

# Expert

Winter 2000



## ASSESSING UNSYSTEMATIC RISK: PART II THE MACROENVIRONMENT

This is the second in a series of articles whose purpose is to propose a framework for analyzing unsystematic risk. For valuers appraising smaller companies, especially those with annual revenues in the \$1 million to \$10 million range, the need for such a framework is compelling because at present we have none.

Drawing on the literature of strategic management and organization theory, the first article in this series<sup>1</sup> identified three levels of unsystematic risk: macroenvironment, industry, and company. Later articles will focus on the industry (including competitors) and on the company (see figure 1 on page 3). In small-company valuation engagements, we often have observed that the biggest source of risk to a closely held company is, you guessed it, the company itself.

Heretofore, efforts to assess unsystematic risk rested on the dubious twin foundations of quasi-incoherent laundry lists and ratio analysis. The former are not helpful, and the latter are insufficient. Data from Ibbotson<sup>2</sup> and from Grabowski & King<sup>3</sup> confirm that risk and company size are negatively correlated.

Understanding risk is one of the keys to understanding how a business works. After independence (required in almost all valuation assignments), objectivity, and compe-

tence assumed to be givens for CPAs the first obligation of the serious valuation professional is to know how the business works. Attempting to value a business whose operational details one doesn't understand ill serves clients.

Moreover, disciplined analysis of wealth-creating mechanisms derives from this understanding. Then it is a matter of estimating the sustainability of those mechanisms. Recently Warren Buffett put it succinctly:

The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but, rather, determining the competitive advantage of any given company and, above all, the durability of that advantage.<sup>4</sup>

As previously noted, the assessment of unsystematic risk requires quantifying qualitative analysis. That task typically is a bigger issue in the valuation of smaller companies because they're generally more risky. It also tends to be more time-consuming because information is harder to come by and what information is available is often less reliable than comparable data used in valuations of larger companies.

### THE MACROENVIRONMENT

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<sup>1</sup> See Assessing Unsystematic Risk, CPA Expert, Summer 1999, pp. 1-5.

<sup>2</sup> See Stocks, Bonds and Inflation 1999 Yearbook (Valuation Edition), Chicago, Ibbotson Associates, 1999.

<sup>3</sup> New Evidence on Equity Returns and Company Risk, by Grabowski and King, Business Valuation Review (BVR), September 1999, pp. 112-130; previous articles appeared in March 1995, September 1996 and March 1997 issues of BVR.

<sup>4</sup> Mr. Buffett on the Stock Market, Fortune, November 22, 1999, p. 220.

Macroenvironmental is often wrongly used interchangeably with macroeconomic. Proprietary products such as Mercer Capital's National Economic Review (NER) and the quarterly update from Wharton Econometric Forecasting Associates (WEFA) reinforce that mistake. Macroeconomic factors are, in fact, a subset of the macroenvironment. They are not a synonym for it.

This article considers the various aspects of analyzing the most remote sources of risk to a company those originating in its macroenvironment. The valuation entity lies at the center of a complex universe. Nearer the company are five industry forces. Beyond them are six more-remote influences comprising the macroenvironment. While these external forces are more distant from the company, macroenvironmental forces nonetheless exert powerful influence on its risk profile.

The six dimensions of the macroenvironment are economic, technological, sociocultural, demographic, political, and global.<sup>5</sup> Because the presence of even two of these factors is only rarely obvious to a company, many owners, and some appraisers, ignore them.

Moreover, small-business principals believe that, because they cannot influence them, why bother thinking about them? With a bow to Bobby McFerrin, I call this the "Don't worry, be happy" approach.

Even if owners and managers delude themselves into thinking they can afford the luxury of this attitude, appraisers cannot. We must research, analyze, and quantify the macroenvironment. Its impact varies from industry to industry because no industry is exactly the same as another. Moreover, the

constant evolution of industries in free markets ensures that any macroenvironmental analysis is a snapshot at a particular point in time the valuation date.

**S** Economic. For most companies, the economic force is the most influential one in their macroenvironment. Because this force involves factors they influence only indirectly interest rates, inflation, unemployment, GDP, fiscal and monetary policy, etc. it also can be the most frustrating for business owners who feel as if their destinies are not within their control. About this dimension, they're right.

Each of the economic factors is measured nationally. Unemployment rates, however, can vary dramatically from region to region or state to state. It is important for the valuation professional to understand how changes in these factors will affect the supply-demand relationship and, thereby, the performance of the client company.

One of the most common errors we've seen is for an appraiser to drop text from WEFA or NER verbatim into a report (often under the heading Economic Outlook or similar phrase<sup>6</sup>) and go blithely on without so much as a by-your-leave about the relevance of that economic outlook to the industry. WEFA and NER are both fine products from reputable companies. However,

<sup>5</sup> Adapted from *Macroenvironmental Analysis for Strategic Management* by Liam Fahey and V.K. Narayanan (St. Paul: West Publishing Co., 1986), p. 29, and *Strategic Management: Competitiveness and Globalization* (3rd Ed.) by Michael A. Hitt, R. Duane Ireland, and Robert E. Hoskisson (Cincinnati: South-Western Publishing Co., 1999), pp. 50-60.

<sup>6</sup> Factor 2, section 4, Revenue Ruling 59-60 is "the economic outlook in general and the condition and outlook of the specific industry in particular."

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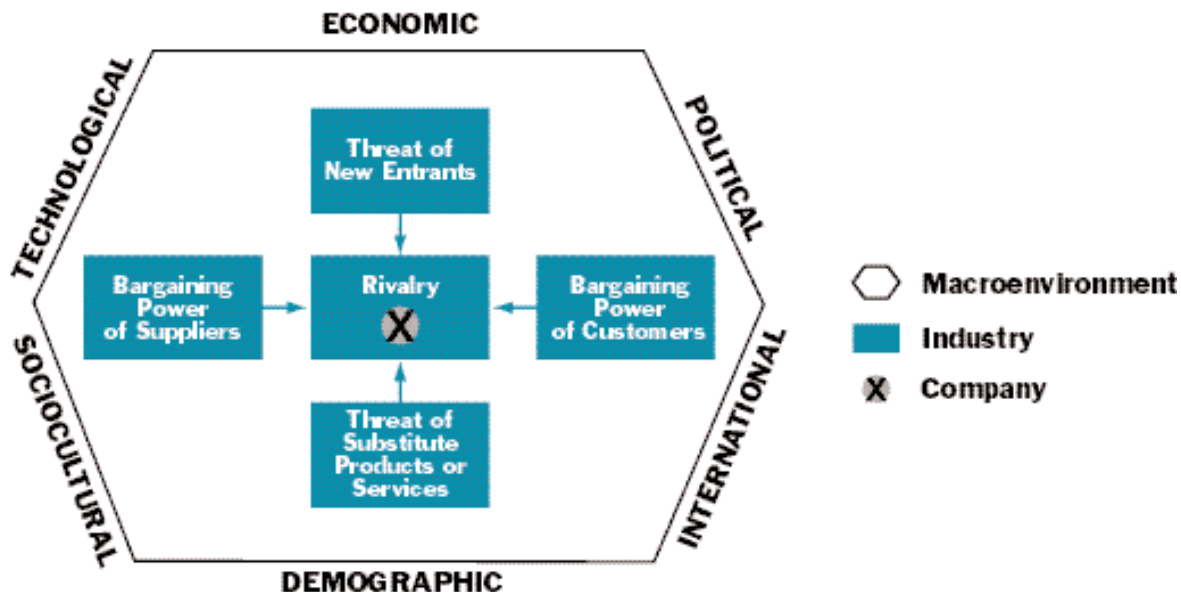
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Figure 1<sup>1</sup>



<sup>1</sup>Chart is adapted from models developed by Liam Fahey and V.K. Narayanan in *Macroenvironmental Analysis for Strategic Management* (St. Paul: West Publishing Company, 1986), and by Michael A. Hitt, R. Duane Ireland, and Robert E. Hoskisson in *Strategic Management: Competitiveness and Globalization* (3rd Ed.) (Cincinnati: South-Western Publishing Company, 1999).

appraisers who fail to put their contents into a valuation context do themselves a disservice. After all, if they don't demonstrate that they understand the impact of this, the most important of the six forces in the macroenvironment, what is the probability that they understand much else about the company's risk profile?

**s** Technological. Many larger companies have R&D budgets. Most small ones, especially those in so-called low-technology industries, do not. Technological innovation, however, is the one force in an individual company's macroenvironment over which it can exert influence. To be sure, it takes resources, time, and more than just a little luck. But it can happen.

For appraisers, the problem with innovation is that it is seldom announced in advance. Yet, as we all know, valuation is prospective. The fact that innovation is usually kept under wraps makes technological innovation hard to research and anticipate.

Still, we must do our best. In addition to keeping abreast of trends in innovation through such publications as MIT's *Technology Review*, appraisers should make it a point to contact relevant trade associations.<sup>7</sup> Always ask for the librarian. When

such a person is on the payroll, we have noticed what seems to be pent-up desire to talk. (Few people, we infer, talk to librarians.) They can be invaluable resources.

In the absence of a librarian, or if the company or trade association lacks technological awareness, the valuation professional must use her or his imagination. For instance, if one is valuing a trash hauler, one will learn that commercial hauling rates are based on volume of trash, frequency of pickup, and tips (landfill fees). One need not know about a small company in the Midwest (which holds two patents on an innovative industrial trash-compacting technology that can reduce the volume of trash by as much as 90%) to be able to envision the impact of such an innovation on the fortunes of a trash hauler whose revenues depend heavily on commercial customers. The savvy appraiser should include a caveat about what could happen if such a contraction came to market.

That caveat would not be the last word, however. Later, at the company level of risk assessment, one would need to write about what the company was doing to protect itself from such an eventuality. Perhaps it is con-

Warren D. Miller, MBA, CPA/ABV, CMA is co-founder of BECKMILL Research, Lexington, Virginia; e-mail: w m i l l e r @ beckmill.com; phone: 540-463-6200. He is a member of the Accredited in Business Valuation (ABV) Examination

<sup>7</sup> See [info.asanet.org/gateway/onlineassoclist.html](http://info.asanet.org/gateway/onlineassoclist.html) for a searchable database of over 2,100 trade associations. There is no www at the beginning of that Web site address.

scious of the risk it faces, is trying to reduce its dependency on commercial revenue sources, and, at the same time, is targeting residential customers.

**S** Sociocultural. This force refers to trends in values and life-styles, which certainly can affect demand for a company's product or service. For instance, the increasing social acceptability of children being born out of wedlock is good news for the daycare industry, even as it is bad news for our society as a whole. Divorce rates matter here, as do trends in household size, food, clothing, and entertainment.

That's true even in a business-to-business industry such as wholesale appliance distribution. On the surface, a distributor selling to appliance stores or directly to home builders might appear impervious to divorce rates and single parents. But a mother and father living apart need two refrigerators, even if they're smaller than the one they had under one roof.

**S** Demographic. Demography refers to the characteristics of a population. What those are depends on the nature of the population. A population of consumers, for instance, has demographic characteristics related to age, education, family size, rate of household formation, disposable income, and so on.

Less obvious, but no less important, is industrial demography. Here we are talking about the number of companies, their lines of business (defined by SIC or NAICS codes), their age, their size, their rate of growth, and the like. Industrial demography isn't as sexy as what we read in a fine publication such as *American Demographics*, but with gross margins steadily shrinking in most distribution businesses, it's a critical factor for a distribution sector.

**S** Political. As distasteful as many of us find politics on any level to be, it is a force we must reckon with in our appraisals. Four aspects of the political dimension are important in valuation: possible electoral results, legislative initiatives, regulatory policy, and judicial decisions. Wining politicians affect legislative, regulatory, and judicial agendas.

In this election year, for instance, the vic-

tor in the presidential election could have a major impact on, say, minimum wage levels. If I am valuing a business in an industry with low barriers to entry, that would be an important issue to consider. Moreover, as we see increasingly around the country, minimum wage no longer is just a federal issue. Cities and states are setting their own minimums. So politics at all levels is an important issue to consider.

The good news here is that, the more local the political issue, the greater the influence an individual company can have if it's willing to get involved. That influence plays out not only in the contributions of political action committees but also in the lobbying activities of trade associations of which a firm is a member. If a company officer is a major supporter of an influential political figure, that support can make for a more benign (or less malign) political environment.

**S** Global. Even small businesses are increasingly affected by what happens many time zones away. Therefore, the appraiser must consider the impact of international events on the future performance of the valuation entity.

For instance, a valuer of a restaurant in Hawaii needs to consider the health of Asian economies. So would her counterpart in Seattle. Ripple effects of currency fluctuations, troop movements, and inflation rates in countries far removed from local competition can affect the fortunes of local businesses.

#### THE AGGREGATE IMPACT

We do not try to weigh these factors individually. Even if we did, the weights would change from industry to industry. Not weighting helps us follow the wise counsel of 59-60: No formula can be devised that will be generally applicable to the multitude of different valuation issues arising in estate and gift cases, or any other cases, either.

However, to give readers of our reports a sense of what we believe to be the opportunity or threat (the O and the T in SWOT<sup>9</sup> analysis) the macroenvironment offers or poses, we close this part of our analysis with a short paragraph that recapitulates the two

<sup>8</sup> Revenue Ruling 59-60, Sec. 3.01.

<sup>9</sup> SWOT is an acronym for Strengths, Weaknesses, Opportunities, Threats. The latter two are external to a company, the former two, internal.

<sup>10</sup> Using the capital asset pricing model (CAPM), though, remember that beta includes macroenvironmental risk. Therefore, under the CAPM, no separate attribution is necessary.

or three most important influences we identified. We also state where, on a scale of 1 (most benign) to 5 (most hostile), we believe macroenvironmental risk resides. We do that in half-point increments (for example, 1.5, 2.0, 2.5, etc.).<sup>10</sup>

A caveat: Under the market approach, of course, there is no explicit increase or reduction in risk resulting from macroenvironmental influences. That is because valuation multiples, like betas in a CAPM scenario, have investors' perceptions of macroenvironmental risk built into them. Nonetheless, even if an appraiser is relying primarily on the market approach, macroenvironmental risk analysis will help her or him to understand better the company and the competitive pressures it faces. That understanding, in turn, will play out in a better and more accurate estimate of value.

Remember that unsystematic risk may be a positive factor (thereby reducing overall risk). Under the income approach, therefore, it might be a subtraction in a discount-rate estimate. In our experience with the build-up method in valuations, macroenvironmental risk premiums have ranged from 1 to +2 percentage points. In a high-interest rate environment, though, we can see it going higher than +2 for cyclical businesses like

auto dealerships.

CLOSING WORDS

Most information found in researching and analyzing macroenvironmental risk is soft data. In the technological, sociocultural, and political dimensions, what else is there?

It is the job of the competent appraiser to quantify qualitative information. That job is subjective, no doubt about it. There are no hard and fast rules about how much risk the presence of a certain factor poses. That is partly because we have no data, but it is also because the impact of a given factor varies from industry to industry.

Still and all, the analysis must be comprehensive, thorough, and rigorous. It also must be based, on the elements of common sense, informed judgment, and reasonableness.<sup>11</sup>

Most of us didn't become CPAs because we wanted our professional lives overrun with subjectivity. Nonetheless, those five words—common sense, informed judgment and reasonableness—aptly describe high-quality business valuations done by competent CPA professionals. Even if macroenvironmental risk in a given valuation is perceived to be neutral, the analysis is essential because it enhances the

## DEFENDING AGAINST UNWARRANTED DAMAGE CLAIMS IN A MEDICAL PRACTICE DISSOLUTION

The Best Defense Is A Good Offense

Not all marriages are made in heaven and neither are all business partnerships. Inevitably, the CPA practitioner will encounter a break-up of a client medical practice or be asked to serve as an expert in assessing damage claims. To assess the claims, the CPA expert needs to be aware of the typical goodwill and damage claim issues, ways to identify their weaknesses, the importance of understanding relevant

regulations, and ways to defeat the claim in appropriate circumstances.

LOSS OF GOODWILL

A typical damage claim (and, typically, an unsophisticated one) involves a claim against one party for loss of goodwill by the other. A typical measure of this goodwill uses an excess earnings approach. For this article, we assume a going-concern, fair market value standard. The excess earnings approach as applied to medical practices typically does not include a return on tangibles since that return is assumed to be included in the statistical baseline earnings. The expert who wants to use a return on tangibles in the model needs to remove that return on tangibles from the statistical earnings because physicians generally withdraw all of the earnings from their practices

Mark O. Dietrich, CPA/AE, practices from his office in Framingham, Massachusetts. Phone: 508-820-0101; Web site: www.cpa.net; e-mail: dietrich@cpa.net. John J. Mayerhofer, CPA, FACHE, FHFMA, is Director of Healthcare Services for The Financial Valuation Group, California. Phone: 510-531-1943; e-mail: jjmayerhof@california.com.

### Example: Three-person Practice, One Partner Expelled

Earnings of entire practice	\$900,000
Statistical earnings (for example, from the Medical Group Management Association (MGMA))	<u>600,000</u>
Excess earnings	300,000
Capitalization rate	<u>20%</u>
Claimed goodwill value	1,500,000
Plaintiff's interest	<u>33.33%</u>
Value to plaintiff	<u>\$500,000</u>

	Dr. Allday	Dr. Begood	Dr. DoLittle
Earnings	\$400,000	\$300,000	\$200,000
MGMA norm	<u>\$200,000</u>	<u>\$200,000</u>	<u>\$200,000</u>
Excess earnings	\$200,000	\$100,000	\$0
Capitalization rate	<u>20%</u>	<u>20%</u>	<u>20%</u>
Value	<u>\$1,000,000</u>	<u>\$500,000</u>	<u>\$0</u>

Note: This example contains the classic valuation mistake of ignoring a physician's total productivity when determining what normal earnings for him or her should be for purposes of measuring excess earnings. We do not suggest that this is the correct approach.

in the form of compensation. The expert also needs to be aware of the definition of fair value as used in the statutes in the state in which the damage case is filed.

Consider, for example, the value to Dr. DoLittle, the plaintiff in a three-partner practice that has expelled him (see sidebar above). When presented with such an analysis, the first questions the expert needs to ask are who among the doctors was responsible for bringing in what portion of the \$900,000? What was the compensation formula? What do the employment contracts say? How many (technical vs. professional) services did each physician provide by CPT (physician billing) code? Did the practice provide any ancillary services (for example, lab and x-ray)? Were these services a source of profits? Were there any physician extenders (for example, nurse practitioners)? If so, were they profitable?

Is there a buy-sell agreement? Typically such agreements exclude accounts receivable to permit a doctor to enter and exit the practice with much lower cash amounts than

would be the case if accounts receivables (A/R) were being purchased. Whether units of ownership are partnership interests or stock shares, the practice should ratify annually the value of each ownership unit. Few do, however, despite the adage that an ounce of prevention is worth a pound of cure.

Assume that of the \$900,000 income, Dr. Allday earned \$400,000; Dr. Begood \$300,000; and Dr. DoLittle, the plaintiff, \$200,000. The damage claim presented effectively redistributes \$200,000 of Dr. Allday's excess earnings to the entire practice, and accounts for \$1 million of the valuation. If Dr. Allday is producing that income through a disproportionate number of the total patient encounters, it will be difficult to convince a court that Dr. DoLittle is entitled to the fruits of Dr. Allday's labor. In fact, Dr. DoLittle is earning only \$200,000 and contributing no excess earnings to the practice. Dr. Allday's counsel might ask Dr. DoLittle if he was ever paid any portion of Dr. Allday's income or whether he ever expected to be paid a portion.

If the doctors in the example were, in fact dividing income equally, Dr. DoLittle might have a better argument, since, as the lowest producer, he would be getting the fruits of someone else's labor. Still open to question is whether the damages are for loss of equity or earnings. (Later in our discussion of Stark Anti-Referral issues, we'll consider the dangers of distributing the technical component of referred procedures based on production.)

#### WRONGFUL DISCHARGE

Another line of inquiry involves whether the damage claim is for loss of an asset—goodwill or whether it is for loss of income due to wrongful discharge from employment. These are two different claims. If the plaintiff presents expert testimony on the loss of an asset, it may be possible to defeat that claim, whereas an improper discharge claim may be more difficult to defeat.

It is important to analyze the underlying intent of the parties with respect to any excess earnings and whether this is to be considered equity or a liability to the producer of that excess for compensation. Perhaps the first inquiry should be whether any prior buy-in transaction included A/R as part of equity or whether the A/R is reallocated via the

compensation system and employment contracts.

The typical employment contract in a small practice provides that on retirement, or other termination of employment for defined reasons, the physician is entitled to receive his or her share of A/R as collected or over a period of time. (A cost of collection may be charged against the receivables to determine the amount due.) Paying those specific receivables at the physician's retirement or other termination clearly puts the offsetting credit on the right side of the balance sheet in the liability, not equity, class. On the other hand, if the total A/R was included in the buyback of stock under the shareholder's agreement, equity clearly would be indicated. If the retiring shareholder was entitled to a pro rata share of the A/R regardless of who produced them, this would enhance Dr. DLittle's claim of loss of equity if he did not get paid out.

#### PRESENCE OF ENTERPRISE OR PRACTICE GOODWILL

In a practice that allocates all compensation on a productivity basis and at retirement pays receivables based on who produced them, is there any enterprise or practice goodwill value? There may well be, but it certainly is not determinable by lumping all the excess earnings into a single bucket. Some portion of the excess earnings, however, may well be attributable to economies of scale resulting from the three doctors practicing together, to workforce in place, or to going-concern value.

In the healthcare industry, the term going-concern value refers to the portion of the enterprise or practice intangible value (including such intangibles as patient medical and billing records and patient encounter forms) representing the positive cash flow of an established practice vs. the smaller cash flow of a hypothetical start-up of the same practice, less working capital and workforce in place. Alternatively, and more relevant to this article, some valuers believe going-concern value is the positive cash flow for the practice of the average size in the industry vs. the start-up of the average practice. Established practices in excess of the average size would then have true goodwill, or excess earning power. The costs involved in starting up a practice include identification of

a billing system, leasing of office space, hiring of staff, and recruitment of patients. (The reader may be familiar with the concept of going-concern value under the residual method of allocation in section 338 of the IRC or in the instructions to form 8594.)

To measure economies of scale, the valuer might compare the overhead expense per physician in a hypothetical solo practice to that of the contested practice. Assume, for example, that such overhead is \$150,000 per physician. In the example discussed above, a three-person practice, it is \$375,000, or \$125,000 per physician, assuming expenses are shared equally. It may be possible for the plaintiff to argue successfully that \$25,000 of each physician's earnings are attributable to being in a group, for a total of \$75,000. Applying a 20% capitalization rate yields a total practice intangible value of \$375,000. (We ignore a return on tangible assets for simplicity.)

Another method of isolating business goodwill as distinct from personal goodwill is to directly value workforce in place (trained employees) and the going-concern value. This can be done by constructing a cash flow forecast for a hypothetical start-up practice like the industry average and comparing that cash flow to that of the contested practice. If the contested practice is of industry average size, then it will have practice (or enterprise) intangible value but no pure goodwill, or excess earnings power, attributable to the individual physicians. If it is greater than the average, it may have pure goodwill. (The method used to accomplish this is commonly referred to as replication cost or avoided cost.)

If the subject is greater than the industry average, four forecasts will need to be done, one each for (1) the start-up of the average practice, (2) the start-up of the subject practice, (3) the established average practice, and (4) the established subject practice.

In the overall forecast, the present value of the difference between the start-up forecasts and the subject practice forecasts should consist of three distinct assets: net working capital (A/R less accounts payable) and workforce in place and going-concern value (whatever is left after the other two assets are computed). Net working capital typically would be allocated based on the compensation formula rather than as equity.

Any valuation of a medical practice must take into account the fraud and abuse laws and the Stark laws.

The goodwill would exist in the valuation subject only if, for instance, the total enterprise value is greater than the sum of net working capital, workforce in place, and going concern value plus the tangible assets of the average practice. In our eat what you kill example, such goodwill or excess earning capacity is considered compensation, not equity, and as such, the replication cost computation for the average practice places a ceiling on intangible value. In our view, however, it is arguable, notwithstanding the above analysis, that if the going-concern value was not paid for at the time of the buy-in or contemplated at the time of practice formation, the parties should be viewed as having allocated the earnings from that asset to compensation.

#### FEDERAL ANTIREFERRAL LEGISLATION

Any valuation of a medical practice must also take into account two principal statutes regulating the referral of Medicare and Medicaid patients for health services: the fraud and abuse laws, also known as the antikickback statute, and the Stark laws (named for the California congressman who introduced them). The fraud and abuse laws are broad in scope and prohibit, generally, payments in exchange for referral of Medicare or Medicaid patients. The penalty offenders fear most is exclusion from participation in the Medicare and Medicaid programs, even in the absence of a criminal conviction.

The Stark laws prohibit payments in exchange for referrals of designated health services. A referral is any request by a physician for designated health services that are reimbursable under Medicare Part A or B, whether or not Medicare actually pays for the service. Designated health services include clinical laboratory services, radiology, and other diagnostic services and inpatient hospital services, as well as several others. A physician can violate the law and regulations by referring Medicare or Medicaid patients to his or her group practice for designated health services, unless the group meets the qualifying definition of a group and is exempted from the provision.

The details of qualification are broad, but overhead and income must be distributed according to an existing methodology, meaning that it must be established in advance of the compensation period and

must not provide an incentive associated with the volume or value of referrals. In addition, proposed regulations issued in January 1998 state that this means there must be centralized decision making, with a pooling of revenues and expenses, and the compensation distribution system set in advance. Satellite office structures with separate profit and loss statements for designated health services are not allowed.

It is conceivable that a settlement negotiated out of court with respect to damage claims may violate these laws, subjecting the parties to civil and criminal sanctions. A valuation methodology that takes referrals into account and allocates value upon dissolution in exchange for past referrals would appear to run a clear risk of violating the statutes.

In performing a valuation, the valuer must first assess the liability employment contracts imposed on the underlying net assets of the practice. Next, the valuer must determine whether the compensation system complies with the various statutes and regulations. That is, is the obligation valid under those laws?

Assuming the system is found compliant, the valuer must use assumptions in constructing the valuation model that respect both the contracts and the regulatory environment.

For facilities, such as an ambulatory surgeon center, that receive a facilities fee from Medicare or Medicaid, the antikickback statute provides special safe harbor rules. A safe harbor is a structure that, if adhered to, should rule out any violation of the federal statute. A failure to meet the safe-harbor does not mean that a violation exists but, rather, that one may exist if investigated.

The following 8 standards were specified as criteria to meet the 60-40 safe harbor rule.

1. No more than 40% of the investment interests can be owned by individuals referring patients to the facility.
2. The same investment terms must be offered to passive investors.
3. Investment terms must not be related to referral volume.
4. Investment terms must not be tied to the need to make referrals.
5. The entity and its owners must not offer services to or perform them for (non-referring) investors differently from those

offered to or performed for non-investors.

6 Investors may not account for more than 40% of the gross revenue of the entity.

7 No loans or loan guarantees may exist for a referring investor.

8 Payments to investors must be directly proportional to their capital investment.

Let's assume, for example, the productivity based compensation system in a multi-specialty practice properly allocates the income from endoscopy to the gastroenterologist who performs the procedure. Many of the referrals come from his partners in the practice, such as general internists, who do not perform such tests. One of these internists is forced out of the practice and seeks damages. Use of an excess earnings method with respect to the gastroenterologist's earnings to determine the value to the internist (1) contravenes the productivity-based compensation system and (2) may violate the prohibition against referral payments, depending on the income streams involved.

Why does the excess earnings method, as described in the example of Dr. DoLittle, risk violating the antireferral rules? Remember that the valuer must first understand the existing compensation system and then assess the system's compliance with the regulatory environment. Obviously, the valuer must have some basis for assuming that the existing compensation arrangements among the parties are to be ignored for purposes of the valuation. Having passed that threshold, if the valuation method chosen changes the allocation of compensation or earnings among the parties as would be the case with the typical application of the excess earnings method the valuer must (again) assess the compliance of his or her new compensation system with the regulations. If the procedure is also compensated with a facility fee, a separate analysis is required with respect to those fees. Clearly, performing this assessment requires the valuer to have an intimate knowledge of the various antireferral laws and regulations.

If the existing compensation system passed muster, the valuer-installed new compensation system also must pass muster and withstand the clear challenge that it is an attempt on behalf of the plaintiff (Dr. DoLittle) to obtain value for past refer-

als, which would likely be a violation of the anti-referral legislation. Again, the defendant's counsel might ask the valuation expert whether the changes to the compensation system are based on assumptions that attempt to reallocate historical results to compensate DoLittle for past referrals. It is not difficult to imagine the unfamiliar expert answering yes to that question.

Valuers should recognize as well that the use of market approaches, such as the guideline publicly-traded company method or actual control acquisitions of private group practices by publicly-traded companies, may not be relevant to valuing a minority interest in a dissolution. There are separate considerations under the antireferral laws when a third party controls the practice and sets or approves compensation arrangements that may be irrelevant to a private control setting where the parties control compensation arrangements among themselves. There is the obvious difference between a nonmarketable minority interest in a private company and a nonmarketable controlling interest in a private company. There is also a valuation difference between a nonmarketable controlling interest in a private company and the marketable controlling interest represented by the acquisition of a practice by a publicly traded company.

Finally, most of the transactions assume the acquirer will retain 15% to 20% of what otherwise would be physician compensation (or predistribution earnings), a typical structure used by PhyCor, for example, and easily seen in its SEC filings (and now being used by consolidators of accounting firms!). Unless this same 15% to 20% of the earnings is reallocated in the valuation method applied to the group practice and such reallocation is valid under the regulations, it is easy to misuse the data. Given the structure of such transactions, it is multiples of earnings actually purchased from the physicians, and not revenue or other multiples, that are the driving the value.

#### ANCILLARY INCOME

If a portion of the practice's excess earnings arises from ancillary services (imaging, laboratory, other testing), the valuer should do a replication cost valuation analysis to determine practice or business goodwill, with the addition of the inquiry as to compliance with

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An out-of-court settlement of damage claims may violate federal laws and subject parties to civil and criminal sanctions.



## SIGHTING MATERIALS ON THE INVISIBLE WEB

I know it is on the Internet, but I have tried a dozen search engines and I can't find it. So I started a recent conversation with a desperate colleague, who was looking for an article that had appeared in the August 1999 issue of *Taxes* magazine. Because she had the full citation, she thought it would be easy to find it on the Internet. After all, had she gone to her local library looking for the article *Life after Davis Estate: Valuation Discounts for Built-in Capital Gains Tax Liabilities*, finding it would have been a relatively straightforward process.

So why was it so difficult to find this on the Internet? My friend approached her search in a methodical way, searching well-known sites such as Yahoo and Excite and lesser known sites such as Google and the Electric Monk. She went to sites that search multiple search engines, such as SavvySearch and Dogpile. Knowing that Commerce Clearing House (CCH) was the publisher of *Taxes* magazine, she went to the CCH site but found only a solicitation to subscribe to the printed version of the magazine. Still, despite all her effort and time, the article eluded her.

An oft-quoted 1999 study by the NEC Research Institute of Princeton published in the journal *Nature* estimated that the most comprehensive search engine covered only 16% of the Web and that the top 11 search engines combined cover only 42%. (See *Beating the Search Engines Odds*, CPA Expert, Summer 1999.) Clearly, the article my friend sought was in the remaining 58%. So what is in the majority of the Web and why can't search engines reach there?

### STATIC VS. DYNAMIC WEB PAGES

Surprisingly, the vast majority of search engines are based on old technology. They were designed to search the static or flat HTML pages. Static HTML pages are the basic Web pages most users are accustomed to. They look a bit like word processing documents dressed up with images and fancy fonts. A distinguishing feature of the static HTML page is that each page has a

unique URL. Say, for example, I wanted to go to the Tennessee State Board of Accountancy Web site. The Tennessee board is a division of the Tennessee Department of Commerce and its Web site resides on the State of Tennessee server. The URL for the board of accountancy is <http://www.state.tn.us/commerce/tnsba>, indicating that the static page for the Board of Accountancy is tnsba. Anytime I want to go to visit the Board of Accountancy site, I can use this URL and I will be taken to the same page each time.

The new technology on the Internet today is dynamic Web page creation. Dynamic Web pages are created on the fly by a database when a search is made. Increasingly, developers are adopting this technology because it allows flexibility and the ability to manage large quantities of data more effectively. Examples of sites that use dynamic Web page generation are MapsOnUS, the site that generates a map based on the address entered and the SEC EDGAR site that queries its database of filings to produce the filing matching the company name entered. Millions of sites use this method of generating pages in response to a specific query to do everything from looking up a zip code to retrieving an article.

Dynamic Web pages are similar in appearance to static Web pages, so it can be hard to determine just by looking whether the page is dynamic. You sometimes can tell by looking at the URL. Dynamically created Web pages have variable URLs that often are lengthy and contain punctuation. For example, the URL for the annual report of Lucent Technologies generated in response to my query on the FreeEdgar site is: <http://www.freeedgar.com/Search/ViewFilings.asp?CIK=1006240&Directory=950123&Year=99&SECIndex=11082&Extension=.tst&PathFlag=0&TextFileType=File&Size=484601&SFType=&SDFiled=&DateFiled=12/21/99&SourcePage=FilingsResults&UseFrame=1&OEMSource=&FormatType=10-K405&CompanyName=LUCENT+TECHNOLOGIES+INC.Whew!>

At this point you may be wondering what dynamic Web page creation has to do with



Eva Lang, CPA, ASA, a contributing editor, is chief operating officer of the Financial Consulting Group, Memphis. [www.fcglc.com](http://www.fcglc.com); phone: 901-747-4224; [lemay\\_lang@csi.com](mailto:lemay_lang@csi.com).

## URLs for Sites Mentioned in This Article

Yahoo .....	www.yahoo.com
Excite .....	www.excite.com
Google .....	www.google.com
Electric Monk .....	www.electricmonk.com
SavvySearch .....	www.savvysearch.com
Dogpile .....	www.dogpile.com
Commerce Clearing House .....	www.cch.com
MapsOnUs .....	www.mapsonus.com
EDGAR .....	www.sec.gov
FreeEDGAR .....	www.freeedgar.com
Lycos Invisible Web Catalog .....	dir.lycos.com/Reference/ Searchable_Databases
iSleuth .....	www.isleuth.telebase.com
Direct Search .....	gwis2.circ.gwu.edu/~gprice/direct.htm
WebData .....	www.webdata.com
AlphaSearch .....	www.calvin.edu/library/as
Powerize .....	www.powerize.com
Uncover .....	uncweb.carl.org
Lexis/Nexis .....	www.lexis-nexis.com
Dow Jones Interactive .....	www.djnr.com
Dialog .....	www.dialogweb.com

search engines. Here is the answer. Without special programming, a search engine cannot find the dynamically created Web pages generated from databases. Search engines hate convoluted URLs like the one above. Most search engines will not index URLs with unusual characters or symbols or those resulting from Common Gateway Interface (CGI) programming which are identified by the `cgi-gin` in the URL.

That is not the only problem search engines have with Web sites that create dynamic pages. When a search engine gets to the search entry box on a site like the one where I entered the name Lucent to obtain the 10-K above, it stops cold. That is why you can't find EDGAR documents using conventional search engines such as Yahoo or Excite. If an EDGAR document does show up in the search results, it is because someone has copied that particular document onto a static page. This may happen when a company puts its SEC filings on the

company Web site for the convenience of visitors.

The 58% of the Web not accessible to conventional search engines is referred to as the Invisible Web. In addition to dynamic pages, the Invisible Web also includes information in formats such as graphics, word processing, and spreadsheet files. Other things can repel search engines and relegate sites to the Invisible Web, such as sites that require registration or sites that don't want to be searched (the Garbos of the cyberworld).

### ACCESSING INVISIBLE SITES

So how do you access documents in the Invisible Web? Unfortunately, there is no super Invisible Web searcher that overcomes the problem of a search engine's inability to query databases, but it is getting easier to penetrate the Invisible Web and find articles like *Life after Davis Estate: Valuation Discounts for Built-in Capital Gains Tax Liabilities*. Sites are assembling collections of databases so users have a starting point for research and a way to identify available databases. Two sources, the Lycos Invisible Web Catalog and I-Sleuth, were discussed briefly in the Summer 1999 issue of the CPA Expert.

The Lycos Invisible Web Catalog launched in July 1999 covers thousands of searchable databases, archives, and other information sources that deliver highly targeted information. For example, the construction industry category has links to full-text back issues of more than a dozen trade publications and the finance section links to detailed IPO information on thousands of companies.

I-Sleuth is a directory of searchable databases with a variety of subjects ranging from business to medicine. The business section gives you access, for a small fee, to detailed company information including D&B credit reports, market research, industry analysis, and population statistics.

Continue your infiltration of the Invisible Web with stops at Direct Search, WebData, and AlphaSearch. Direct Search is a database listing maintained by Gary Price, a librarian at George Washington University. The selection of databases here is eclectic, ranging from Threatened Animals of the

World Database to NASDAQ Monthly Share Volume Reports. All the databases are listed on a single (static HTML) page, so be prepared to scroll to find databases of interest.

It is easy to be distracted from your task of searching databases at WebData. The home page has a tempting array of comparative shopping guides that will let you compare prices on items as diverse as airfares and flowers. Don't be swayed by the CD sale (only \$9.59 for Stan Getz At Storeville!); go directly to the databases section and you will find databases in a variety of subject areas. The content in the business section is somewhat thin, but you still can find databases such as the Mercury Venture Capital Survey, a searchable database of U.S. companies that received venture capital financing, and the Florida Business and Professional Regulation Database of vendors licensed to sell alcoholic beverages.

AlphaSearch, compiled by Calvin Theological Seminary, has a much smaller collection of databases but the choices are high-quality sites focusing primarily on academic sources. The business and economics section includes a link to the FDIC database of demographic data and financial profiles for U.S. financial institutions.

PERIODICAL DATABASES

If you are looking for articles, consider using one of the Web's periodical databases such as Powerize or Uncover. Powerize.com, launched in 1999, has a large collection that draws on more than 10,000 sources including newswires, newspapers, newsletters, and journals. The site indexes 32 million articles, profiles, reports, analyses, and other documents. Approximately one-fourth of the items in the Powerize database can be downloaded at no charge; the remaining items can be purchased individually, most for less than \$5 each.

Carl Uncover is a database of current article information taken from more than 18,000 multidisciplinary journals. It includes approximately 9 million articles published since 1988. The Carl Corp. has been providing high-quality periodical management to libraries for years and has access to periodicals not easily obtainable elsewhere. Like Powerize, searching the Uncover database is free. Unfortunately, rather than making these articles available for download as does Powerize, UnCover faxes copies of the article (if the publisher permits) for a small fee.

Many of the databases on the Invisible Web now accessible through the sources described above were once available only through large commercial research services such as Lexis/Nexis, Dow Jones Interactive, or Dialog. These commercial

## COURTS WANT FACTS, NOT FAIRY TALES

Unpublished District Court Order Rejects Expert Testimony on Causation and Damages

In *Children's Broadcasting Corporation v. The Walt Disney Company and ABC Radio Networks, Inc.* (U.S. District Court, District of Minnesota case no. 3-96 CIV 907), the plaintiff's financial expert, a CPA, relied on his client's financial projections prepared prior to the litigation as a basis for his estimate of lost profits. This is not an uncommon situation for CPAs. The court's view of this approach, however, came from the

federal court judge who harshly criticized the plaintiff's expert in an unpublished court order dated January 15, 1999. The case provides an insight into issues associated with lost profits as well as those associated with causation.

In the case, the jury found for the plaintiff and awarded substantial damages. However, the federal court judge overruled the jury's verdict for several reasons, some of which are discussed below.

BACKGROUND

CBC, which produced and broadcast children's radio programming, entered into an agreement with ABC Radio in November 1995. The agreement specified that ABC Radio would assume responsibility for

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CBC's national advertising sales and assist CBC in affiliate marketing and expansion. The agreement was terminable on 90 days notice by either party and specifically provided that it did not limit the ability of ABC Radio or companies affiliated with ABC Radio to produce or market a competing product.

Several months before the agreement, Disney had announced plans to acquire ABC, Inc., which included ABC Radio as a subsidiary. About eight months after the agreement was reached, ABC Radio notified CBC that it intended to terminate the agreement. On the same day, ABC Radio and Disney announced their intent to create Radio Disney, a children's radio format in direct competition with the CBC programming. The first broadcast of Radio Disney was after the 90-day termination notice expired.

#### CAUSATION

The plaintiff's CPA expert testified as to causation and damages. The court found that [a]lthough [the plaintiff's expert's] testimony was lengthy, it lacked any credible analysis to support his causation theory. The substance of [the] testimony regarding causation was that any breach of contract by ABC Radio, no matter how minor, or any misappropriation of a trade secret, no matter how minor, was responsible for the destruction of CBC's entire business and caused damages in the sum of \$177 million. No facts support [these] conclusions, and [the plaintiff's expert] never explained how any particular breach or misappropriation by ABC Radio or Disney could cause damage to CBC. Remarkably, [the expert] testified that he did not know specifically what information was allegedly misappropriated by the Defendants, but he assured the jury that whatever the information was it caused [CBC's children's programming] to go out of business.

#### DAMAGES

The plaintiff's CPA expert prepared and presented CBC's damages and stated that every alleged breach of contract or misappropriation of trade secrets was responsible for CBC's children's programming failure. He valued the programming at \$177 million. He reached that amount by extending into the

future financial projections prepared primarily by CBC several months before the agreement between CBC and ABC Radio, subtracting the value of CBC as of the date of trial, and then grossing up the resulting figure to account for income taxes to be paid by CBC. The expert opined the damages the defendants caused were \$177 million.

The court found that [t]he first difficulty with [the plaintiff's expert's] testimony was that it relied on inaccurate and unreliable financial projections. The evidence at trial established that the projections did not actually describe what actually occurred [later that year and prior to the CBC-ABC Radio agreement]. [The expert] offered projections in court that went so far beyond realistic optimism so as to have a fairy-tale like tone to them.

The court also said the jury rejected the plaintiff's expert's testimony and had to resort to speculation and conjecture to arrive at its verdict on damages (which the judge overruled).

#### LESSONS FOR EXPERTS

First, let's discuss the damages. The court said the plaintiff's expert's financial projections have a fairy-tale like tone to them. How many of us would want a comment like that about our work put in writing? The expert will likely hear this comment again when being cross-examined on other engagements?

The plaintiff's CPA expert relied on the client's financial projections prepared prior to the alleged wrongful actions and litigation. How many times has this been done? Yet it was rejected strongly by this court. Why? The court considered how accurate the projections were (compared with the actual financial results after the projection but before the alleged wrongdoing) and found they were not very good. Hence, it rejected the projections that were the foundation for the expert's damage opinion. (Alternatively, courts can examine the company's history of making accurate projections.) Not only did the court reject the projections and resulting damages of \$177 million but also it harshly criticized the expert for not rejecting them himself.

Second, the court noted that the expert failed to support his causation opinion with facts. Although it seems obvious, an expert

Michael A. Crain, CPA/ABV, is a shareholder of Peed, Koross, Finkelstein & Crain, PA, Fort Lauderdale, a member of the Financial Consulting Group. E-mail: mcrain@pkfccpa.com. He is a past member of the AICPA Litigation and Dispute Resolution Subcommittee and currently serves on the Accredited in Business Valuation (ABV) Examination Committee. He adapted this article from a Financial Consulting Group case analysis.

witness should not be rendering opinions as based on my experience or because I'm the expert. Nevertheless, it is not uncommon to hear such statements, even from very experienced CPAs. As recently underscored in the Kuhmo Tire case, expert witnesses rely on facts and data to form their opinions.

PLAYING BY THE RULES

Let's revisit what the courts expect from expert witnesses. Note the use of the terms facts and data in the first sentence of Federal Rule of Evidence (FRE) 703 (Bases of Opinion Testimony by Experts):

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence.

Furthermore, the Notes of Advisory Committee on Rules elaborate the meaning of the FRE. Regarding Rule 703, they say that [f]acts or data upon which expert opinions are based may, under the rule, be derived from three possible sources. The first is the firsthand observation of the witness, with opinions based thereon traditionally allowed. A treating physician affords an example. The second source, presentation at the trial, also reflects existing practice. The technique may be the familiar

hypothetical question or having the expert attend the trial and hear the testimony establishing the facts. The third source contemplated by the rule consists of presentation of data to the expert outside of court and other than by his own perception. In this respect the rule is designed to broaden the basis for expert opinions beyond that current in many jurisdictions and to bring the judicial practice into line with the practice of the experts themselves when not in court. Thus a physician in his own practice bases his diagnosis on information from numerous sources and of considerable variety, including statements by patients and relatives, reports and opinions from nurses, technicians and other doctors, hospital records, and X-rays. Most of them are admissible in evidence, but only with the expenditure of substantial time in producing and examining various authenticating witnesses. The physician makes life-and-death decisions in reliance upon them. His validation, expertly performed and subject to cross-examination, ought to suffice for judicial purposes.

What does all of this mean? It is a healthy reminder to us that the courts expect expert witnesses to perform a detailed analysis of the facts and data before reaching an opinion. Gut feelings and in my experience are not what the courts want to hear, nor should they. Nevertheless, it happens all the time. Perhaps one of the key differences between a good CPA expert and a not-so-good one is how he or she can relate the facts and data to

The courts expect expert witnesses to perform a detailed analysis of facts and data before reaching an opinion.

Mark Your Calendar

The following AICPA conferences may be of interest to readers:

National Advanced Conference on Divorce

May 22-23, 2000, Caesar's Palace, Las Vegas  
Pre-conference workshop on May 21

Advanced Medical and Legal Practice Consulting Conference

June 8-9, 2000, Grand Hyatt Washington, DC

Advanced Estate Planning Conference

July 24-26, 2000, Boston Marriott Copley Place  
Pre-conference optional session, July 23  
Post-conference optional session, July 26

National Conference on Fraud

September 21-22, 2000, Caesar's Palace, Las Vegas  
Pre-conference optional session September 20, 2000

Advanced Litigation Services Conference

October 16-17, 2000, The Beverly Hilton, Beverly Hills, California

National Business Valuation Conference

November 12-14, 2000, Loews Miami Beach Hotel at South Beach

For more information, call 888-777-7077.

## BOOK

YEAR 2000 VALUATION  
EDITION OF SBBI:A  
REVIEW

The second annual Valuation Edition of Ibbotson Associates (IA) Stocks, Bonds, Bills and Inflation (SBBI) yearbook soon will be available. The classic edition of the SBBI yearbook has been updated each year since 1976, when Roger Ibbotson analyzed the long-term returns of the principal asset classes in the U.S. economy. Ibbotson documented the relationship between financial risk and return and quantified the ability to reduce risk through diversification. The underlying study of long-term returns on asset classes also led to the development of cost of capital concepts such as the equity risk premium and the size premium.

To meet the special needs of business valuers, IA published a Valuation Edition (VE) of SBBI in 1999. The VE added a discussion of discounted cash flow (DCF) concepts and expanded its coverage of beta and the Capital Asset Pricing Model. A key feature of the 1999 VE that many valuation professionals found very helpful was the expanded coverage of size premiums. This coverage facilitated quantification of risk, using the IA empirical data, based on size of entity considerations. Another excellent feature was its expanded discussion of the underlying theory of capital market behavior over time and the related influence on risk and rates of returns.

## FEATURES OF THE SECOND EDITION

The new VE expands the coverage of the

use of Ibbotson data in the build-up method of rate determination, new industry risk premiums to be used in the build-up method, and a new study of size premiums

by industry. The chapter on international cost of capital considerations provides some interesting guidance on the capital markets in several established and developing countries, much of which draws on capital market studies by Morgan Stanley, as well as Ibbotson research. (More detailed international data can be obtained in the Ibbotson International Cost of Capital Report at <http://valuation.ibbotson.com>)

Added to the VE book this year are the key summaries of statistical data and tables included in the classic edition. Most of the statistical data are in appendices, which makes it much easier to digest the text the data support.

Table 1-1 of the VE offers an excellent snapshot of key data points, showing a summary of annual returns for the 1926-99 period. The data, sorted by geometric and arithmetic means, are presented with the standard deviations and serial correlations for the various stock market classes (for example, large, mid-cap, and micro-cap stocks and a new category called Ibbotson small company stocks), corporate and government bonds, treasury bills, and inflation.

This year's VE also expands the discussion of the build-up approach to rate determination with examples of how IA data should be used with this approach. The focus of the VE continues to be on the development and application of discount rates under the DCF approach to valuation. There is also a very good basic discussion of the relationship between discount rates developed using IA data and tax rate assumptions, the use of cash flows vs. other benefits streams, and the impact of debt- and weighted-average-cost-of-capital-related methods. The new VE also covers the Fama-French Three Factor model and beta estimation methodologies in detail.

## INDUSTRY RISK PREMIUMS

The most important component of the new VE is its expanded discussion and quantifi-

## Additional Business Valuation Resources

I urge practitioners to tour the new Ibbotson Cost of Capital Web site to learn about other useful resources available for nominal fees on a per-usage basis. The resources include tax rate studies and Ibbotson's Cost of Capital Quarterly data by SIC code. In addition, new information important for valuers of small valuation subjects is available: the full text of the recent update of the ongoing PriceWaterhouseCoopers studies by King and Grabowski, which further break down the 10 deciles studied for size premiums into 25 size categories sorted by various criteria, such as number of employees and total assets.

cation of industry risk premiums, which are derived from the beta estimation process, also covered in detail. IA has developed an industry premium methodology that business valuers can use to build rates and cite in their reports. IA developed these data by quantifying a risk index for each industry included in the study, comparing the specific risk of that industry to the market as a whole over time. Table 2-3 of the VE, for example, lists estimates of industry premiums for more than 60 general SIC codes as of September 30, 1999. The estimates are shown as percentage adjustments ranging from 2.59% to +7.41%. The text includes some excellent examples of how to apply

the new data in build-up rate determinations.

The new VE book also expands coverage of the relationship between company size and returns, with the new coverage integrating the new industry effects as well. (Look for an article on this aspect of the IA data, with a thorough analysis of the underlying concepts on size premiums by Harold Martin, Barry Sziklay, and Steve Bravo in an upcoming issue of CPAExpert.)

Priced at \$110 for one year and \$199 for two years, the VE, with its evolving enhancements is a must-have for any valuation practitioner involved in risk assessment and rate determinations. To order,

Ronald L. Seigneur, CPA/ABV, CVA, is a member of the AICPA Business Valuation Subcommittee and serves on an Ibbotson Associates advisory panel for its cost of capital workshops. Contact ron@cpavalue.com.

## THE FUNDAMENTALS OF BUSINESS VALUATION: A NEW AICPA CURRICULUM

Opportunities for business valuation engagements continue to grow in number and scope. Recent surveys have confirmed that business valuation is one of the fastest growing practice segments for qualified practitioners. At the same time, the skill set necessary to practice competently in this area has evolved to a much higher degree of specialized knowledge, which requires access to more sophisticated resources.

Recent emphasis on the need for competent valuation services by governmental and regulatory bodies, such as the IRS and the courts, has added to the need for practitioners to undertake a sincere lifelong learning commitment to excel in this discipline. The four recognized U.S. organizations providing business valuation credentials (the AICPA, the American Society of Appraisers, the Institute of Business Appraisers, and the National Association of Certified Valuation Analysts) have responded to the increased need for enhanced, cutting-edge business valuation education.

### FROM CEA TO FBV

One of the AICPA's responses to this oppor-

tunity is the new Fundamentals of Business Valuation (FBV) curriculum, which has evolved from the Certificate of Educational Achievement (CEA) offerings. The FBV program responds to the emerging trends in the business valuation profession. A

group of carefully selected, nationally recognized authors over the past year have updated the CEA materials for this new program. In 2000, the curriculum will move from a format of eight one-day modules to two three-day courses covering the fundamental aspects of business valuation knowledge.

The FBV educational objective is to provide participants with a basic knowledge required to practice in the BV arena. The curriculum is not intended to provide everything a practitioner needs to know to be successful and fully competent in all aspects of the discipline but, rather, to cover the core competencies of the BV body of knowledge. Unlike the CEA one-day courses, no examination is given and no certificate of completion is awarded at the end of the program. Each of the two three-day programs can be taken independently of the other, although both are recommended in order to obtain a full overview of the underlying subject matter.

### BODY OF KNOWLEDGE

The program focuses on the body of knowledge used to create the Accredited in Business Valuation (ABV) program. Participants

## Fundamentals of Business Valuation Offerings

The Fundamentals of Business Valuation (FBV) I and II are offered by state CPA societies. As of now the tentative offerings in the year 2000 are

State	FBV I	FBV II
Arizona	August 2	
Colorado	June 22	July 20
Indiana	September 13	October 18
Kentucky	August 14	
Michigan	June 8	October 12
Minnesota	May 17	August 28
New York	June 19	September 23
Oklahoma	June 19	
Texas		
Dallas	August 7	September 18
Houston	November 12	December 18
Washington	November 28	

who meet the qualifying criteria and are planning to sit for the ABV examination will benefit from the FBV curriculum, although it is not specifically developed as a preparation program for the ABV exam. The Institute has a separate two-day ABV review course, which serves as a refresher on the BV body of knowledge, which the exam tests on.

### CASE STUDY APPROACH

A unique aspect of the curriculum is a detailed case study of a 15-unit steakhouse restaurant business, which researches and

analyzes all aspects of the business, leading up to a final conclusion of value. This case study allows the FBV participants to apply the concepts and valuation principles covered in the program to a real-life factual valuation engagement. It includes evaluation of economic trends, consideration of proper normalization adjustments, discount and capitalization rate determination, and the proper quantification and application of discounts and premiums. The case study is

based on an actual valuation assignment undertaken by one of the program authors, with a format allowing for interactive class discussion of the rationale for each aspect of a valuation assignment.

Adding significantly to the quality of the curriculum, the FBV courses will be team taught by discussion leaders carefully screened, not only for their knowledge and experience in business valuation principles, but also for skills in leading dynamic and engaging discussions.

The new three-day format best serves the widest range of constituents and emulates other successful educational offerings in the BV community. Although the AICPA recognizes this format requires a significant time commitment for both participants and sponsoring firms, it believes many participants are willing to travel to find such specialized knowledge. To justify the numbers required to support the program and its commitment to the team teaching concept, the Institute determined that the three-day format would best fulfill the curriculum objectives at a competitive cost. Many states have scheduled the two three-day segments to include a Saturday as the third day, thereby partially offsetting the business days required out of the office and possibly saving travel and lodging costs for many participants through the lower air fares offered for Saturday night stays. (See the tentative list of program sites on this page.)

Practitioners who want to increase or enhance the BV services already provided

## SPECIAL BENEFITS FOR ABVs

Ralph Ostermueller, CPA

A substantial discount will be available to CPAs who hold the ABV designation on compensation data research software purchased through the AICPA's newest affinity program participant, Economic Research Institute (ERI). A lesser discount will be available to all AICPA members. ERI's Com-

pensation Assessor software, which is most useful to business valuers, will be available to ABV holders for \$569 and to other AICPA members for \$669. The AICPA member price is a \$1,520 reduction from the regular price of \$2,189.

The AICPA marketing and product management team recruited this excellent provider of compensation data/software whose products are used worldwide by compensation professionals, business valuers, and tax and legal professionals (including the IRS). ABV designees will receive a 15% discount on all other ERI products purchased, and all other AICPA members will get a 10% discount.

Ralph E. Ostermueller, CPA is with the Ostermueller Group, St. Louis. He is a member of the AICPA Business Valuation Subcommittee.

COMPENSATION DATABASE SURVEY

ERI's Compensation Assessor software enables quick searches by SIC of SEC's EDGAR database, and quick downloads of available proxies and 10-Ks. Also available at ERI's Web site ([www.erieri.com](http://www.erieri.com)) will be a per each search service of ERI's formidable survey database for the average total compensation ranges for individual positions. The service will cost \$38, less the applicable 15% or 10% discount. The data provided are specific by position title, industry, company revenue, size, geographic region, and time period.

ERI will begin this offer in March on its Web site, and through the AICPA Web site ([www.aicpa.org](http://www.aicpa.org)), as well as through direct mailings to AICPA members.

EXECUTIVE COMPENSATION ASSESSOR

ERI's Executive Compensation Assessor (ECA) software reports competitive salaries and bonuses for more than 300 senior management positions in multiple industries. Data can be adjusted for geographic area, industry, organization size, and compensation valuation date. The ECA can assist the practitioner in making precise evaluations of market pay. It is the only source of its kind that analyzes data compiled from all public executive compensation surveys along with direct analyses of SEC proxy data.

When subscribers use the software with ERI's Platform Library, they can review the actual proxy data used to create ECA's projected weighted averages and ranges. In addition, a menu allows users to select up to five elements of comparable companies' summary proxy data to be included in a print report. The data includes the following elements:

- s Individual profile.

- s Executive maximum reasonable compensation analyses.

- s Position descriptions.

- s Selected comparable companies.

- s ERI methodology.

- s About ERI.

Competitive base salaries and annual incentives for senior management are reported by industry, date, organization size, and geographic area. The specific position incumbents that were used to develop the salary ranges and averages are reported for these positions, based on the availability of proxy data by industry and executive position.

A graph plots the actual proxy data points with varying sized points to indicate the closeness of the match. Additionally, 2-digit, 3-digit and 4-digit SIC matches can be displayed. By selecting a dot on the PC screen while using ERI's Platform Library, the user can display the actual salary data extracted from the proxy.

Subscribers can use filters to review only companies within a specific SIC/NAIC or geographic area. The Platform buffer contains the SIC number last used in an ECA file so that the closest public company's compensation proxy data are automatically extracted (as a default) for comparison purposes.

ERI audits the results of other executive compensation surveys with its analysis of proxy data. The analysis uses base salary and annual incentives with maximum reasonable compensation ranges being set at 3.01 standard error above the mean in a skewed distribution for IRS tax planning.

The system requirements are a Windows95 or later operating system or MAC (with Virtual PC), and 7Mb hard drive space for ECA. Platform Library can be accessed from a CD-ROM or copied onto the hard drive (250 Mb without some geo-

Attention ABV Holders

If you earned the Accredited in Business Valuation (ABV) designation before November 1999, you should have been receiving the AICPA ABV E-Valuation Alert, an electronic newsletter exclusively for holders of the ABV designation. Attempts to send the newsletter via e-mail to some designees has failed

because the e-mail addresses on record are out-of-date.

If you have not received the Alert (four issues have been mailed since December 1, 1999), please contact Madeline Feldman, ABV Coordinator, at 201-938-3653 or [mfeldman@aicpa.org](mailto:mfeldman@aicpa.org). If you do not have an e-mail address and would like the Alert faxed to you, call 201-938-3502.

FYI

## ABV POOL INCREASES BY 28%

The results of the third examination for the Accredited in Business Valuation (ABV) designation are in: 241 new ABV holders were added to the existing pool of 849 for a grand total of 1,090 ABV designees. The next ABV exam is scheduled for November 6, 2000 at locations to be determined.

## CLINTON PROPOSES CONSISTENT VALUATION FOR ESTATE AND INCOME TAX PURPOSES

Steve Leimberg's News of the Week (February 2, 2000) reports that President Clinton's tax proposal would require consistent valuation for estate and income tax purposes. A person taking a basis under Code Section 1014, property acquired from a

decendent, would be required to use fair market value as reported on the estate tax return if one is filed as the basis for the property for income tax purposes, to require an allocation of basis for part-sale/part-gift transactions (bargain sale rules), and to eliminate nonbusiness-valuation discounts (except as they apply to active businesses). ([www.leimberg.com](http://www.leimberg.com))

## FRAUD HANDBOOK AVAILABLE

The CPA's Handbook of Fraud and Commercial Crime Prevention is available from the AICPA. The Handbook is a comprehensive reference source that features:

- s Ten chapters on fraud prevention.
- s A Microsoft Word disk containing checklists.
- s Business sector case studies.
- s An annual update.
- s A bi-monthly newsletter.



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