worth. ■