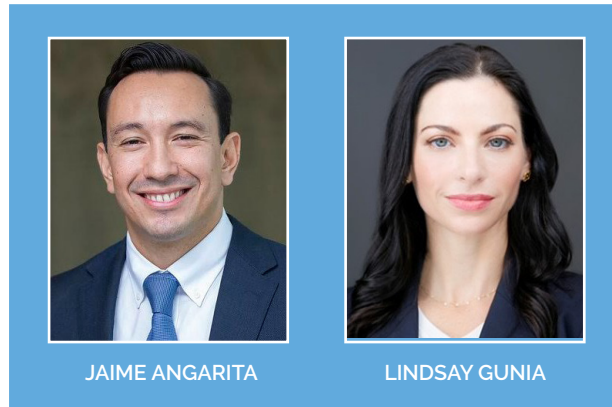


Business Valuation Disputes: Analyzing, Interpreting, and Cross Examinations in Family Law Matters

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How can two or more highly trained, credentialed professionals come to different conclusions on the value of a business? This question remains a perplexing query for family law attorneys, litigants, and judges alike. In the realm of business valuation in family law, conflicts often arise due to varying contextual viewpoints of information and methodologies employed by professionals. Valuing a business accurately is crucial for making informed decisions, whether it involves buying or selling a company, settling disputes, or securing financing. Nevertheless, variation in inputs and their contextual significance result in users of business valuation reports being faced with differing conclusions of value. As aptly stated by Dr. Shannon Pratt, "[t]reatment of various issues in valuation is more diverse from one jurisdiction to another in marital dissolution cases than in any other context of business valuation."¹ Coupled with the complexities of a valuation (i.e. different approaches and methods, discount rates, growth rates, discount for lack of marketability, etc.), family law attorneys face the onerous task of identifying, assessing, and critically analyzing these inputs and their contextual implications.

Valuation practitioners rely on an array of inputs – data, empirical facts, and underlying assumptions – to construct their valuation models. The specific



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selection of these inputs significantly influences the valuation's results. For example, relying on an assumption that an individual business owner is either underpaid or overpaid, coupled with the resulting normalization adjustment, can impact the valuation by hundreds of thousands of

dollars. This is just one example family law attorneys and their clients encounter when trying to "reconcile" valuation differences.

An effective approach for family law attorneys to follow is to **identify** and **assess**: (1) where the variations exist between differing opinions of value; and (2) the basis for the valuation professional's assumptions and assertions. This is easier said than done without knowing where to

look. In the context of family law, two common issues recurrently lead to differing valuation conclusions: premise of value, and valuation methodologies.

When valuing businesses in Florida divorces, attorneys and valuation practitioners rely on the guidance from and the interpretation of such seminal cases as *Thompson*,² *Weinstock*,³ *Kearney*,⁴ and, more recently, *Stephanos*.⁵ In each of these cases, litigants along with their valuation professionals come to differing value conclusions depending on whether a business should be valued on a going-concern basis or on a liquidation basis (referred to as "premise of value" within the profession's texts). "A *premise of*

value is an assumption regarding the most likely set of transactional circumstances applicable to the subject valuation (e.g., going concern or liquidation – either orderly or forced).⁶ In the course of litigation, discovery is focused on defining, interpreting, and presenting to the trier of fact, as well as to the other party, what is the most likely set of transactional circumstances in a business when considering the definition of personal goodwill and its interpretation within a matter's unique set of circumstances. It is those set of circumstances that can produce unreliable or inaccurate valuation results.

It is common for valuation professionals to expand the definition of the traditional premise of value from a going concern to a liquidated value when assumptions related to the "value" of a marital litigant within the subject company is in dispute. Litigants who are owners and/or work within the business have their own set of assumptions regarding their involvement and input (e.g. worth) that differ from economic or market realities. Valuation professionals may be influenced wrongly by such assumptions causing alternative premises of value,⁷ such as:

- Value in continued use, as part of a going-concern business enterprise;
- Value in place, but not in current use in the production of income;
- Value in exchange, as part of an orderly disposition; and
- Value in exchange, as part of a forced liquidation.

Other concepts, commonly defined in valuation literature as *value to holder* or *value in exchange*, may also lead to biased assumptions resulting in unreliable or inaccurate valuation results. However, attorneys need to remember that the standard in Florida divorce courts is *fair market value*, which is defined, in part, within Internal Revenue Service ("IRS") *Revenue Ruling 59-60* as:

"the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and

the latter in not under any compulsion to sell, both parties having reasonable knowledge of relevant facts. Court decisions frequently state in addition that the hypothetical buyer and seller are assumed to be able, as well as willing.."

The important term in that definition is "**willing**". Attorneys, along with their respective valuation professionals, should present a conclusion of value grounded in the concept of a willing seller, rather than an unrealistic value steeped in a perception of self-worth in the economic market. Litigants who are business owners tend to harbor an inflated perception of their worth within their own business enterprise, which is expressed in some conclusions of value. By understanding the causal connection between the fair market value standard along with the appropriate premise of value to be used, attorneys can assist the trier of fact in understanding if the valuation results align with accepted standards.

If goodwill or premise of value issues aren't present (i.e. asset approach-liquidation vs. income or market approach), it is likely that the professionals are utilizing the same approach. For instance, consider a scenario where a lawyer-owner is a party in a divorce, and both valuation professionals agree on the amount of goodwill, as well as agree to utilize a net asset value. Despite this alignment however, there are valuation differences that may be due to the varying amounts, or types, of assets on the 'balance sheet' used in the net-asset valuation approach. This is complicated further when two valuation professionals come to different conclusions of value by employing income or market valuation approaches.

In the market approach, the use of different valuation multiples is a potential distinction that can be investigated on the quality and applicability of the data used by the professional. An attorney should be meticulous in eliciting detailed information from valuation professionals that illustrates the rationale—both qualitative and quantitative—underpinning the selection of multiples and their relevance to the

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subject company being valued. Factors like revenue size, industry specifics, the timeline of transaction data, and analogous information serve as key considerations aiding legal counsel in thoroughly reconciling disparities in valuation viewpoints.

If the valuation professional used the income approach, such as capitalization of earnings, differences generally emanate from three key areas:

1. Growth Rate;
2. Discount Rate; and/or
3. Cash Flow.

For instance, within the cash-flow analysis applied in the income approach, the contemplation of normalizing adjustments for owner-occupied properties in considering the fair market value for rent, often necessitates an appraisal, or it may result in varying estimates between valuation professionals. Similarly, normalizing adjustments for owner-compensation or remuneration for family member employees involve analyses of different sources that can significantly differ among valuation practitioners.

Discount rates and growth rates also diverge between valuations, which stems from valuation experts using subjectivity when scrutinizing the subject company's risks and anticipated future benefits. In analyzing a Company Specific Risk Premium, a family law attorney may find it prudent to scrutinize the criteria employed to establish such premium-components, and then compare the responses provided by opposing experts. In addition, growth rates should reconcile with the business history, its associated risks, the owner's level of involvement and significance, and the life cycle of the business and its industry.

There is a plethora of articles that discuss a number of scenarios and examples of how differences may arise, but in the context of a specific case where valuation professionals share an identical dataset and fact basis, the assumptions employed

in any of the three aforementioned areas can have material impacts on conclusions of value. Throughout the discovery process, counsel would benefit by focusing on the specific information and assumptions utilized by the valuation professional in these areas to determine where they differ and why.

Below you will find common questions⁸ that family law practitioners can use as a foundation for reconciling divergent outcomes across valuation appraisals:

Business Valuation Bench Book Questions

1. Under the facts and circumstances of the case, has the expert chosen the correct premise of value and standard of value?
2. Has the expert considered the market, income, and asset approaches and what is his or her support for using one approach over the other?
3. Does the expert have a thorough understanding of the business and has he or she considered the eight factors of Revenue Ruling 59-60?
4. Which expert has the more reasonable, understandable, and supportable adjustments to the income?
5. For the *reasonable compensation adjustment*, would a nonowner employee perform this work for this amount of money?
6. Why does the expert believe his or her determination of the normalized income to capitalize best represents the expected future performance of the company?
7. For the *cap rate*, has the expert adequately explained the components of discount rate, especially the specific company risk premium and the appropriate long-term growth rate in light of past performance, and the expected future performance, the economic and industry conditions?
8. Has the expert matched the income to the cap rate?
9. For the *DCF method*, why does the expert believe the (multi-period) DCF method is more

appropriate than the (single-period) capitalization of earnings method?

10. Under the DCF method, can revenues realistically grow at the projected rates and do the expenses support the revenues?
11. Does the discount rate for the DCF adequately present the risk of achieving the projected income?
12. For the *asset approach*, is this an asset holding entity or an asset-intensive business such as real estate, which is appropriate for the methodology?
13. For *excess earnings*, which expert provided the best documentation and explanation for:
 - a. Return on net tangible assets; and
 - b. Cap rate on excess earnings.
14. For the *market approach*, is the sale of assets or stock; for an asset sale, what assets are or are not included in the sales price?
15. Have appropriate adjustments been made to make the companies or transactions comparable?

Mr. Jaime Angarita is a licensed CPA and seasoned financial and accounting expert with over 17+ years of experience at esteemed international and regional firms. He is the founding partner of ALTA Collaborative PLLC, a boutique firm dedicated to assisting mid-sized corporations and clients in maximizing value and recovering assets. Mr. Angarita provides advisory services in the areas of bankruptcy, commercial litigation, complex financial investigations, and forensic accounting. He is an Accredited in Business Valuation ("ABV") and a Certified Insolvency & Restructuring Advisor ("CIRA"). Mr. Angarita frequently testifies as an expert witness at both the federal and state courts.

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Endnotes

¹ *Shannon Pratt's Valuing a Business: The Analysis and Appraisal of Closely Held Companies*. Pratt, Dr. Shannon. McGraw Hill, 2022.

² *Thompson v. Thompson*, 576 So.2d 267 (Fla. 1991).

³ *Weinstock v. Weinstock*, 634 So.2d 775 (Fla. 5th DCA 1994).

⁴ *Kearney v. Kearney*, 129 So.3d 381 (Fla. 1st DCA 2013).

⁵ *Stephanos v. Stephanos*, 357 So.3d 1230 (Fla. 4th DCA 2023).

⁶ *Ibid.*, pg. 28

⁷ *Valuing Intangible Assets*. Reilly, Robert and Schweih, Robert. McGraw-Hill, 1999. Pgs. 59 – 64.

⁸ *The Business Valuation Benchbook*. Fishman, Jay & Morrison, William. April, 2017. Business Valuation Resources ("BVR").