Book Review: How Much is Enough?

by Robert W. Wood • San Francisco

How much is a business worth? Some of this may depend on the times. Indeed, MeA Tax Report readers are presumably all aware that business valuations only a halcyon few years ago were typically much higher than they are today. Still, such ruminations don’t begin to answer the large technique and methodology questions that go into any assessment of value. I’ve often said that tax lawyers need to have at least passing understanding of financial accounting rules, simply because sometimes the accounting incentives are so huge that one cannot have a decent grip on the way in which the tax rules operate on a company without also knowing about the accounting rules.

Earnings charges for stock options might be a good example of this phenomenon. Much the same you need to know some of this mantra should operate in the context of financial statements and appraisals. For that reason, I was delighted when a copy of Shannon Pratt’s book, The Lawyer’s Business Valuation Handbook, published by the American Bar Association, crossed my desk. This is a soft cover book, and even the cover tells you a fair amount about what’s inside. The book carries the subtitle Understanding Financial Statements, Appraisal Reports, and Expert Testimony.

Also telling is the cobbling together of different ABA Sections that produced the book. It is a joint product of the Sections of Family Law, General Practice, and Solo and Small Firm Sections of the ABA. It is not too imposing a paperback to carry around for those unanticipated delays or mass transit commutes, though I find it helpful now to keep on the shelf. Although there is one author, there are many contributors, but this feature seems to add to the value of the book rather the detract from it, providing a mix of different perspectives.

The book starts with chapters on different valuation techniques and the various business appraisal credentials and standards. Chapter 3 commences with expert valuation rules, and the admissibility of expert valuation testimony. Chapter 5 covers alternative dispute resolution, with a predictable focus on the use of appraisal and valuation professionals in that context.

Guts of Work

It is the second part of the book that most MeA Tax Report readers will find most useful. Chapter 6 provides an overview of accepted business valuation approaches, methods and procedures, starting with the usual methodology, the benefits of different approaches (establishing a kind of hierarchy for use). Chapter 7 covers financial statement terminology that is used in a business appraisal. Again, this is the real meat of the book. Subsequent chapters then are devoted (one chapter each) to the income approach (Chapter 8), the market approach (Chapter 9), the asset-based approach (Chapter 10), goodwill and the excess earnings method (Chapter 11), etc. Although discounting is discussed in various places, one whole chapter (Chapter 13) is devoted to discounts and premiums. Such important topics as lack of marketability discounts, minority vs. control factors, etc., are discussed in enough detail to be helpful but not so much detail as to be annoying or repetitive.

Considering that much of this book lays out a variety of different appraisal approaches, and then methodically walks us through them (what else do appraisers do!), many readers will find the reconciliation chapter (Chapter 14, which covers juggling different appraisal approaches, weighing them, reconciling divergent results, etc.) quite helpful. In only ten pages or so, this chapter gives the reader a good sense of how appraisers push one factor over another and engage in the constant juggling that is an appraiser’s primary repertoire.

Part Three of the book (Chapters 15 through 22) includes some materials that are probably too basic for many MeA Tax Report readers. Chapter 15 covers financial statement adjustments, followed by comparative financial statement analysis (Chapter 16), followed by economic and industry analysis (Chapter 17).

The last three chapters of the book deal, respectively, with shareholder and partner disputes (Chapter 20), employee stock ownership plans (Chapter 21) and medical practice valuation issues (Chapter 22). Although the last chapter will be of little value to MeA Tax Report readers, Chapters 20 and 21 contain useful demystification both of the fairness and fair value disputes common to corporations and partnerships (Chapter 20), and of the legal standards and economic dynamics of ESOP transactions.

Reading The Lawyer’s Business Valuation Handbook didn’t cause me to want to become an appraiser. Still, I find it more than a handy reference, demystifying a significant amount in this field. It is available from the ABA for $124.95, or $114.95 for certain ABA Section Members (1-800-285-2221).