FINANCIAL PLANNING

Big biz crowd soon heading for exits

By PETER WEINSTEIN

Statistics show that up to 70 per cent of business owners will be in a position to retire before 2020. It has been our experience that many business owners rely extensively on their accountants for business advice. Accountants can continue to assist their clients by providing proactive guidance regarding succession planning, in particular as it pertains to business valuation.

Succession planning involves handing over or selling a company to a new group of owners or managers. There are many different elements to developing a succession plan, including deciding who will own the company, who will manage the company and when management will be transitioned. It is also necessary to set a selling price for both a sale to a related person, or to a third party. Each of these issues requires careful consideration and possibly several years to plan and implement.

The more accountants understand and are involved in the valuation process, the better their advice to clients will be. Since accountants often have longstanding relationships with their clients and they are aware of the history of operations, they are in a good position to assist their clients throughout the valuation process.

Accountants can provide advice about retaining a valuator, determining the type of valuation required, acting as the client contact for the valuator, providing information during the valuation process and reviewing the report once it is completed. There is often an income tax planning transaction that occurs concurrently with the preparation of a business valuation. The value arrived at can affect the manner in which the income tax plan is implemented. By being involved, the accountant will be able to monitor whether the findings from the valuation affect the tax plan being implemented.

Our recommendation is for accountants to be proactive about speaking to clients about the value of their business to ensure a smooth transition. Here are some areas where accountants can assist their clients when a valuation is required.

Clarify the mandate's details

This includes specifying exactly what is to be valued, the valuation date and the purpose of the valuation. Understanding this reasoning, whether it is for income tax purposes or a third party sale, will help determine the best assumptions needed for the calculations.

In addition, there can be different approaches and discounts applied, depending on whether it is a valuation of an entire company or a valuation of a minority interest. The anticipated timing for the report's completion should be discussed at an early stage to ensure that required deadlines and expectations are met.

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Specify the type of report

Based on the professional standards of the Canadian Institute of Chartered Business Valuators, there are three types of reports. In order of increasing assurance, they are: calculation, estimate comprehensive.

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Generally, there is an increase in the cost as the level of assurance rises. There are specific requirements for valuations done for income tax purposes that are specified in Canada Revenue Agency information circular 89-3.

Accumulate required information

One of the first tasks when preparing a valuation is to identify the information required. A significant portion of it, such as financial statements and income tax returns, will be readily available. Additional information, such as details regarding owner compensation and related party transactions, can be compiled by the accountant as they often have detailed financial records available. Accountants can also identify when real estate appraisals are required, such as when the real estate holdings are material to the overall value. By assisting to pull together this information, the accountant can reduce the time and increase the efficiency of the valuation process.

Identify adjustments

Assuming that an earnings-based approach is used, it will be necessary to adjust the financial statements for both a) transactions that are not at economic amounts and therefore would not be incurred by third parties, such as related party compensation or rent, and b) transactions that are considered to be non-recurring, such as large onetime expenses or losses. Given the accountants longstanding relationships with the company and their experience with operations, they would be able to assist to identify both related-party transactions and non-recurring transactions. This helps to ensure that key issues are identified and addressed at an early stage.

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Best expectations for the business

This involves identifying the probable or most likely future operating results considering all risks and opportunities. This will involve making an assessment about the anticipated income that will be earned in the future. As this is not known at the valuation date, an assessment will need to be made based on either past performance or anticipated future results relying on projections and forecasts.

It is possible to arrive at different value conclusions, depending on the perspective taken and the reliance placed on this underlying information. The company accountant is often able to provide a good perspective on this information as he or she is familiar with the company's operations, its industry and the manner in which the company operates.

Evaluate risk of achieving results

The risk of achieving the anticipated results will be factored into the discount or capitalization rate selected. A company with a higher risk will have a higher discount rate (or a lower earnings multiple). Clients and their advisors often ask about the manner in which a discount or capitalization rate is selected. This is one of the main aspects of valuation that is considered to require judgment. Although there is significant data available regarding required equity returns as well as premiums for size and other risks, ultimately, the valuator will need to select an earnings multiple or discount rate taking into account internal and external risk factors.

The accountant is able to focus this discussion and identify the significant issues at an early stage.

Review of the report

Once the report is completed it is common to discuss the findings and approach with the client. An accountant involved throughout the process will be able to assist in clarifying issues with the client and in presenting the client's perspective to the valuator.

A recent study by the Canadian Institute of Chartered Business Valuators shows that more than 50 per cent of retiring business leaders are not prepared for succession. Knowing this, accountants can play a crucial role in providing advice and helping clients to transition out of the workforce and into retirement, while having peace of mind knowing that they are leaving their company in a solid position, so that it will carry on.

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