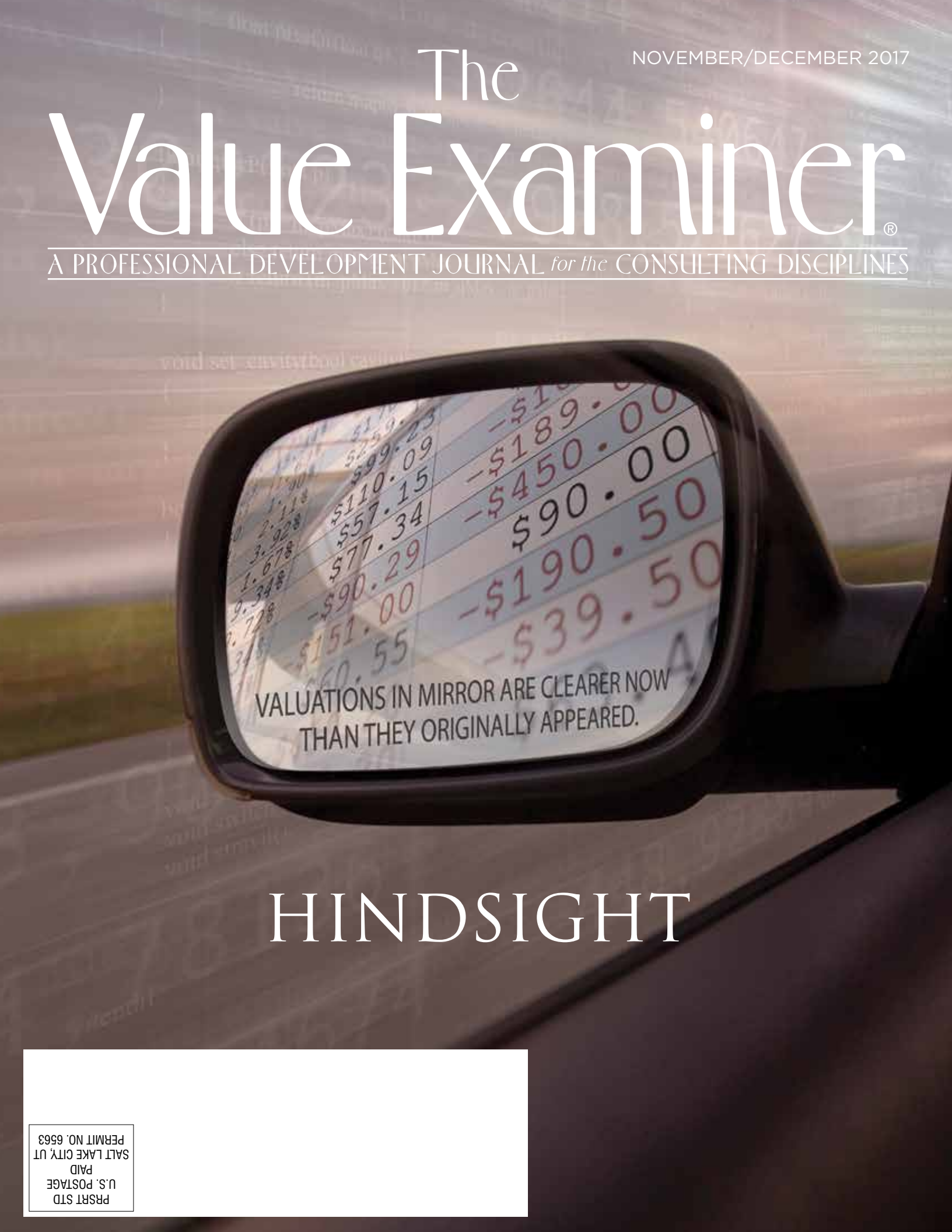
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On The Cover



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THE VALUE EXAMINER: The Year in Review

By Nancy McCarthy, Senior Editor, The Value Examiner

Hindsight can teach us a lot. As we wrap up 2017, *The Value Examiner* takes an opportunity to present three articles that previously appeared in the publication that touch on things all practitioners may wish to keep in mind in the coming year. We also give a nod to the present and the future with our columns and thank the contributors who made the year possible.

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By Martin H. Abo, CPA, CVA, ABV, CFA, CFF

Despite our constitutional right to a fair and unbiased hearing, some defendants are perceived guiltier than others, even before their day in court. High profile cases involving celebrities, government officials, or people with ties to organized crime—to name a few—can be tried and convicted in the media—both conventional media and social media. One intrepid professional found that sticking to the basics can help you keep your eye on task at hand. This article originally appeared in the Special Issue of *The Value Examiner* in September/October 2016.

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ACADEMIC REVIEW

ONE OPINION ON THE DIRECTION OF BUSINESS VALUATION PROGRAMS IN ACADEMIA: AN INTERVIEW WITH PETER LOHREY, PHD, CVA, CDBV

By Nancy McCarthy, Senior Editor, The Value Examiner

Peter Lohrey has been contributing to "Academic Review" for the past eighteen months. His column is a compendium of significant works in academia related to business valuation. In this month's issue of *The Value Examiner* we have the opportunity to know a bit more about Peter and his thoughts on the direction of business valuation programs in academia.



LITIGATION CONSULTING

HOW THIS BAND ROCKED THE BUSINESS WORLD

By David Bookbinder, ASA, CEIV

Contracts are important. As this article, reprinted from the Huffington Post with the permission of the author points out, reading the contract determines if the band goes on or if everyone goes home.

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By Eric A. Kreuter, PhD, CPA, CGMA, CMA, CFM, CFFA, CFE, CBA; and Eric J. Barr, CPA, ABV, CFF, CVA, CFE

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ROBERT JAMES CIMASI, MHA, ASA, FRICS, MCBA, CVA, CM&AA

By Nancy McCarthy, Senior Editor, The Value Examiner

The Value Examiner honors the passing of one of the titans of the industry.

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The Value Examiner is devoted to current, articulate, concise, and practical articles in business valuation, litigation consulting, fraud deterrence, matrimonial litigation support, mergers and acquisitions, exit planning, and building enterprise value. Articles submitted for publication should range from 500 to 3,000 words. Case studies and best practices are always welcome.

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All articles should be thoroughly edited and proofread. Submit manuscript by e-mail (in standard word processing format) to Nancy McCarthy: NancyM1@NACVA.com. Include a brief biography to place at the end of the article and a color photo of the author. See authors' guidelines and benefits at www.nacva.com/examiner/Publishing_Articles.pdf. *The Value Examiner* accepts some reprinted articles, if accompanied by appropriate reprint permission.

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VALUATION

The Value Examiner: The Year in Review

By Nancy McCarthy, Senior Editor, The Value Examiner

There is something of a Dickensian mindset this year as we prepare this issue: we have decided to do a bit of past, present, and future. Hindsight is often the best teacher. In that vein, we have reprinted some popular feature articles from past issues. From January/February 2014 we are reprinting (with permission from the authors) "Valuation by a Monday Morning Quarterback," by Seth Fliegler, MBA, CFE and John Duvoisin, which discusses the role hindsight plays in valuation; "Defending the Devil: An Expert Witness Tells All," by Martin Abo, CPA, CVA, ABV, CFA, CFF, from September/October 2016; and "Impact of Inadequate Discovery in a Divorce Proceeding," by Eric A. Kreuter, PhD, CPA, CGMA, CMA, CFM, CFFA, CFE, CBA and Eric J. Barr, CPA, ABV, CFF, CVA, CFE, which appeared as part of Tips for Practitioners in January/February 2016.

The present is represented by a new series on healthcare by Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA and Todd A. Zigrang, MBA, MHA, FACHE, ASA. The first article in this six-part series is "The Due Diligence Imperative for the Valuation of Healthcare Enterprises, Assets, and Services."

Finally, the future is signified by two articles: Peter Lohrey, PhD, CVA, CDBV, our Academic Review columnist, shares his thoughts in an interview, "One Opinion on the Direction of Business Valuation Programs in Academia;" and Jim Crumlish, CPA, CGMA, our tax expert, breaks down the changes that may be coming via the new tax bill in his article, "The New Tax Bill: A Run Down on What is Changing." There is a whimsical piece by David Bookbinder, ASA, CEIV, on how a rock band rocked the business world. And, to think, it all started with brown M&Ms. Rounding out the issue, Rod Burkert continues his series on Sole Practitioners with an interview with Paul Wonch, CPA, ABV, CVA, MAFF, from Indianapolis, Indiana.

TRANSITIONS

Transitions are never easy. *The Value Examiner* is saying farewell to one friend and colleague and goodbye to another. Eric Bar, who has contributed so much in terms of his articles, insights, and suggestions, will be retiring at the end of the year. He will continue to participate on the editorial board through June of next year, but I want to personally thank him now for all the work he has done professionally and for this publication. His contributions will be missed, but he has some wonderful adventures planned and I can't help but wish him the best and hope he thinks of his friends at TVE from time to time! Another goodbye is much harder to report. Sadly, this is Bob Cimasi's last series of articles in *The Value Examiner*. Bob passed away on December 6, 2017. His memorial also appears in this issue.

AULD LANG SYNE

No end of year issue would be complete without a thank you to the contributors, columnists, editorial board, editors, designers, production, who review, comment, edit, design, lay-out, and ultimately get the publication out the door. It is not a simple process and I am constantly reminded how talented, committed, and sometimes just plain determined everyone involved with TVE are. The names of our board members are listed in the masthead; and to them I want to say a heartfelt thank you for your continued support over the

years. We had an enviable list of contributors this year and I want to thank them, too, for staying with the process from initial submission through Peer Review and final print.

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As always, I want to thank Brien Jones, NACVA Chief Operations Officer and Executive Vice President, and CEO & Publisher, Parnell Black for their continued support and insights.

All the Best,

Nancy McCarthy

Senior Editor,

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VALUATION

Defending the Devil: An Expert Witness Tells All

By Martin H. Abo, CPA, CVA, ABV, CFA, CFF

In spite of our constitutional right to a fair and unbiased hearing, some defendants are perceived guiltier than others, even before their day in court. High profile cases involving celebrities, government officials, or people with ties to organized crime—to name a few—can be tried and convicted in the media—both conventional media and social media. Popular opinion cannot be easily dismissed; in varying degrees, it can influence the participants in the judicial system from the jury pool to the presiding judge. This prejudice—warranted or otherwise—can make the role of an expert witness for the defense a carefully negotiated minefield of protocol.

A case in point is one which involved known members of a Philadelphia-based crime family, a businessman with legitimate successes, but with unsavory ties to the crime family, racketeering charges, and an accountant from New Jersey, Martin Abo, CPA, CVA, ABV, and CFF. This is his story.

IT AIN'T PERSONAL. IT'S BUSINESS

In 2013, Nicodemo S. Scarfo—son of jailed mob boss "Little Nicky" Scarfo—and eleven associates were brought to

THE RIGHT TO A FAIR TRIAL

One of the very basic tenets of the American judicial system is that defendants are guaranteed the "right to a speedy and public trial." Specifically, the Sixth Amendment to the Constitution states:

> *In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defense.*[1]

Over the past 250 years, the rights guaranteed in the sixth, seventh, and other amendments have been clarified, refined, explained, and codified. In the twentieth century, landmark decisions regarding rules of evidence gave interpretations of what could and could not be used as "expert evidence." Starting with Frye[2] in the 1920s, to the development of the Federal Rules of Evidence in 1975,[3] to the Daubert[4] Standard increasingly used in modern court proceedings, have attempted to give the courts as much information as possible to render fair and unbiased decisions.

Further ensuring that defendants are given fair representation, both the federal government and the states have striven to guarantee that defendants are provided with professional legal counsel. The Criminal Justice Act (CJA), first enacted in 1964, has ensured this representation. In 1970, Congress established a full-time federal defender service within the judicial branch. Today, nearly ninety percent of federal criminal defendants are aided by lawyers, investigators, and experts paid for under the CJA.

1 U.S. Const. amend. XI. Sec. 2.
2 *Frye v. United States*,293 F. 1013 (D.C. Cir. 1923).
3 Rule 702. Testimony by Expert Witness (Pub. L. 93–595, §1, Jan. 2, 1975, 88 Stat. 1937; Apr. 17, 2000, eff. Dec. 1, 2000; Apr. 26, 2011, eff. Dec. 1, 2011.).
4 *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).

AMERICA'S FASCINATION WITH ORGANIZED CRIME

The fascination with organized crime—in particular with the Mafia—reached its peak in the early 1970s with the release of the movie, The Godfather, and with the novel on which it was based by Italian American author, Mario Puzo. Puzo's book, and the subsequent movies directed by Francis Ford Coppola, whetted America's appetite for knowledge about the secret organization. However, almost from the early days in this country, the Mafia has held a certain appeal with the general public. The organization itself was shrouded in mystery in those early years and, to some extent, still is. According to the website Complex http://www.complex.com/pop-culture/mafia-influence-on-pop-culture-today), the Mafia has been in America since the late 1800s:

> *The Mafia has always relied on secrecy and misdirection... This extends even to the mention of its criminal activities in common conversation. For the Mafia, there is no Mafia. There is only Cosa Nostra, or "our thing." Within the nascent American Mafia of the early 1900s, this term came to signify a new order in its new home.*[5]

While a defendant's prior behavior or connections should not have a bearing on a current court case, it can be difficult to ignore. This is nowhere more apparent than when the defendant has ties to organized crime. Popular culture has made the world of "dons" and "consiglieres" almost accessible. Movies such as The Godfather or TV series' such as The Sopranos, give a peak into a world where respect is gained through fear, and where force and intimidation are signs of strength. In its series on the Mafia, entitled From Bootleggers to MCs: The History of the Mafia in Popular Culture, the website Complex says:

> *...the Mafia quietly embedded itself in all phases of American life, and popular culture was no exception. Hollywood was enamored with gangsters and the early days of American cinema saw countless depictions of mob life... One of the earliest gangster hits was the film, The Public Enemy, released in 1931, starring Jimmy Cagney. Close to sixty years later, Public Enemy (the rap group) would be one of the most important groups in hip-hop, speaking for a generation of inner city youth.*[6]

5 From Bootleggers to MC's: The History of the Mafia in Pop Culture, Complex, www.complex.com/pop-culture/mafia influence-on-pop-culture-today.
6 *Ibid.*

trial by the federal government. The 108-page federal criminal indictment for racketeering charged, among other things, that Scarfo and his associates (including long-time friend and business man, Salvatore (Sal) Pelullo) took over the Texas-based[1] firm, FirstPlus Financial, by illegal methods. By using fear and intimidation, the government alleged the defendants had stolen at least twelve million dollars from the company. This money, it was charged, had gone to furnish lavish lifestyles that included expensive homes, a plane, and a yacht.

According to FBI Special Agent Joe Gilson, "Essentially, Scarfo and Pelullo used extortion and other illegal means to gain control of the company. And then they systematically looted the company."

AN OFFER THEY COULDN'T REFUSE

In the mid-1990s, FirstPlus was a successful multimillion-dollar mortgage company specializing in second mortgages. In 1999, its leading subsidiary went bankrupt—primarily because Wall Street's appetite for sub-prime loans which were packaged and sold as securities to institutional investors had soured. By 2006, the company was receiving money into a trust. The trust had a total of forty-one million dollars. According to the government, Scarfo, with the help Pelullo, took over the ailing company in 2007. According to Scarfo and Pelullo, it was their intention to restructure the company and build it back into a viable, multi-integrated operation. Pelullo put in place a business model that had been successful in turning around another company he had acquired in 2005. He also recommended friends and associates with expertise in business to serve on the company's board of directors.

In its indictment, the government alleged that the defendants and several others—including Scarfo's father who gave his blessing from the confines of federal prison—had several meetings about taking over FirstPlus, and they threatened the existing management. The government further alleged that Scarfo and Pelullo then coerced FirstPlus to purchase, in exchange for millions of dollars, companies owned and controlled by the two defendants.

1 According to the bylaws, the company was based in Nevada, but doing business in Dallas, Texas.

The government noted, although Scarfo and Pelullo were running and controlling the company, their names never appeared on any company documents, or on filings with the SEC, or other government agencies. Testimony from former employees and associated professionals, including a top Pelullo aid turned informant, Cory Leshner, helped the government build its case. According to the indictment, the men used both "physical and financial threats" to take control of FirstPlus in order to plunder the company for their own financial gain. Scarfo, Pelullo, and their partners replaced the company's board of directors (which at one time included former vice president Dan Quayle and pro-football great Dan Marino) with their own cronies. They then named their accomplice, lawyer William Maxwell, as special counsel to FirstPlus so that Maxwell could use that position's authority to funnel millions back to, whom the government termed, "the mobsters." In a raid of a yacht owned by the Scarfo and Pelullo Family Trust, the FBI found a cache of handguns, rifles, a shotgun, and more than 2,500 rounds of ammunition.

The case, which took six months to prosecute, included expert testimony from both sides, extensive presentation of bank documents, and wiretap recordings. Assistant U.S. Attorney Steven D'Aguanno and FBI Agent Joseph Gilson lead the probe which also included the SEC; The Department of Labor; and the Bureau of Alcohol, Tobacco, Firearms, and Explosives. Paul Fishman, U.S. attorney for New Jersey, prosecuted the case. According to Fishman, the defendants gave new meaning to the term "corporate takeover."

Lawyers for the defense argued that the prosecution was capitalizing on Scarfo's father's association with organized crime.[1] The defense also argued FirstPlus was in turmoil well before Scarfo and Pelullo took control in 2007. They maintained FirstPlus—and the defendants—were impacted by the poor economy, cash flow, and growing pains typical of any "main street" business and even public companies. Finally, they contended the defendants were victims of the crippling and purposely timed raid by the FBI. Significantly, they argued that the negative coverage of the company's woes was exaggerated in the press and other media once the federal investigation became public.

TAKE THE BUSINESS DOCUMENTS; LEAVE THE ENGAGEMENT LETTER

Martin Abo was approached by the CJA-appointed defense attorneys regarding the business practices of Salvatore Pelullo. After much debate and discussion with his partner and others, Abo decided to accept the appointment. He knew this was going to be a long, involved case. There were thousands of financial documents seized by the government, which included accounting programs/ledgers, hundreds of bank statements, tax and regulatory filings, appraisals, pertinent communications, to name only some of the documents that needed to be analyzed and corroborated.

The question was deceptively simple: Did Pelullo observe legitimate business practices in the takeover of FirstPlus Financial? Abo's challenge was to review and assess the indictments alleging:

- Personal gain to the defendants through the takeover and alleged looting of FirstPlus
- Lack of disclosure and transparency by the defendants to avoid detection by the SEC, the public at large, the shareholders, and law enforcement
- Wire fraud in connection with the several consulting and legal services agreements

In choosing Abo, defense counsel was looking for an experienced and impartial expert witness who could provide a strong defense for Pelullo. Abo, a practicing CPA for forty years, has been involved in numerous business acquisitions and dispositions, has been a business appraiser—a past acting interim CFO/consultant to a public company—a director of a thirty-five-million-dollar healthcare enterprise, and has served on the board of a bank and as head of its audit committee.

In spite of its notoriety, Abo approached it like any other case. "As I have said in multiple conversations and presentations, it all begins with the engagement letter," says Abo.

"The basics still apply: set the parameters of what you will and will not do, get everyone to agree to that concept, determine the facts."

1 The elder Scarfo (who is serving a life sentence at the U.S. Penitentiary in Atlanta, Georgia) was a member of the Philadelphia-based crime family and is widely seen as the most violent mob boss of his era.

THE ENGAGEMENT LETTER

In any business situation, communicating the scope of your work is a way to manage expectations of the client and to minimize risk. The engagement letter allows you to:

- Define the services you are being engaged to perform
- Identify the responsibility and authority to avoid potentially severe penalties
- Explain fees, billing, and payment terms
- Assure the client that additional services will not be initiated without advance approval

This holds true whether you are dealing with the office of the CJA or with a private client. In this case, Abo wanted the client, the attorneys, and the judge to understand what he would and would not be doing.

DETERMINING THE FACTS

After sifting through thousands of pages of testimony and business documents, Abo concluded that the government was wrong in its assessment of how FirstPlus was handled as a business. He determined that the charges against the defendants did not adequately consider the business and strategic logic behind the multiple acquisitions and the amount of credible due diligence undertaken. Says Abo, "The impression the government was giving was, 'it's organized crime; it's all bad,' and that wasn't necessarily the case." In terms of the paper trail, he concluded, Pelullo did everything by the book. "I was hired to review Pelullo's actions, and, on paper, he made exhaustive efforts and performed due diligence to bring the company into complete compliance."

Martin Abo testified in open court for five days. Over the course of the five days he was questioned at length about the hiring of outside professionals, the consulting and other professional fees paid, the investment value of the business and various acquisitions, and other aspects of this public company. Based on his exhaustive analysis, especially in light of Pelullo's prior business experience and following the "successful" logic employed, Abo concluded that: the defendant utilized a business model that had helped turn around other businesses, that the government's allegations were not substantiated, and lack of prudent judgment by Pelullo—in terms of a business perspective—was not supported.

CONCLUSION: THE FBI RUINS EVERYTHING

In the end, the jury went for the conviction. Both Scarfo and Pelullo along with the Maxwell brothers (John, former FirstPlus CEO, and William, special counsel to FirstPlus) were convicted of racketeering and conspiracy to sell and possess firearms. Scarfo and Pelullo were later sentenced to thirty years in federal prison; John Maxwell received ten years and his brother, William, received twenty years. The other defendants—the SEC attorney, the business/tax attorney, and Scarfo's personal attorney were found not guilty.

Martin Abo stands by his conclusions. "It's no exaggeration to say that this case included about as much data as did the ENRON case. For a trial spanning four days a week from early January through the first week of July, there was just so much financial and often sophisticated information for the jury to get its head around. And, frankly, some of the defendants had shady pasts and really questionable associates. I think it was difficult to make the distinctions," says Abo.

Would he encourage other practitioners to take on a case of this scope?

"Yes," he says. "But it is important you know what you don't know, and then get the help you need to compliment your skill set." As a practice pointer, he also stresses the importance of the engagement letter in outlining the scope of what you will do, and the ability to bring in resources to help you deliver on your promise. Although this was a high profile criminal case, at the end of the day, it was about a business and opining on whether or not legitimate business practices were followed. Says Abo, "Aside from his unfortunate associations, Pelullo took steps that any prudent business owner would and, even more so, dictated by what a public enterprise must adhere to. That is what I was brought in to assess. And that is how I called it." VE



Martin H. Abo, CPA, ABV, CVA, CFF, has comprehensive experience in individual and corporate financial, business, and tax planning. His previous experience includes several years with the tax department and audit staff of a Big Four CPA firm as well as regional firms before he founded the present enterprise. Mr. Abo has also developed a specific expertise in performing litigation support and other consulting services. Clients, as well as the banking, insurance and legal community, have increasingly called upon him to provide technical assistance, arbitration or expert testimony on financial accounting matters, business valuations, structuring buy-ins and buy-outs, divorce, estate controversies, insurance claims and other forensic/investigative analysis covering a wide range of topics and industries. E-mail: marty@aboandcompany.com

THE DEFENDANTS IN *USA V. SCARFO ET AL*

Scarfo and Pelullo were the most prominent of the twelve defendants, but the other defendants included a former FirstPlus CEO, and four attorneys—one of whom was the brother of the former CEO and special counsel to the company.

DON'T ASK ME ABOUT MY FATHER'S BUSINESS

Nicodemo Scarfo Jr. is the son of Nicodemo "Little Nicky" Scarfo. He grew up in South Jersey and, by all accounts, was not involved in his father's business until after he graduated from high school. In 1988, Little Nicky Scarfo was convicted on more than thirty-two counts of racketeering, which included eight counts of murder, four counts of attempted murder, two counts of illegal distribution of methamphetamine, one count of loan sharking, fourteen counts of extortion, and one count of illegal gambling.

On Halloween night in 1989, Scarfo was dining at an Italian restaurant in Philadelphia. When a man wearing a Batman mask and holding a bag of candy entered the restaurant, no one paid much attention. That is, until he approached Scarfo's table, pulled a MAC-10 machine pistol from the bag of treats and pumped eight rounds into Scarfo's neck, arms, and torso. Remarkably, no vital organs were damaged and Scarfo recovered from the attack in fewer than nine weeks. According to newspaper accounts, after the shooting, Scarfo moved back to Philadelphia and sought the protection of the Lucchese family. His father, it is alleged, arranged for him to become a "made" member of the New York-based crime family.

Later, Scarfo moved to New Jersey and was an active member of a Lucchese crew. Law enforcement believed a rival, former Philadelphia mob boss, Joseph "Skinny Joey" Merlino, was the shooter in the hit on Scarfo. They believed that Merlino and his crew were looking to take control of the Philly-based mafia, and that Scarfo was a possible proxy for his jailed father.

When residents of Galloway, New Jersey—the town where Scarfo and his family lived—learned of his indictment in the FirstPlus case, they had no idea he was involved with the crime family. His neighbors knew him as a family man who worked in construction.

BUSINESS MAN OF THE YEAR

In his CV, Salvatore Pelullo describes himself as having "more than twenty years of finance and management experience with small to mid-size companies as a principal and consultant. His diverse experience encompasses operational, managerial, and financial administration functions in multi-market multi-product areas." At the time of his indictment, he was a forty-five-year-old business man with a tenth grade education and a string of businesses he had successfully turned around. His strategy was to identify struggling companies, and supply the management and cash assistance to pull them out of bankruptcy. Then he would either sell or run the newly constructed company.

Pelullo and Scarfo were childhood friends—their families were close when they lived in the same South Philadelphia neighborhood. In high school, Pelullo developed a dependency on alcohol. His father placed him in a school for troubled teens in Orlando, Florida, where the family had moved while the elder Pelullo worked on a hotel project.

In the late '80s, Pelullo borrowed $30,000 from his father and, with a partner, started Express Real Estate. While the company made a great deal of money buying and selling houses, Pelullo blew the profits on cars, partying, and alcohol. "I grew up fast because everyone was older than me; I tried to compete with my (older) brothers, but couldn't," he is quoted as saying. He also seemed to live in the shadow of a much older brother Leonard, a business consultant convicted of defrauding a Stockton, California savings and loan company he controlled of $2.2 million.

Prior to his trial, Pelullo would blog inappropriate and inflammatory comments about the proceedings and, in particular, the judge. His lawyer argued that his medical and psychological records demonstrated that Pelullo was suffering from bi-polar disorder and was therefore not responsible for his actions. The judge disagreed.

VALUATION

Valuation by a Monday Morning Quarterback

By Seth Fliegler, MBA, CFE; and John Duvoisin

Hindsight. The Monday morning quarterback. 20/20 vision. In the world of valuation, these terms are often met with skepticism. The topic of hindsight in retrospective valuations is a reoccurring issue in court cases particularly when economic conditions subsequent to the valuation date often alter the perceived value of the company. This has become relevant once again, for example, in a recent ruling by Judge Peck of the Bankruptcy Court S.D.N.Y. *In re: Lehman Bros. Holdings Inc.,* which brought to light the very issues of hindsight that can arise in retrospective valuations.[1] The court found that the plaintiff's experts' valuation of the assets in dispute was based on hindsight and *not* on the prevailing market conditions at the time they were acquired. By relying on hindsight, rather than contemporaneous projections, the plaintiff's experts' opinions were found to have reflected strong litigation biases.

Valuation professionals are once again reminded by *Lehman* that it is critical to understand the contemporaneous economic climate and conditions surrounding any transaction. By bringing hindsight into a retrospective analysis of a transaction, an expert runs the risk of ascribing a value that is inconsistent with contemporaneous market views as of the date of the valuation. As detailed in this article, the courts have shown that they are often leery of a valuation that is inconsistent with prevailing market opinion. Yet if court opinions were so clear that hindsight should not be applied, why should there be any debate as to its use in valuations? The reason is that hindsight has also been permitted (and even encouraged in some instances) in various situations as a means to support analyses, opinions, and the calculation of damages in areas such as intellectual property disputes. This article briefly defines hindsight in the context of determining valuation and damages, reviews precedent court cases that addressed (and largely rejected) the use of hindsight, and presents areas where hindsight has been more openly welcomed by the courts.

APPLYING HINDSIGHT

According to *Webster's Dictionary*, hindsight is the "perception of the nature of an event after it has happened." Thus, inherent in the application of hindsight in any valuation analysis is the fact that "perceptions" derived *after* the fact are influencing contemporaneous events. Very few professional valuation associations, however, provide guidelines regarding the application of hindsight in valuation analyses, instead offering only definitions of hindsight rather than practical considerations for its applications. One exception is the Statement on Standards for Valuation Services issued by the American Institute of Certified Public Accountants (AICPA), which states:

> Generally, the valuation analyst should consider only circumstances existing at the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a subsequent event. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions.[2]

Such standards apply to AICPA members who are engaged to estimate value "that culminate in the expression of

1 *In re: Lehman Bros. Holdings Inc.*, 445 B.R. 143 (Bankr. S.D.N.Y. 2011).

2 *Statement on Standards for Valuation Services,* AICPA, June 2007, page 20.

a conclusion of value or a calculated value."[3] Aside from these standards, the use of hindsight by valuation professionals in analyses is largely guided by commentary and a disjointed set of guidelines established by judicial opinions.

THE COURTS AND THE USE OF HINDSIGHT

Several court cases have been decided based on the issue of incorporating hindsight into a valuation. In *Lehman*, the plaintiff (the Unsecured Creditors Committee of Lehman Brothers) alleged that the fire-sale value of certain Lehman assets sold to the defendant (Barclays) in the turbulent days after the Lehman Brothers bankruptcy filing was compromised by conflicts of interest among the Lehman employees performing the appraisal of Lehman's assets during the very limited due diligence process.[4] At trial, the plaintiff introduced six valuation experts who asserted that the purchase price paid by Barclays was below the fair market value for those assets at the time of the asset sale.[5] In particular, the plaintiff argued that Barclays's financials reflected multi-billion dollar negative goodwill as a result of the purchase of Lehman Brothers, which, according to plaintiff, was a clear indication of the significant windfall achieved through Barclays's acquisition.[6]

The court, however, found that the plaintiff's experts' valuation of Lehman's assets purchased by Barclays was benefited by hindsight and not driven by the perspectives of market participants operating in September 2008. Specifically, Judge Peck concluded that, "the opinions, reflecting an unsurprising litigation bias, came across as having been designed and manufactured for the trial and were not at all persuasive."[7] The court believed that employees of both Lehman and Barclays acted in good faith in marking down the assets held by Lehman. Judge Peck rejected the assertion that the employees "breached their duties of loyalty to the estate because of the prospect of future employment or as a consequence of signing lucrative employment contracts with Barclays."[8] Given the distressed nature of the sale, the courts found that there was no reason to regard this transaction as being characterized by equal bargaining power. Since there were no other buyers at the time and the seller had no leverage, the courts dismissed the plaintiff's experts' assumption that Barclays ascribed "low-ball" values to the assets.[9]

As the court opined, "the proceedings have illuminated the factual background of the largest, most expedited and probably the most dramatic asset sale that has ever occurred in bankruptcy history" and that it was "the most momentous week of the greatest financial crisis of our lives."[10] The court asserted that the extreme uncertainty in the market caused most market participants to have increased sensitivity to the downside risk of contemporaneously purchasing financial assets. The court further emphasized that the plaintiff's experts' *de novo* after-the-fact valuation analysis, done in a litigation setting, is less persuasive than the perspectives of "those actively participating in the market in September 2008."[11]

The finding in *Lehman* was consistent with Judge Peck's ruling in another earlier precedent setting case in which there was significant focus on the use of hindsight in valuation analysis. In the case of the bankruptcy proceedings of Iridium, LLC, the court also found disfavor with the plaintiff's expert's use of hindsight in his retrospective solvency analyses.[12] Iridium was a business spun off by Motorola to establish a network of low-altitude satellites that would allow those travelling for business to have telephone connectivity in remote locations. Iridium's stock had an initial public offering at $20 per share in June 1997 and rode the wave of positive market sentiment to an all-time high of $72.19 per share on May 1, 1998.[13] The product launch failed and Iridium subsequently filed for bankruptcy in August 1999. Plaintiff (the Statutory Committee of Unsecured Creditors) brought suit against Motorola for, amongst other issues, constructive fraudulent conveyance and preference claims, due to Iridium's alleged insolvency at the time of certain transfers from Iridium to Motorola.[14]

In support of its insolvency claim, the plaintiff presented analyses from two valuation experts. One of the experts created revised bottom-up projections of the company instead of relying upon the numerous contemporaneous projections prepared

3 *Id* at 5. The use of hindsight is, to some degree, a judgment call with respect to certain accounting analyses such as purchase price allocations. SFAS 141(R) issued in December 2007 states that, "The acquirer must consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognized or whether that information results from events that occurred after the acquisition date. This determination requires judgment…Decisions made by the combined company and economic events occurring after the acquisition, do not result in an adjustment of the provisional amounts." Financial Accounting Standards Board. Statement of Financial Accounting Standards No. 141. December 2007. Other examples of guidance regarding hindsight include IRS Revenue Ruling 59-60 Section 3.03, which states, "Valuation of securities is, in essence, a prophesy as to the future and must be based on facts available at the required date of the appraisal." The ruling highlights the fact that there is a difference between unexpected and probable or reasonably foreseeable (*i.e.*, through prophesy) future events.

4 *In re: Lehman Bros. Holdings Inc.,* 445 B.R. 143, 148-149 (Bankr. S.D.N.Y. 2011).

5 *Id.* at 184.

6 *Id.* at 152, 159.

7 *Id.* at 159.

8 *Id.*

9 *Id.* at 182.

10 *Id.* at 148-149.

11 *Id.* at 187.

12 *In re: Iridium Operating LLC,* 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

13 Bloomberg L.P. (2013).

14 *In re: Iridium Operating LLC,* 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

by Iridium management and various other parties at the time that the contested transactions were completed. The expert created his own assumptions and applied them to consultant reports rather than the company's internally developed models. The expert's projections significantly reduced the projected revenue streams created by market participants at the time, "believing that his analysis of the information was superior to the analysis done at the time."[15] Judge Peck, however, found that the analysis leaves "the distinct impression that [the Expert's] work was carried out with litigation bias and for the express purpose of showing that Iridium was insolvent."[16] The court determined that due to the expert's application of hindsight, the expert's work product was not a reliable valuation analysis; instead it emphasized that financial projections should be consistent with both how the market views the industry as well as how the company has historically met its projections. This is often determined by the robustness of the projections and the substantiation of the methodologies used by management.

An expert must be cognizant of the motivation behind the projections provided to him or her so as to not assume that management's assertions at the time of a transaction were, in fact, what the actual market was signaling. In some instances, it is not post-transaction market data that influences the analysis, but, rather that of management or a third party that has an interest in, and as a result, a bias in the underlying data. In these cases, it is necessary to adjust management projections based on the true contemporaneous market sentiment. This problem was illustrated in the case *In re: Yellowstone Mountain Club*.[17] The *Yellowstone* case focused around the borrower, Blixseth Group Inc., receiving substantial loans from the lender, Credit Suisse, based on inflated projections of the Yellowstone Mountain Club (a resort development near Yellowstone National Park majority owned by Blixseth Group); ultimately Yellowstone Mountain Club and the borrower (Blixseth Group Inc.) filed for bankruptcy.

Prior to the funding, Yellowstone had missed its projections continually by a wide margin and thus it was argued by the plaintiff's expert that the projections were never an accurate reflection of the company's outlook. As such, the projections were deemed excessive due to management's belief that, no matter what, the company would succeed. In contrast, the plaintiff developed its own set of projections that incorporated the financial outlook based on past history, as well as its perception of the business, which trended the projections down significantly. The court found that the lower projections that the plaintiff developed for trial reflected the true value of the business whereas the original contemporaneous projections developed by management were artificially inflated given its bias to have the company succeed.

The Delaware Chancery Court, widely seen as the nation's preeminent business court, has similarly limited experts' use of hindsight in valuation testimony. In *Agranoff v. Miller*, the court was tasked with opining on the fair value of Defendant Agranoff's warrants acquired by the plaintiff, Miller, in an attempted takeover bid.[18] To support his opinion, the plaintiff's valuation expert created projections as of the valuation date based on conversations with business managers who knew what the *actual* results of the company were and therefore had inherent hindsight bias. The court compared this process to the following example:

> Suppose there was an interview with Sir George Martin from 1962 in which he opined as to how many number one songs he thought would be released by his new protégés, the Beatles. Could one fast-forward to 1971, interview Martin, and revise Martin's earlier projection in some reliable way, recognizing that Martin would have known the correct answer as of that date? How could Martin provide information that would not be possibly influenced in some way by his knowledge of the actual success enjoyed by the Beatles and his recollection of his earlier projection?[19]

The court refused to give any weight to this expert's valuation analysis, indicating that the "possibility of hindsight bias and other cognitive distortions seems untenably high."[20]

APPLYING HINDSIGHT IN A VALUATION

Although the previous examples have highlighted that hindsight is rarely permitted by courts, there have been instances where courts have indirectly relied on hindsight to support their opinion. The difference in these matters is that hindsight was used solely to provide emphasis and context on analyses that, on a standalone basis, had already sufficiently supported the expert's opinion using contemporaneous data. In other instances, the courts have allowed the principle of retrojection, which states:

Where a debtor is shown to be insolvent at a date later than the date of the questioned transfer, and it is shown that the

15 *Id.* at 340.
16 *In re: Iridium Operating LLC*, 373 B.R. 283, 342 (Bankr. S.D.N.Y. 2007).
17 *In re Yellowstone Mountain Club, LLC*, 436 B. R. 598 (bankr. D. Mont. 2010).
18 *Agranoff v. Miller* 791 A.2d 880 (Del. Ch. 2001).
19 *Id.* at 892.
20 *Id.* at 892.

debtor's financial condition did not change during the interim period, insolvency at the prior time may be inferred from the actual insolvency at the later date.[21]

A prime example in which (1) hindsight was deemed inapplicable (and that contemporaneous market prices were a true representation of the firm's value), and (2) the use of retrojection was allowed as relevant support, was VFB LLC v. Campbell Soup Co.[22] Vlasic Foods was spun off from the Campbell Soup Company in a leveraged transaction in 1998. The transaction involved the creation of Vlasic as an independent company (VFI), the assumption by Vlasic of $500 million in debt, and the issuance of stock in Vlasic to Campbell shareholders as an in-kind dividend. The company subsequently filed for bankruptcy in 2001. VFB, LLC (an entity established to prosecute claims of Vlasic's shareholders and creditors against Campbell) sued on the basis that the spin off was a constructive fraudulent transfer and that Campbell aided and abetted a breach of fiduciary duty regarding Vlasic's directors. Such a breach, VFB argued, included the preparation of operating results of certain corporate divisions included in the newly spun-off Vlasic that were artificially inflated and should have been trended lower at the time of the spin off.

In its decision with respect to the solvency of Vlasic at the time of the transfers, the court simultaneously rejected the use of hindsight, but supported the use of data after the relevant transactions in its opinion. Based on the defendant's expert's valuation, which reflected contemporaneous market values, the court determined that Vlasic was solvent at the time of the transaction and the spin off was not a fraudulent transfer. Of note, however, is that the court relied in part on the price of Vlasic's stock, which remained high after the truth of the manipulated operating figures was publicly disclosed, to further validate Vlasic's solvency. In supporting the opinion of the district court, the Court of Appeals stated that despite the issues disclosed to the public, "VFI did not fold. The price of its shares on the New York Stock Exchange remained essentially steady… More than a year after the spin, in June 1999, VFI successfully completed its required issue of $200 million in unsecured debt to institutional investors." The court concluded that "nobody claims that VFI's fortunes were improving, so the market's valuation of VFI as solvent in FY 1999 was strong evidence that VFI was solvent at the time of the spin, and therefore received reasonably equivalent value of its $500 million."[23] As such, an analysis using contemporaneous data proved solvency, while market data subsequent to the transactions provided additional emphasis.

In contrast, the court rejected plaintiff's argument and its experts' valuations on the basis that the opinions were primarily based on hindsight evaluations and did not reflect the true value of the company at the time of the spin-off. Specifically, the court determined that the market price is, "a more reliable measure of the stock's value than the subjective estimates of one or two expert witnesses."[24] In Vlasic, we see a court rejecting the use of hindsight by plaintiff's experts, but concurrently allowing the inclusion of post-transaction data (i.e., Vlasic's market price after the spin-off) as a means of concurring with the solvency of the company at the time of the transaction.

THE BOOK OF WISDOM

While the application of hindsight in retrospective valuation analyses is tenuous, some level of hindsight by experts has been permitted by courts where the value of damages is in question. In particular, hindsight has been allowed to various degrees in patent infringement disputes. Where data subsequent to the point of infringement (i.e., *ex-post*) may benefit a more precise estimate of the value of damages, some courts have permitted the use of post-infringement data. For example, in the precedent setting 1933 case of *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, the Supreme Court ultimately confirmed that hindsight was permissible in calculating damages asserted by the plaintiff.[25] In *Sinclair*, the plaintiff loaned to the defendant certain experimental stills used for cracking petroleum oils to produce gasoline. Per executed agreements, any improvements made by defendant to the apparatus or process belonged to the plaintiff. Defendant, however, was issued patents for the improvements and plaintiff brought suit for patent infringement. Upon reaching a decision, Supreme Court Justice Cordozo wrote in the opinion:

This is not a case where the recovery can be measured by the current prices of a market. A patent is a thing unique. There can be no contemporaneous sales to express the market value of an invention that derives from its novelty its patentable quality…But the absence of market value does not mean that the offender shall go quit of liability altogether…At times the only evidence available may be that supplied by testimony of experts as to the state of the art, the character of the improvement,

21 *In re Arrowhead Gardens, Inc.,* 32 B.R. 296, 301 (Bankr.D.Mass.1983).
22 *VFB LLC v Campbell Soup Co.*, 482 F. 3d 624 (3d Cir. 2007).
23 *Id.* at 633.
24 *Id.* at 633.
25 *Sinclair Refining Co. v. Jenkins Petroleum Process Co.,* 289 U.S. 689 (1933).

and the probable increase of efficiency or saving of expense… This will generally be the case if the trial follows quickly after the issue of the patent. But a different situation is presented if years have gone by before the evidence is offered. Experience is then available to correct uncertain prophecy. Here is a book of wisdom that courts may not neglect. We find no rule of law that sets a clasp upon its pages, and forbids us to look within.[26]

In its opinion, the Supreme Court opened the possibility of using post-infringement (*ex-post*) data to help in evaluating the value of the patent, and, hence, damages to be paid by the infringing party.[27] That is, unlike the valuation of a company, a plaintiff can concretely determine, with the benefit of hindsight, the number of items sold using the alleged infringing patent. The opinion further states that allowing such information "is not to charge the offender with elements of value nonexistent at the time of the offense. It is to bring out and expose of light the elements of value that were there from the beginning."[28]

More recent decisions have emphasized the use of hindsight in patent disputes as initially stated in *Sinclair*. For example, in 2008, the Eastern District of Texas held in *Ariba Inc. v. Emptoris, Inc.* that "the jury may consider the infringer's actual sales and revenue up to the date of trial as part of the 'book of wisdom.'"[29] Furthermore, in its 2009 decision regarding *Lucent Technologies, Inc. et al., v. Gateway, Inc.,* the U.S. Court of Appeals for the Federal Circuit reaffirmed that considering "evidence of usage after infringement started can, under appropriate circumstances, be helpful to the jury and the court in assessing whether a royalty is reasonable."[30] As such, in instances where an infringement suit is filed years after a patent is awarded, hindsight may be permitted by the courts.[31]

CONCLUSION

Valuation professionals must be diligent in determining when and where hindsight is applicable in analyses. When creating retrospective valuations, it is necessary to understand the nature of the projections as well as the economic conditions surrounding the time that the projections were created in order to fully capture the true value. It is paramount to remove the biases that occur when there is knowledge of what transpired post-valuation date. The case of In re: Lehman Bros. Holdings Inc. is a reminder and continues to highlight the fact that courts are skeptical of analyses laden with hindsight. By analyzing the projections in terms of who initially created the projections and their inherent biases as well as incorporating the prevailing economic conditions, the ultimate valuations will be viewed more favorably by the courts.

At the same time, the use of hindsight may be appropriate when providing context and analytical support to a valuation, or in calculating damages. In the former instance, conclusions of value (or solvency) are reached based on contemporaneous data while hindsight is used simply to emphasize those results. The latter scenario is not simply the application of hindsight, but the use of historical data to accurately determine a plaintiff's monetary loss. Analyzing events that happened after the date of an alleged source of damages may be the only way to effectively make a party whole. Knowing when a valuation professional is aptly using hindsight or is playing the role of the Monday morning quarterback, however, may determine the winning or losing team at trial. VE



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26 *Id.* at 697-8.

27 Damages can be assessed through the calculation of a reasonable royalty rate, the specifics of which are not covered in this article. Professionals often determine the royalty through evaluation of a hypothetical negotiation between the patentee and the alleged infringing party at or around the time of infringement. The Supreme Court, in *Sinclair*, allowed the possibility to use post-negotiation facts in determining the royalty.

28 *Sinclair Refining Co. v. Jenkins Petroleum Process Co,* 289 U.S. 689, 698 (1933).

29 *Ariba, Inc. v. Emptoris, Inc.*, 567 F. Supp. 2d 914, 917 (E.D. Tex. 2008).

30 *Lucent Technologies, Inc. et al., v. Gateway, Inc. et al.*, 580 F.3d 1301, 1333-4 (Fed. Cir. 2009).

31 While the focus here is on patent infringement matters, there continues to be debate as to the use of *ex-post* (after the fact) versus *ex-ante* (before the fact) analyses in economic damage disputes in general.

ACADEMIC REVIEW



One Opinion on the Direction of Business Valuation Programs in Academia: An Interview with Peter Lohrey, PhD, CVA, CDBV

By Nancy McCarthy, Senior Editor, The Value Examiner

Peter Lohrey has been contributing to "Academic Review" for the past eighteen months. His column is a compendium of significant works in academia related to business valuation. In this month's issue of *The Value Examiner* we have the opportunity to know a bit more about Peter and his thoughts on the direction of business valuation programs in academia.

VE: Can you tell us a bit about where you teach?

PL: I am truly privileged to teach at Montclair State University (MSU). Our business school has seen tremendous growth over the past three years. Our business faculty, in particular my colleagues in the Accounting and Finance Department, are everything I could ask for. They are talented, gifted, and highly qualified professors who possess superb scholarly capabilities along with tremendous professional experience.

VE: What do you teach?

PL: I teach NACVA's business valuation course to become a Certified Valuation Analyst (CVA) in large part due to their support and interest in developing our graduate students for careers in Forensic Accounting.

I began teaching the CVA course in the Spring of 2016. I have since taught the CVA course two more times at MSU and once—as an adjunct to cover for one of my colleagues—at Sacred Heart University in Fairfield, CT. I have also attended NACVA's annual conferences on three separate occasions where I have meet with fellow academics who also teach the CVA course at their respective institutions.

VE: I understand that teaching is not your first career.

PL: No, it isn't. And, neither is accounting. I was in the service for ten years after attending West Point during my first year of college. I left West Point and went on to the University of Delaware, where I earned a BS in business administration and where I played intercollegiate lacrosse. I then went on to earn an MBA in finance at Loyola University, MD, as graduate assistant to the men's lacrosse team. From there, I went on to Pensacola, FL, and obtained a Commission as a Reserve Officer and Naval Aviator specializing in Anti-Submarine Warfare and Intelligence Collection. I served my last two years of active duty in the Navy as a Liaison Officer to the U.S. Senate. After that, I worked on the personal staff of U.S. Senator Alfonse D'Amato in Washington. Then I decided to switch gears. I went on to get my MS in finance from Loyola University, MD, while working for an investment bank and at Price Waterhouse. When I graduated, I decided to pursue my PhD at George Washington University while I worked in the office of the Economic Analysis at the U.S. Securities and Exchange Commission. At that time, I was also an adjunct professor at GWU teaching in the MBA program.

VE: Did you ever sleep in those days?

PL: Probably not. But that's where my military training came into play. As part of the curriculum for training Naval Aviators, we participated in Survival, Evasion, Resistance, and Escape (SERE) training which is a program that provides U.S. military personnel with the needed training to survive, evade capture, resist interrogation, and escape imprisonment. You learn to make do with very little sleep.

VE: I guess that is good basic training for most professions. Where did you start your accounting career?

PL: I worked for Price Waterhouse in Baltimore, MD, before going to graduate school at GWU. I then worked for Arthur Andersen, LLP in their Washington, DC office after completing my graduate studies. I focused on business valuation, commercial damages, and complex claims. Now, in addition to teaching, I am the Director of the Forensic and Valuation Services Department for Paritz & Company, PA. My experience over the past twenty years has been in litigation services, valuation, mergers and acquisitions, loan workouts, and expert witness matters. I've provided many fair value reports for financial reporting purposes for several different clients as the Northeast regional director of a national valuation firm.

VE: What would you say is your area of expertise?

PL: I would say I specialize predominantly in commercial damage calculations and business valuation for tax, litigation, and forensic purposes.

VE: So, you really have a foot in both worlds. Why did you go back to academia?

PL: I don't think I'll ever stop working, so I needed to find a job where they can't fire me due to my age. Once you get tenure, you can work until you can't move any longer. I told the Dean that if I succeed and gain tenure, they will have to carry me out of MSU horizontally. Plus, oh by the way, I love people, and teaching provides a wonderful way to work with younger people.

VE: **What do you see as the future of the CVA programs?**

PL: As of December 2017, there are nine universities in the United States that teach business valuation as part of their business school programs. They all teach the CVA course at the graduate school level, while none of them teach the CVA course at the undergraduate level. My comments are based on my observation and in speaking to colleagues such as Lari Masten at the University of Denver, Ashok Abbott at West Virginia University, and Danny Pannesse at Sacred Heart University who have been teaching CVA programs. First, it should be noted that the CVA course is a basic course. It is designed to introduce individuals to the fundamental concepts used in business valuation. It focuses on the three approaches to business valuation (Asset, Income and Market)[1] and provides detailed material, including a wide range of problems that are used to teach the six most commonly used methods for business valuation (Adjusted Net Asset, Book Value, Capitalization of Earnings/Cash Flows, Discounted Earnings/Cash Flows, Guideline Public Company, and Comparable Private Transaction)[2]. Additional topics such as how to perform normalization adjustments, content of a detailed business valuation report, professional standards, report writing, and a case which presents four separate scenarios under which the valuation report is being produced are contained in the course.

The CVA course focuses primarily on fair market value as the standard of value when presenting most of the materials. It does provide insight into the standard of fair value along with several prominent course cases that have had a major impact on various aspects of business valuation. Currently, several of my colleagues are participating with personnel from the Consultants' Training Institute to update the course content because the use of the techniques and methods taught in the CVA course are being applied to a wider variety of applications and situations every year.

Business Valuation education at American universities is being taught exclusively at the graduate level. While there may be several reasons for this, I believe, at least from my own perspective, that the CVA course combines several different areas of business school education into one course. It requires the empirical application of topics such as: finance, accounting, statistics, and microeconomics in order to produce a business valuation report. Therefore, it is presented at the graduate level where it belongs, which is after an individual completes their undergraduate education—as many students spend their undergraduate education focused primarily on just one of these areas of study.

I do not believe that it would be appropriate to offer the CVA course at the undergraduate level. Many students need to possess a strong foundation in one, if not at least two or even more of the various academic disciplines within a business school's curriculum. Further, I feel the content of the course will need to become even more complex as the amount of critical thinking and analysis needed to provide business valuation services will increase substantially in the foreseeable future.

VE: Can you give an example?

PL: Yes. At MSU, we provide our business graduate students with the opportunity to obtain a certificate in forensic accounting—provided they meet the curriculum requirements. While our current certificate content contains four required courses, we are adding new courses due to the

1 NACVA CVA course, Fundamentals, Techniques & Theory – Chapter 6, p. 1.

2 *Ibid*.

needed teach courses that are relevant and cover current topics. One step in this direction has been the creation of a course in Fair Value Analytics,[3] which I was asked to do. A significant portion of the course will utilize many of the fundamental methods that students learn in the CVA course.

VE: So, if you had a crystal ball, how would you envision business valuation education at American business schools?

PL: I don't have a crystal ball, but based on my observation and reading, I do think business valuation education in the U.S. will increase in importance. I am glad to be part of this trend. And, I have to say, NACVA is to be congratulated for leading the way. The AICPA has recently realized this, for they now offer the AICPA University Program in Business Valuation. Their Model Business Valuation Curriculum (MBVC)[4] was recently rolled out and made available to university professors during the spring/summer of 2017.

VE: Will we continue to hear from you in 2018 via your Academic Review column in *The Value Examiner*?

PL: Absolutely! VE

As Rod Burkert would say, that's a wrap. We thank Peter Lohrey for spending time with us. If you want further information on the NACVA CVA University program, please contact Chanda Chuon at ChandaC1@nacva.com. If you have any questions for Peter, please send him an e-mail at lohreyp@montclair.edu.



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3 I would like to give credit to My Graduate Program Co-Ordinator, Jim DiGabriele, who recognized the need for this type of course – based on the current environment in financial reporting.

4 https://www.aicpa.org/content/dam/aicpa/interestareas/forensicandvaluation/membership/downloadabledocuments/aicpamodelbusinessvaluationcurriculum.pdf

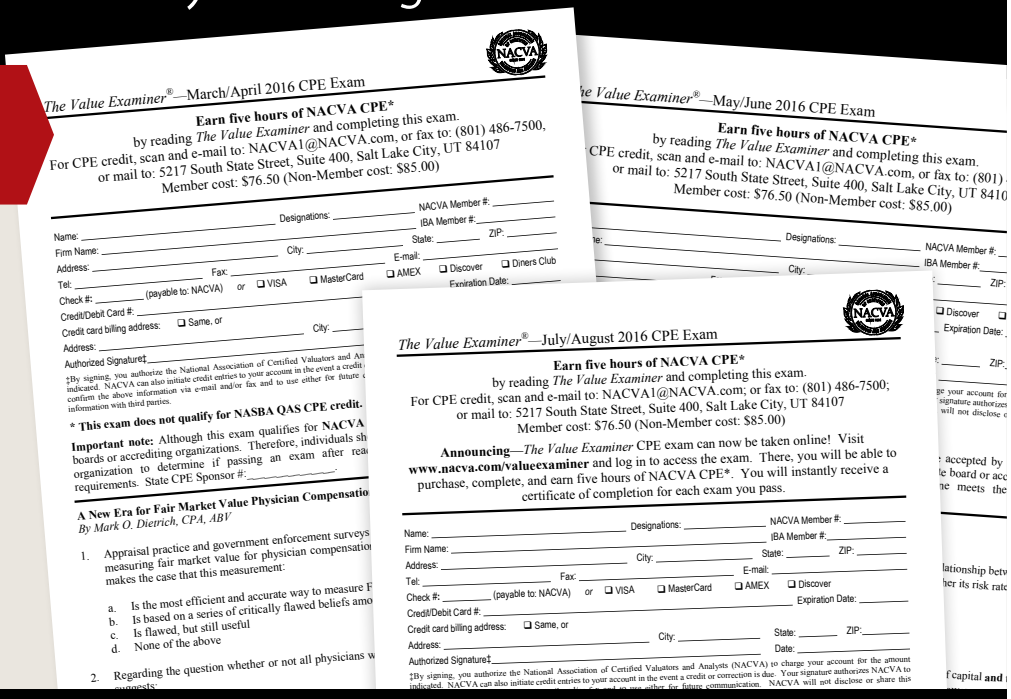
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LITIGATION CONSULTING



How this Band Rocked the Business World

By David Bookbinder, ASA, CEIV

This article originally was published in March 2017 in the Huffingtonpost. It appears in The Value Examiner, *with permission of the author.*

Van Halen is a band that is known for a hard-driving sound that featured the guitar wizardry of Eddie Van Halen and the vocals of their iconic front man and lead singer, David Lee Roth.

They are also known for some dramatic changes in personnel, as well as a particular disdain for brown M&Ms. In this article, we explore the fascination with the brown M&Ms and their impact from a business perspective.

ERUPTION

Van Halen burst onto the rock music scene in 1978 with the release of their first album, simply called "Van Halen." Founded by the Van Halen brothers, Eddie on guitar and Alex on drums; the original lineup featured singer David Lee Roth and bassist Michael Anthony.



Van Halen helped to popularize the hard-rock genre of music with their larger-than-life stage shows and their innovative, signature guitar sound. It also helped that they had a highly visible, and camera-friendly lead singer.

Van Halen's music videos were popular items on MTV and in addition to receiving critical acclaim, the band also captured an award for Best Stage Performance for their hit song "Jump."

The band underwent several "public" and "messy" lineup changes over the years that included replacing singer David Lee Roth with Sammy Hagar, as well as a brief stint with Gary Cherone replacing Hagar as lead singer; followed ultimately by a reunion with David Lee Roth. Bassist Michael Anthony was also replaced by Eddie's son, Wolfgang.

While the "Van-Hagar" era was also a successful one for the band, including their first #1 album (5150) and several songs that made it to the singles charts, the Cherone-led incarnation of the band has been characterized as being a less-successful endeavor.

Eddie Van Halen has been recognized as the eighth best guitar player of all time by Rolling Stone,[1] while Alex was recognized on the 100 Best Drummers of All Time at number 51[2] by the same publication.



Van Halen was inducted into the Rock and Roll Hall of Fame in 2007.[3]

1 http://www.rollingstone.com/music/lists/100-greatest-guitarists-20111123/eddie-van-halen-20111122

2 *Ibid.*

3 ttps://www.rockhall.com/inductees/van-halen

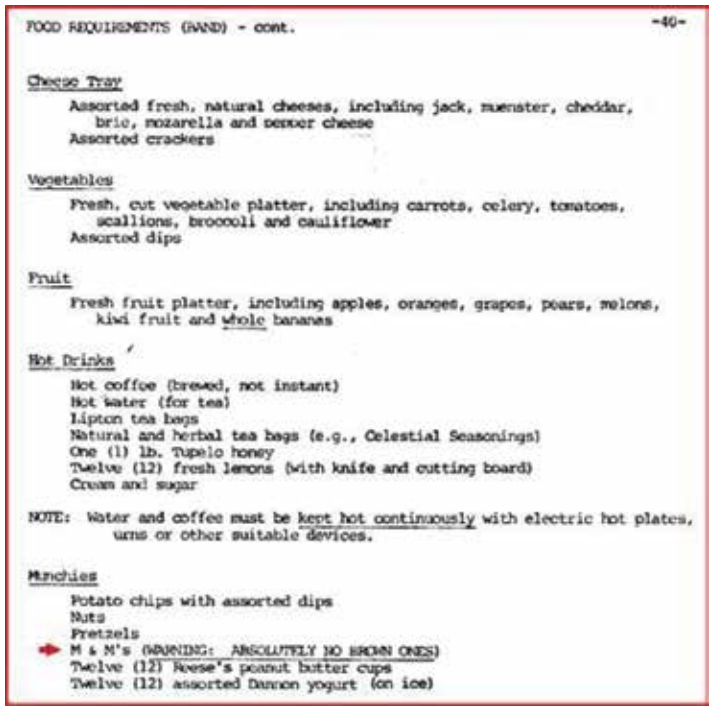
RUNNING WITH THE DEVIL

It is not uncommon for performers to have special requests that appear in their contract riders. Oftentimes these riders will specify what types of food or beverages are desired for the artist's backstage area either because of allergies or simply by preference. Some riders, however, contain provisions that borderline on the outrageous.[4]

The devil, as they say, is in the details.

One of the more outrageous contract riders of all-time is Van Halen's clause that demanded that M&Ms be present in their dressing room, but...as the contract reads...

"ABSOLUTELY NO BROWN ONES"



FOOD REQUIREMENTS (BAND) - cont. -40-

Cheese Tray
Assorted fresh, natural cheeses, including jack, muenster, cheddar, brie, mozarella and Dekker cheese
Assorted crackers

Vegetables
Fresh, cut vegetable platter, including carrots, celery, tomatoes, scallions, broccoli and cauliflower
Assorted dips

Fruit
Fresh fruit platter, including apples, oranges, grapes, pears, melons, kiwi fruit and whole bananas

Hot Drinks
Hot coffee (brewed, not instant)
Hot water (for tea)
Lipton tea bags
Natural and herbal tea bags (e.g., Celestial Seasonings)
One (1) lb. Tupelo honey
Twelve (12) fresh lemons (with knife and cutting board)
Cream and sugar

NOTE: Water and coffee must be kept hot continuously with electric hot plates, urns or other suitable devices.

Munchies
Potato chips with assorted dips
Nuts
Pretzels
M & M's (WARNING: ABSOLUTELY NO BROWN ONES)
Twelve (12) Reese's peanut butter cups
Twelve (12) assorted Dannon yogurt (on ice)

The consequence of brown M&Ms being found in the dressing room was a cancellation of the show, with the band being paid in full nonetheless. Quite a penalty for a piece of chocolate.

The band was also known to have trashed a dressing room or two upon finding brown M&Ms in the room.

Such divas!

Or were they?

Van Halen's staging required certain electrical parameters being met, as well as specific load-bearing requirements to support their massive stage rigging. Their contracts specified these requirements in great detail.

At a minimum, a failure to adhere to these stipulations could result in concert start-times being delayed. However, as many of the older arenas at the time were unequipped to handle such staging, if these parameters were not met the results could be catastrophic.

Apparently, many arena managers and show promoters did not bother to read the contract in great detail to understand these important stipulations. The band, having been burned by promoters not reading the contract thoroughly, wanted to avoid finding this out the hard way.

The "no-brown M&Ms" clause was devised as a clever way for the band to easily know if the contract was read in detail.

If there were brown M&Ms in the dressing room, they knew at a quick glance that the contract was not read properly, and the stage rigging needed to be checked out immediately, and in detail.

The brown M&Ms were their "Fair Warning" so-to-speak.

YOU REALLY GOT ME

Reading contracts in painstaking detail can certainly be tedious, but how else can you really know what you are agreeing to?

During my career I have consulted with thousands of companies, and while it is not an everyday occurrence, I have seen what happens to clients who get blind-sided by contracts that were not properly read or understood; including, among other things, giving up way more of the company in a complex conversion than was expected!

The lessons from Van Halen's "Brown M&M" clause are a great reminder that the details matter. They also serve as a reminder to think about triggers that you might be able to use to get people to pay attention to those details, even when their eyes have glazed over from reading the contract.

What are the "brown M&Ms" in YOUR contracts?



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4 http://abcnews.go.com/Entertainment/Music/story?id=6461409&page=1

HEALTHCARE INSIGHTS



The Due Diligence Imperative for the Valuation of Healthcare Enterprises, Assets, and Services

(Part One of a Six-Part Series)

By Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA; and Todd A. Zigrang, MBA, MHA, FACHE, ASA

With the emergence of value-based reimbursement, such as accountable care organizations (ACOs), clinically integrated networks (CINs), and bundled payment models, which rely on achieving the "Triple Aim" of healthcare at a lower cost.[1] U.S. hospitals are increasingly looking to change how services are being delivered by seeking more collaborative relationships with physicians, including vertical integration strategies such as the acquisition of healthcare-related enterprises, assets, and services (e.g., physician practices), direct employment, co-management, and joint venture arrangements with physicians and other providers.

The rise of these emerging healthcare organizations (EHOs) to address value-based reimbursement initiatives has led to a growing number and complexity of transactions in the healthcare delivery marketplace, accompanied by increased federal and state regulatory scrutiny regarding the legal permissibility of these arrangements. Most notably, government regulators (more specifically, the Office of the Inspector General [OIG] of the U.S. Department of Health and Human Services [HHS], and the U.S. Department of Justice [DOJ]) have, in some cases, more aggressively challenged an increasing array of these transactions under various federal and state fraud and abuse laws.

Therefore, now more than ever, conducting a level of due diligence appropriate to the scope and complexity of a given assignment is critical to the development of the valuation opinion. First and foremost, the appraiser serves in the role of a proxy for the universe of typical investors and buyers inherent in the requisite hypothetical transaction of the fair market value standard, which standard may not be exceeded to withstand regulatory scrutiny.[2]

Due diligence may be defined as:

1. "such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case";[3]
2. "a fact-finding project…designed to find hidden risks";[4] and,
3. "an investigation in order to support the purchase price of the business."[5]

1 "Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 1, Hoboken, NJ: John Wiley & Sons, 2014, p. 231-244; "The Adviser's Guide to Healthcare, Second Edition" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA; and Todd A. Zigrang, MBA, MHA, FACHE, ASA, Volume 1, New York, NY: AICPA, 2015, p. 138.

2 "The Adviser's Guide to Healthcare, Second Edition" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA; and Todd A. Zigrang, MBA, MHA, FACHE, ASA, Volume 2, New York, NY: AICPA, 2015, p. 144–146.

3 "Black's Law Dictionary" 5th Edition. West Publishing Company: 1979.

4 "Valuation for M&A: Business Value in Private Companies" By Chris M. Mellen and Frank C. Evans, Second Edition, Hoboken, NJ: John Wiley & Sons, 2010, p. 322–325.

5 "Business Valuation Resource Guide" By Stephen Bethel, Glendale, CA: Mattatal Press, 2003, p. 283.

There are two distinct classes of information generally required for due diligence related to healthcare valuation: (1) general research; and, (2) specific research.[6]

General research is typically comprised of information and data related to national and regional healthcare industry trends; reimbursement trends; competitive marketplace assessments; medical industry specialty and technological trends; transactional data; and, investment risk/return data, as well as, other research not specifically related to, or obtained from, the subject enterprise, asset, or service being appraised. General research is obtained to providing a context within which the analyst considers the specific research and information gathered.[7]

Specific research is related to information to the historical operational performance and financial condition of the subject enterprise, asset, or service, as well as, the pertinent clinical related data. Specific research is typically obtained from the client or the appropriate contact designated by the client.

In conducting the general and specific research required for the due diligence process, the analyst must develop an understanding of the market forces and the stakeholders that have the potential to drive healthcare markets. It is useful to examine what value relates to the four paramount market influences of the healthcare industry, i.e., the Four Pillars of healthcare—reimbursement, regulatory, competition, and technology.[8] These four elements of the healthcare industry marketplace shape the dynamic by which providers and enterprises operate within the current transactional environment; while also serving as a conceptual framework for analyzing the viability, the efficiency, the efficacy, and, ultimately, the value that may be attributed to property interests, whether enterprises, assets, or services.[9]

General research may be attained from a variety of sources, including:

1. Books and monographs;
2. Journals and periodicals;
3. Government agencies;
4. Proprietary data aggregators and portals;
5. Professional societies and trade associations;
6. Conferences and webinars;
7. Online databases; and,
8. Academic and industry "think tanks" and research foundations.[10]

While the process of obtaining general research provides the valuation analyst with an adequate grasp of the body of knowledge applicable to a particular property interest being appraised, it is the efficacy of the valuation analyst's subsequent application of generally accepted analytical methods to that data that determines the successful outcome of the assignment. The technical tools that the valuation analyst needs to employ to provide clients with the observations, findings, conclusions, and opinions that are to be deliverable under an engagement involves the synthesis of a substantial amount of data that may be pertinent to the valuation assignment, as well as the appropriate analysis, calculations, and considerations of the various types and forms of that data. Among the technical tools available to analysts is the benchmarking process, i.e., a comparison of specific research data from the subject property interest to industry indicated normative benchmark data, and may include the performance of a simple variance analysis on a single characteristic, such as a patient outcome metric related to "readmission within thirty days of discharge," or may be comprehensive in scope, including the comparison of numerous clinical, operational, and financial metrics.

Benchmarking is used to establish an understanding of the operational and clinical performance and financial status of a healthcare enterprise.[11] Benchmarking techniques can also be utilized to illustrate the degree to which an organization

6 Chapter 12: Research and Financial Benchmarking in the Healthcare Industry, By Robert James Cimasi, Todd A. Zigrang, and Anne P. Sharamitaro, in "Financial Management Strategies for Hospitals and Healthcare Organizations" David Marcinko, M.D., MBA, CMP and Prof. Hope Rachel Hetico, RN, MHA, CMP Ed., Boca Raton, FL: CRC Press, 2014, p. 300–306.

7 *Ibid*, p. 300.

8 "Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Vol. I, Hoboken, NJ: John Wiley & Sons, 2014, p. 1–2.

9 *Ibid*.

10 "Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 2, Hoboken, NJ: John Wiley & Sons, 2014, p. 241–242.

11 Chapter 12: Research and Financial Benchmarking in the Healthcare Industry, By Robert James Cimasi, Todd A. Zigrang, and Anne P. Sharamitaro, in "Financial Management Strategies for Hospitals and Healthcare Organizations" David Marcinko, M.D., MBA, CMP and Prof. Hope Rachel Hetico, RN, MHA, CMP Ed., Boca Raton, FL: CRC Press, 2014, p. 312.

diverges from comparable healthcare industry norms, as well as, providing vital information regarding trends within the organization's internal operational performance and financial status.[12] For example, benchmarking in the healthcare services sector serves several purposes:

1. Offers insight into the enterprise and practitioner performance as it relates to the rest of the market (e.g., allowing organizations to find where they "rank" among competitors, and as a means for continuous quality improvement);
2. Objectively evaluates performance indicators on the enterprise and practitioner levels;
3. Indicates variability, extreme outliers, and prospects;
4. Identifies areas that require further attention and possible remediation (e.g., re-distributing resources and staff, and increasing operating room utilization);
5. Promotes quality and efficiency improvement (e.g., improving average length of stay and other clinical efficiency measures); and,
6. Provides enterprises with a value metric system to determine if they comply with legal standards for fair market value and commercial reasonableness.[13]

In contrast to general research, specific research is information and data that is directly related to, or obtained from, the subject enterprise, asset, or service being valued. Specific research will often be comprised primarily of those documents received by the valuation analyst through the information and data gathering process (or discovery process in the case of litigation support engagements) including, but not limited to, preliminary legal/organizational and transactional documents, so that any material compliance issues may be identified.[14] A sample of some of the requested preliminary legal/organizational and transactional documents in a healthcare transaction due diligence process are as follows:

1. Legal/organizational documents:
   - (a) Articles of incorporation, limited liability company (LLC) formation agreements, partnership certifications, certificates of trust;
   - (b) Bylaws, operating agreements, trust agreements;
   - (c) Shareholder agreements, member agreements, partnership agreements;
   - (d) Pertinent executive meeting minutes;
   - (e) Existing employment agreements and curriculum vitae for key personnel;
   - (f) Real property lease agreements;
   - (g) Personal property lease agreements;
   - (h) Existing buy-sell agreements;
   - (i) Existing consulting or management services agreements;
   - (j) Loan agreements;
   - (k) Related party vendor/supplier agreements;
   - (l) Third party payor agreements;
2. Transactional documents:
   - (a) Asset purchase agreements;
   - (b) Stock purchase agreements;
   - (c) Bills of sale;
   - (d) Asset contribution agreements;
   - (e) Buy-sell agreements;
   - (f) Standstill agreements;
   - (g) Non-disclosure and confidentiality agreements;
   - (h) Letters of intent;
   - (i) Transaction term sheets;
   - (j) Proposed employment agreements;

12 "The Adviser's Guide to Healthcare, Second Edition" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA; and Todd A. Zigrang, MBA, MHA, FACHE, ASA, Volume 2, New York, NY: AICPA, 2015, p. 56.

13 "The Joint Commission's Perspective" By Paul M. Schyve, MD, in "Measuring Clinical Care: A Guide for Physician Executives," by Stephen C. Schoenbaum, MD, MPH, the American College of Physician Executives, 1995, p. 57; "The Physician Compensation Plan As an Instrument of Cultural Change," Aspen Health Law and Compliance Center, in "Physician Compensation Arrangements," By Daniel K. Zismer, An Aspen Publication, 1999, p. 108-115; "Measuring Physician Work and Effort," in "Physician Compensation Plans: State-of-the-Art Strategies," by Bruce A. Johnson, JD, MPA and Deborah Walker Keegan, PhD, FACMPE, Medical Group Management Association, 2006, p. 110–111; "Financial and Clinical Benchmarking: The Strategic Use of Data" Healthcare Financial Management Association, HCIA, 1997, p. 76–77.

14 "Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 2, Hoboken, NJ: John Wiley & Sons, 2014, p. 232.

(k) Proposed lease agreements; and,

(l) Proposed compensation plan details.

Upon the valuation analyst's review and analysis of the preliminary documents and information provided, a customized supplemental request for documents and information should be developed in consideration of the unique attributes and circumstances in that healthcare transaction, including, but not limited to, the items set forth in Table I, see http://www.nacva.com/17NDVE.

Additional subject-specific information may also be obtained through the site visit/management interview. Some of the types of subject-specific information that may be collected during the site visit/management interview are listed below:

1. History and background information;
2. Premise/location/building description;
3. Transition to electronic medical records;
4. Quality of staff and depth of management;
5. Competitive trend analysis;
6. Patient base trends;
7. Managed care environment;
8. Hospital privileges and facilities;
9. Referral sources and patterns;
10. Strength of financial management and credit collections policy;
11. Operational efficiency assessment; and,
12. Future plans, e.g., growth, transition to value based reimbursement.[15]

As part of the requisite due diligence associated with a specific engagement, the valuation analyst should conduct independent research, specific to the subject enterprise, to supplement any information provided by the subject entity, in line with the old Russian proverb, "Trust but Verify."[16] For example, the valuation analyst may conduct a Uniform Commercial Code (UCC) search to determine if the subject enterprise has any undisclosed outstanding liabilities or whether the subject enterprise leases, rather than owns, their tangible personal property, i.e., furniture, fixtures, and equipment. Similarly, a search for filings related to the subject enterprise with the Office of the Secretary of State in which the subject enterprise operates should be performed to identify pertinent information related to the actual legal organization of the subject enterprise, as well as, performing a brief search of online legal databases, such as Public Access to Court Electronic Records[17] for federal litigation, and state litigation databases, such as Case.net[18] in Missouri, to reveal any past and ongoing litigation involving the subject property interest, including shareholder disputes, commercial damages and liabilities, and malpractice cases. Further information related to the subject enterprise, asset, or service, which might not have been disclosed, may be gleaned from state licensing and certifying agencies and disciplinary boards, and may have an impact on the reputation, as well as the clinical and operational performance and financial status of the subject enterprise.[19] It should be noted that subsequent events, i.e., events that would not have been known or knowable as of the valuation date, but which may also have a deleterious effect on the value indication for the subject property, must be disclosed, within the valuation report, to the client. However, these subsequent events do not have an impact on the valuation opinion, as of the valuation date, and may require a decision by the client as to whether an updated valuation report, i.e., with a valuation date after the subsequent events, should be undertaken.

The valuation analyst should also restate and adjust the subject enterprise specific financial data received to: (1) facilitate industry benchmark comparisons of the specific line item allocations of the subject entity's financial statements to comparable industry indicated benchmark norms for those line items; and, (2) reflect the true economic operating performance and financial status of the subject enterprise. Accordingly, the valuation analyst should carefully consider restating certain line items related to the revenue and expenses of the subject entity, e.g., owner compensation and benefits; discretionary expenses not required to support the projected revenue of the subject enterprise; and, extraordinary non-operating income and

15 "Healthcare Valuation: The Financial Appraisal of Enterprises, Assets, and Services" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA, Volume 2, Hoboken, NJ: John Wiley & Sons, 2014, p. 247.

16 Attributed to Vladimir Lenin and popularized by U.S. President Ronald Reagan. See President Reagan's "Remarks on Signing the Intermediate-Range Nuclear Forces Treaty" December 8, 1987, https://reaganlibrary.archives.gov/archives/speeches/1987/120887c.htm (Accessed 9/21/17).

17 "Public Access to Court Electronic Records" United States Courts, www.pacer.gov (Accessed 8/29/17).

18 "Missouri Case.net" Missouri Courts, https://www.courts.mo.gov/casenet/base/welcome.do (Accessed 8/29/17).

19 See "The Adviser's Guide to Healthcare, Second Edition" By Robert James Cimasi, MHA, ASA, FRICS, MCBA, AVA, CM&AA & Todd A. Zigrang, MBA, MHA, FACHE, ASA, Volume 2, New York, NY: AICPA, 2015, p. 60.

expenses. Likewise, the valuation analyst should consider restating certain assets and liabilities of the subject entity, e.g., remove non-operating assets; adjust tangible personal property (i.e., furniture, fixtures, and equipment) from book value to economic fair market value; and, removing those assets excluded from the property interest being appraised, such as accounts receivable and cash.

The next step in the due diligence process is to determine the extent and the probability of the continuity of the subject business's benefit stream and competitive advantage into the future. A valuation analyst who leads such a process must follow three credos to "discover the truth":

1. "Be Skeptical"—Do not believe what you read or what people tell you, or at least be aware of the biased information you are receiving. Always seek corroborative evidence;
2. "D&D: Disclose and Disclaim"—The due diligence process is, by its very nature, a documentation-intensive engagement. In addition to maintaining an organized filing system, it is important to disclose all findings, even those to be deemed immaterial; and,
3. "Follow the Scientific Method"—Although there is an art to this work, a successful due diligence process uses the scientific method. In the world of due diligence, it truly can be stated that "the product is the process." The successful valuation analyst will generate hypotheses, establish method(s), test hypotheses, report results, and develop conclusions in an orderly, documented, and replicable manner. In keeping with the philosophy of scientific research, due diligence must be objective in its approach and conduct.[20]

The due diligence process of a healthcare transaction is a critical exercise for the valuation analyst. This is especially important in consideration of the Four Pillars of Healthcare Valuation, i.e., regulatory, reimbursement, competition, and technology, which are unique areas of risk that shape the market forces within the U.S. healthcare industry, in the valuation of healthcare enterprises, assets, and services. A complete and thorough due diligence of the subject interest is an iterative process that requires a consistent and persistent approach, and is not for the faint of heart. VE

20 "A Rationale for Due Diligence for the Business Intermediary: By Robert James Cimasi, CBI, CBC, IBBA News, Fall 1998, p. 10.



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PRACTICE MANAGEMENT



Impact of Inadequate Discovery in a Divorce Proceeding

By Eric A. Kreuter, PhD, CPA, CGMA, CMA, CFM, CFFA, CFE, CBA; and Eric J. Barr, CPA, ABV, CFF, CVA, CFE

Accurately determining the value of a business ownership interest in a divorce proceeding at statutory points in time (date of marriage/date of commencement) is dependent on several factors, one of which is the quality and completeness of the data from which the valuation is derived. Such data is obtained by the valuator or forensic accountant in several ways:

- Through documents and information submitted through counsel
- Provided by the engaging spouse
- The product of subpoena
- Depositions
- Interrogatories
- Court order resulting from motion practice

Not all is fair in love and war when it comes to the fight for business records within a matrimonial action. When one spouse is denied adequate discovery, his or her case can begin to unravel. Usually some records are available, either because the spouse had some previous access or there was a partial document production. "For many dependent spouses, it is an uphill battle to force the other spouse to divulge much-needed information; yet full financial disclosure is critical for an informed settlement in equitable distribution proceedings."[1]

Sometimes the business records provided by the custodial spouse indicate clear manipulation of transactions, leading to situations where one spouse reported substantially lower income to the taxing authorities and the court than determined by the other spouse's financial expert. Examples of such manipulations include: unreported business revenues, understatement of accounts receivable, under reporting of inventory, and improper recording of owner's compensation (including perquisites), dividends, and loans. In cases where there is a depletion of working capital by the custodial spouse, valuation can be permanently or temporarily reduced. Moreover, if the withdrawn funds are hidden, there are additional adverse financial consequences to the non-moneyed spouse. Thus, understanding the true nature of cash outflows caused by the custodial spouse will influence equitable distribution and alimony, as well as child support obligations.[2]

DISCOVERY

Discovery is intended to "make a trial less a game of blind man's bluff and more a fair contest with the basic issues and facts disclosed to the fullest practicable extent."[3] However,

1 "Sanctions for Discovery Violations", National Legal Research Group, Inc., 1998.

2 Describing the specific forensic accounting procedures in a divorce proceeding to be performed by the appraiser is beyond the scope of this article. For guidance with respect to such procedures, see Forensic Accounting for Divorce Engagements, a Practical Guide, third edition, published by the American Institute of Certified Public Accountants, 2009.

3 *United States v. Proctor & Gamble*, 356 U.S. 677, 682 (1958). https://supreme.justia.com/cases/federal/us/356/677/case.html)

the court has discretion in determining what discovery is necessary, and if the analysis used by an expert to reach conclusions is reliable and admissible.

The Federal Rule of Evidence 702: Testimony by Experts states:

> If scientific, technical, or other specialized knowledge assist the trier of fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise if: (1) the testimony is based upon sufficient facts or data; (2) the testimony is the product of reliable principles and methods; and (3) the witness has applied the principles and methods reliably to the facts of the case.

In *Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 589 (1993),* "the trial judge's responsibility with regard to expert opinions is to ensure that any and all scientific testimony or evidence admitted (at trial) is not only relevant, but reliable." Accordingly, a court can reject a business appraiser's findings if it is based on incomplete or erroneous data. There are many published cases where the testimony of financial experts has been excluded due to inadequate factual data.

The message from the courts is clear—use all appropriate means to obtain the evidence needed to render a reliable conclusion.

CASE STUDY

The following is an example of what can occur if there are limitations imposed on discover.

In a hypothetical divorce case, husband and wife jointly owned several business entities. Husband was in full control over the operational management of the businesses and maintained the business records. As a way of thwarting a complete forensic analysis, husband objected to a motion to open up the records for physical inspection; he also objected to paying the necessary retainer. Instead, he was able to convince the judge to allow the wife to access the electronic recordkeeping system only during non-business hours. He successfully convinced the judge that allowing her access during business hours might disrupt the business. The expert, meanwhile, explained to wife's attorney that the manner of reviewing records set forth by the court would not allow a complete forensic review and would, therefore, be inadequate.

The few business records available strongly suggested that husband was taking money from one of the jointly held businesses and recording the outflows of cash as shareholder loans. In effect, he was borrowing interest-free from wife, at least the extent of fifty percent of the aggregate amount.

Inadequate access to the full array of business records resulted in insufficient data on which to base forensic findings. As such, the disadvantaged spouse was left unable to plead her case with the accuracy needed to present a credible case. At husband's deposition, he stonewalled the examination through evasive answers or assigning responsibility for the books and records to the outside accountant. Because the non-moneyed spouse did not have ready access to the bank accounts of the closely-held businesses, she was on unequal footing with her husband. Accordingly, she was unable to engage the proper level of expert assistance.

The unsympathetic judge contributed negatively to the dilemma by focusing his attention on matters involving the couple's children and did not hear the pleas of wife or wife's attorney. Instead, he accepted the unsupported assertions of husband that the businesses had seriously declined and were unable to provide the same level of financial support to wife as they did during the marriage. The expert's affidavits reporting the suspected taking of additional cash through loans were ignored by the judge, allowing husband to live comfortably while choking off the cash flow to wife who did not have equal access to the accounts of the businesses. Transactions posted to the General Ledger masked by journal entries made by the outside accountant resulted in further confusion.

AVAILABLE REMEDIES

Though costly, the wife could have brought a shareholder derivative action seeking access to the books and records vis-à-vis her stock ownership interest and therefore bypass the vagaries of Family Court. However, without adequate funds she was unable to commission this step. Thus, the sheer lack of available funds to commission a deeper legal and forensic investigation hampered the non-moneyed spouse's desire to have the truth uncovered.

Wife's counsel could have petitioned the court for sanctions against husband for refusal to produce records where there was a clear and willful defiance of court-ordered cooperation.

In cases where each spouse has equal ownership rights, the judge should understand that where one spouse borrows needed funds but the other spouse cannot do so, then the spouse in full control has a distinct and unfair advantage. If the spouse not having access or control cannot fund his or her case, then justice will be more difficult to achieve because the truth will be kept well-hidden.

The independent outside accountant could be deposed and asked to produce the work papers associated with the filed tax returns. Often the accountant is fully aware of what is going on, but might not be willing to conceal the truth at the deposition table.

SUMMARY

It is critically important for a business appraiser to obtain adequate discovery in connection with the development of a reliable valuation conclusion. Failing to obtain and critically examine necessary documents can result in failing to identify owner manipulations such as understatements of revenues, overstatements of expenses, and improper and/or nonrecurring transactions. Business appraisers should consider all appropriate means to obtain needed discovery. Failing to obtain sufficient, reliable discovery can ultimately result in the production of a report that is incorrect and/or rejected by the courts. VE

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PRACTICE MANAGEMENT



Practicing Solo

"Practicing Solo" features interviews with our industry's seasoned sole practitioners. If you are itching to join the solo ranks, or striving to be more efficient and effective in your established one-person firm, this column offers you practical advice, steeped in experience from the trenches, that can move you forward.

By Rod P. Burkert, CPA, ABV, CVA, MBA

INTERVIEW: PAUL WONCH

I hope you enjoyed last issue's interview with Gladys Riccobono. Our interview series continues, with this issue featuring Paul Wonch, CPA, ABV, CVA, MAFF. Paul hails from Indianapolis, where all those racecars keep turning left around the track every Memorial Day.

Paul has been operating as a sole practitioner since November 2015, and he can be found at Wonch Valuation Advisors, LLC (WonchValuation.com). His practice wheelhouse includes business valuations for owner exits/buy-ins and legal disputes for companies with up to $100 million in revenue.



Paul Wonch

Rod: What was your first year like, and what would have made it better?

Paul: My first year was very encouraging. My business contacts and friends reacted very positively to me starting my own practice, and work started coming in almost immediately. People were very supportive and excited for me. There is a kind of new energy that comes your way when you start on your own.

Unfortunately, my health was not perfect in my first year. I was admitted to the hospital more than once, which made getting the work done more difficult. This experience reinforced the notion that when you go on your own, you are very dependent on one person, i.e., yourself. My health is much better now, and I should be able to have a steadier focus. Of course, in answer to your question, not having the health problem would have made my first year better.

Rod: Did you have a formal (or even semi-formal) business plan?

Paul: I have what I would call a semi-formal business plan. It included financial objectives, marketing and promotional items, and process improvements. But I am working toward getting it more formalized because I believe it will be helpful to have it more developed and in writing.

The process of putting a plan together is probably as valuable as having the plan in the first place. It helps me think through what has worked, what has not, and what needs to be done to move forward. Also, my plan has milestones set for the future—so I know when to stop, evaluate, and reassess.

Rod: How did you first attract clients, and how did that strategy evolve over time?

Paul: I had the advantage of not being a complete unknown in the field when I started. The first thing I did was to let those I knew, and had done business with in the past, know that I had started my own practice. I try to keep in contact with those folks and expand that network as I complete valuation projects.

Rod: What kinds of engagements did you start with?

Paul: My first engagement valued an ownership interest in an IT company. The owner wanted to let a key employee buy to give him a stake in the business and assure his continued involvement. The company was experiencing significant growth in various segments of the business. This made the

DCF method the more appropriate method. I worked with the owner to produce a projection of cash flows, which was an enjoyable experience.

Rod: Do you practice in a specialized niche today?

Paul: I perform valuations for businesses in a wide variety of industries including construction, real estate, retail, wholesale trade, banking, manufacturing, professional practices, trucking, healthcare, automobile dealerships, etc. Having performed over two hundred valuations for car dealerships or related businesses, I have an industry specialty there.

I really enjoy the car dealership work. It is one of the few things that occasionally gets me out of Indiana. Some of my contacts and referral sources refer work all over the country, and as a result, I've done dealership valuations from coast to coast. I even did one for a Bentley dealership. Unfortunately, I did not get to drive any of them.

Working in the automobile dealership niche has made me more of a "car guy," which is a lot of fun. And automobile dealers are enjoyable to work with; they typically are real car guys who know their industry and know their cars.

Rod: What has been your best marketing tactic?

Paul: My best marketing tactic has been to network and maintain contact with other CPAs who do not do business valuation work and are able and willing to provide referrals.

Rod: How do you price work?

Paul: Typically, I price my work based on a range of flat fees that are in line with the market. For projects that are less clearly defined, I charge an hourly rate. In either case, I always require a retainer up front.

Rod: How do you differentiate yourself from larger firms?

Paul: I offer the same level of expertise as most larger firms but with fewer constraints and expenses. In addition, a larger firm is more likely to delegate much of the work to a staff member with less experience and expertise, whereas I run the whole engagement (typical for a sole practitioner).

Rod: Do you work from a home office or an "office" office?

Paul: I have both. My "office" office is part of a suite of offices giving me access to two boardrooms and a training/conference room in addition to my small office. The access to the other rooms has been very helpful with meetings with clients and seminars. I found a less expensive alternative to something like Regus that really suits my needs.

Rod: What is your current mobile device?

Paul: An Apple iPhone 7 Plus. It has the latest photo and video capabilities, and I would like to do more to take advantage of it in my practice. In addition to the camera, I'm probably not taking full advantage of the available apps.

Rod: Describe your current computer workstation set up.

Paul: I have an HP laptop that fits into a docking station and dual monitors, an HP LaserJet printer, a ScanSnap scanner, keyboard, and mouse. The primary software I use is Office 365. I also use Backblaze (www.backblaze.com) for backup and Trend Micro (www.trendmicro.com) for security.

Rod: Besides your phone and computer, any office hardware or software that you just couldn't live without?

Paul: The most useful item I have is the ScanSnap iX500 (www.fujitsu.com/us/products/computing/peripheral/scanners/scansnap/ix500). It works seamlessly and scans quickly using a feeder; it provides very clean scans. I would recommend it to anyone. My understanding is that it actually has a cult following.

Rod: What do you listen to while you work?

Paul: I typically don't listen to music while I work. I like quiet or the sound of my fan. Sometimes I hear the commodities broker in the next office, who is often quite loud. For some reason, it doesn't bother me. Funny thing is, he gets the loudest when arguing with vendors, not in his commodities trading. Today it's quiet.

Rod: What tool(s) do you use to manage your to-do list?

Paul: I use an Excel spreadsheet to manage projects and an app on my iPhone called Clear for simple checklists. I have Evernote and plan to learn more about it to see if it can help me better manage my time.

Rod: How about your favorite productivity tip that saves you lots of time?

Paul: Evernote—it's on my computer, iPhone, and iPad. I use it to photograph business cards when I receive them to save time getting new contacts into Outlook. It's much faster than entering the business card information by hand. I know there is a lot more to Evernote, and I believe the real benefits probably go well beyond the business card application. As with most things like this, I need to invest more learning time, so I can reap the benefits.

Rod: Early bird or night owl—what's your sleep routine?

Paul: I am not an early bird, but I typically try to get to bed by 10 p.m. and be up by 6 a.m.

Rod: Do you have any office/admin staff?

Paul: My wife helps with the administrative work. She does bookkeeping, billing, banking, IT, marketing, and whatever else comes up. If I didn't have her help, I don't know if I could have started my own practice. I found that there are a lot of things to do besides the valuation work!

I am also in the process of hiring a part-time person to help do the valuation work. I am fortunate in that the individual wants to work part-time and is willing to work somewhat as needed. As most folks will tell you in the business of business valuation, the work doesn't always come in at an even flow. Having someone available with that flexibility should be very helpful.

Rod: Do you have a support group to call on?

Paul: I have a variety of individuals I can call on to bounce valuation questions/ideas off. My involvement in the Indiana Chapter of NACVA has helped with that. It even goes beyond the valuation questions. There are a lot of people who can help with the other aspects of the practice. I have found that the key is working with people who best align with my business needs and perspective.

Rod: How do you stay technically current with changes in the profession?

Paul: Like most people in the field, I read the valuation literature that comes out regularly. I also try to have the most current versions of the key valuation books including the PPC Guide. Also, I try to attend the NACVA conferences. I attended the one this past June in Chicago, and it was excellent.

Rod: What non-BV business book have you read most recently or want to get to, and why?

Paul: One that you suggested: *The Daily Stoic* by Ryan Holiday[1]. It shares a perspective that is very useful if you are practicing on your own. The book has three hundred and sixty-six daily meditations designed to help you focus on what you can control and not waste energy on what you can't. There is a little more to it than that, but I'd say that captures the gist of it. The meditations/passages are very helpful for the business practitioner on his or her own.

Rod: How do you recharge? What do you do when you want to forget about work?

Paul: For fun, I enjoy movies, gardening, walking, and kayaking. And as I mentioned before, I have become a bit of a car guy. Indianapolis has a lot of car shows I love attending, and of course, we have the Indianapolis Motor Speedway. I went to the one hundredth running of the Indianapolis 500, which had a sellout crowd of over 300,000. The Speedway also has an automotive museum, which I have enjoyed going to on repeat occasions.

Indianapolis has a great history in the auto industry, and I'm a member of the Indiana Landmarks Automotive affinity group. This group celebrates the early auto visionaries and their products, and promotes the preservation of the cars, the factories and showrooms, the homes of auto moguls, and the landscaped parkways and roadside architecture birthed by the auto age. It's all a great way to integrate my interest in automobiles with my valuation practice.

Rod: What practice areas do you think offer the most promise to someone going solo now?

Paul: The ones I am focused on…business valuation for owner exits/buy-ins and legal disputes. The transition of baby boomers out of their businesses should continue for quite some time. Legal disputes will probably always present a need for experts in our field when the value of an ownership interest in a business is at issue.

Rod: Finish this sentence: If I knew then what I know now, I would…

Paul: …not join as many networking groups. While I enjoy the social aspects of being part of groups and organizations, I simply don't have time for the demands they tend to place on you. I'm still involved with several groups and organizations; however, I've stuck with the ones that have a more professional focus or those that I truly enjoy. VE

That's a wrap! Do you have a Practicing Solo issue you would like me to address? E-mail me at rod@rodburkert.com



Rod Burkert, CPA, ABV, CVA, is a practice development coach who helps overwhelmed BVFLS professionals create more time and income margin in their practices and their lives, so they can execute with more purpose and have more freedom to do the things that matter most to them.

1 Ryan Holiday, *The Daily Stoic: 366 Meditations on Wisdom, Perseverance, and the Art of Living*, trans. Stephen Hanselman (New York: Penguin Random House, LLC, 2016)

In Memoriam: Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA

By Nancy McCarthy, Senior Editor, The Value Examiner

My first memory of Bob Cimasi was about five years ago. I had been hired as the senior editor of *The Value Examiner* (TVE) a few months earlier and I had, maybe, three issues under my belt. I had never met Bob, but was eager to speak with him and see if he would contribute to the publication. Our meeting was short and to the point. He was a bit gruff and a little rushed. He told me what he'd like to see happen and, until it did, he would not be interested in publishing in TVE. It took two years, but progress was apparently being made. Not only did Bob start submitting articles, but in 2015 he offered to serve on the editorial board.

Bob died on December 6, 2017. I learned of his passing from Lari Masten, chair of TVE editorial board. I had to read her e-mail several times to comprehend its significance. I was just getting to know Bob as a colleague. His insights, comments, and reviews were always timely and on point. Although I didn't know him well, I saw flashes of his personality as a man who was passionate about his work and his life.

Bob Cimasi was a nationally known lecturer on healthcare industry topics and a renowned author of nine books; he contributed numerous chapters that were featured in legal treatises and anthologies; he published articles in peer reviewed professional journals and industry trade publications; and, was often quoted by the healthcare industry press. He was a pioneer of the business and healthcare valuation profession, and devoted a significant amount of his professional life giving back to his colleagues as a mentor, educator, and array of other endeavors. As Lari Masten so eloquently said in her e-mail, "Bob was an amazing trail blazer, mentor, and a generous protector of both the old and new guard in BV."

Todd Zigrang, MBA, MHA, FACHE, ASA, President of Health Capital Consultants, has provided the following information on Bob:

> Bob founded Health Capital Consultants, a nationally recognized healthcare financial and economic consulting firm headquartered in St. Louis, Missouri, in 1993. During his thirty-five-plus years in the valuation profession, he earned distinction as an Accredited Senior Appraiser; Certified Valuation Analyst; Certified Healthcare Business Consultant; Master Certified Business Appraiser; and, Mergers and Acquisitions Certified Professional. In 2006, Bob was honored with the prestigious "Shannon Pratt Award in Business Valuation" conferred by the Institute of Business Appraisers (IBA). In 2007, he was named a member of the College of Fellows of the IBA. In 2011, he was named a Fellow of the Royal Institution of Chartered Surveyors (RICS). In 2016, Bob was named a "Pioneer of the Profession" as part of the recognition of the NACVA "Industry Titans" awards, which distinguishes those whom have had the greatest impact on the profession.

In addition to his business valuation family and friends, Bob leaves behind his wife Laura, his brothers, sisters, brothers- and sisters-in law and dozens of nieces and nephews.

Along with his family, his friends, and the people whose lives he touched, I wish Bob Cimasi Godspeed. He will be missed, but his influence will be with us for generations to come.

A Business Appraiser in Heaven

By Robert James Cimasi, MHA, ASA, FRICS, MCBA, CVA, CM&AA

Bruno dreamt he went to heaven, 'cause St. Peter was ringin' his bell
Now that, in itself, was amazin', since he'd spent a lifetime goin' to Hell.
I guess it just goes to show you, with a business appraiser, you never can tell.

Now I didn't know what they told you, or what you've been led to believe,
But Heaven, Bruno thought, would be Paradise, a reward you had to die to receive.
With so much love, peace, and pleasure, you're supposed to not want to leave.

So gladly, with anticipation, Bruno answered that Heavenly call,
And stood at those Pearly-Gates proudly, like Lucifer back 'fore the fall.
Already feelin' that Paradise feelin', and worried 'bout nothin' at all.

Now that, in itself, ought to tell you, the direction this tale's gonna take
For history's shown that business appraisers, venture boldly where others just quake,
And a business appraiser with nothin' to worry about, is a disaster just waitin' to make.

So, when the Pearly Gates swung wide with a flourish, Bruno couldn't believe his own eyes.
For he saw there floating before him, much to his shock and surprise.
A replica of mighty Mt. Rushmore (only greatly expanded in size).

Foremost was carved a dignified Shannon, with Jay Fishman placed off to his right,
On the left, shone the visage of Ray Miles, and then Bruno's jaw dropped down at the sight,
Stunned to see Aswath Damodaran chiseled in stone, and squeezed in behind Shannon real tight.

Then Bruno heard St. Peter address him, as he stood there entranced with the scene
St. Pete said, "Welcome to business appraisal heaven—the celestial palace of all that's serene.
You'll find here every delight of the intellectual palate, beyond the imagination of your wildest dream."

Then St. Peter said, "Bruno, here's the ground-rules—your observations you may discuss if you must.
But you only get to hold polite, quiet discourse—you'll opine no conclusions in Heaven we trust!
Clouds here can't bear the gravity of strong opinions, under the weight of argument they will just bust."

"Now, as a mortal you dreamed up your own Heaven, from things you desire and upon which you dwell,
All the pursuits that in life you adored most, you wish will surround you, in Heaven, as well.
But you've got to resist that belief if you stay here, 'cause here for eternity you must be passive as Hell."

Bruno was certain St. Pete must be joking, so he faced him squarely and forcefully replied,
"You've clearly never experienced the thrill of pursuing—a well-crafted argument that can't be denied,
Or, St. Peter, I know you'd quickly agree, it feels so right to argue, the urge just can't be denied."

"And though Heaven is certainly lovely, and eternity sounds so sublime,
With your ban on argument I would have to be leaving, or I'd soon be a vocal proponent of crime.
If I can't assert, then defend, my opinions in Heaven—somewhere else is where I'll be spending my time."

Upon which the firmament trembled about him—Heaven exploded in a great burst of light,
And the clouds 'neath Bruno's feet dissipated, as he tumbled back down through the night.
Then just as he passed through the Hell's fiery gates, he awoke from his dream full of fright.

Now the lesson to be learned from Bruno's story, is that business appraisers should ensure that it's worth,
Giving in to the temptation to argue like Hell (where most appraisers seem to be heading since birth)
And since their urge to contend is so hard to resist, it's for them, Heaven (as well as Hell) here on earth!

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