

VALOREM PRINCIPIA

The Principles of Value

Volume 10 Issue 1 February 2002

A New Era of Accounting Standards

by: Sanli Pastore & Hill, Inc.

AMORTIZE: To liquidate or extinguish a mortgage, debt or other obligation, especially by periodic payments to the creditor or to a sinking fund.

GOODWILL: An intangible, salable asset arising from the reputation of a business and its relations with its customers.

By reading these definitions of amortize and goodwill, as provided by The Random House Dictionary, one might conclude that goodwill should increase as a company grows, rather than diminish at some arbitrary rate. However, over thirty years ago, the Accounting Principles Board (APB)² issued Opinion No. 17 (APB 17), requiring goodwill resulting from an acquisition where purchase method accounting was applied to be amortized systematically over a finite life.

Ever since then, many analysts and investors have been arguing against this unfounded practice of reducing a company's earnings.

The Financial Accounting Standards Board (FASB)² recently overturned APB 17 with Statement of Financial Accounting Standards No. 142 (FAS 142) - Goodwill and Other Intangible Assets. Pursuant to FAS 142, goodwill amortization has been eliminated for financial reporting purposes. Instead, all newly acquired and existing goodwill is to be tested annually³ at each reporting unit to determine whether it has been impaired, applying a 2-step test:

STEP 1: Conduct "Screening Test" - compare reporting unit's Fair Value (FV) to its Carrying Value (CV):

- i) The FV of reporting unit is defined by FASB as "the amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale."

Conclusion on Page 2

Business Valuations in Shareholder Disputes

by: Thomas E. Pastore, Chief Executive Officer

Numerous circumstances can create the need for shareholders to determine the value of their privately-held company. Common reasons include retirement, execution of a buy-sell agreement, or divorce. Regardless of the cause, the situation typically bears some level of dissension and can lead to litigation. This article presents three ways in which a business valuation expert can help resolve shareholder disputes with respect to business value - either in or out of the courtroom.

When the shareholders of a business are faced with the dilemma of determining their business' value, a business valuation expert can assist in resolving the matter.

Experts typically are retained to:

1. Determine a preliminary assessment of business value and/or damages;
2. Provide a third-party, independent opinion of value of the business to both parties in the dispute; and/or
3. Provide a valuation opinion for litigation support.

PRELIMINARY ASSESSMENT

Retaining a business valuation expert to conduct a preliminary assessment of business value and/or damages can be an efficient method of resolving a shareholder dispute outside of a courtroom. A preliminary assessment often is employed to determine damages,

such as lost profits and lost business value, and usually can be provided by the expert in a timely and cost-effective manner. The client and legal counsel may utilize this information before and during negotiations for settlement purposes. A preliminary assessment also is useful in determining whether pursuing litigation would be a cost-effective approach to resolving the dispute.

A preliminary assessment of business value only requires a limited level of diligence. The scope of work typically includes the following:

- ◆ Limited review of financial statements

Conclusion on Page 2

INSIDE THIS ISSUE

- 1-2.....A New Era of Accounting Standards
- 1-2.....Business Valuations in Shareholder Disputes
- 3-4.....Friends of SP&H: Davis, Fox & Berke, LLP
- 3.....Goodwill Loss Seminars
- 3.....Fairness Opinions for Public-Private Partnerships
- 3.....San Diego Expansion
- 4.....SP&H Calendar: Recent & Upcoming Events

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Continued from Page 1

- ii) The CV of reporting unit is the total asset reported on its balance sheet.

If FV > CV, no further actions are taken

STEP 2: If FV < CV, proceed with detailed analysis to determine goodwill impairment:

- i) Determine FV of reporting unit's net assets.
- ii) Deduct FV of reporting unit's tangible and intangible net assets to determine implied FV of goodwill.
- iii) Deduct implied FV of goodwill from CV of goodwill to determine impairment charge, if negative.

What does this mean for companies carrying goodwill on their balance sheets? While they may incur additional upfront costs to have an independent provider of business valuations conduct the annual goodwill impairment test, their earnings will reflect a more accurate snapshot of their operations.

Who is qualified to perform goodwill impairment testing? The SEC recently issued revised auditor independence rules stating that a company's accountant cannot provide independent valuation and audit opinions if it is reasonably likely that the results of the valuation would be material to the financial statements, or where the accountant would audit the results.

SP&H is a premier, independent provider of business valuations, with an emphasis on valuing intangible assets and goodwill. SP&H's sole business is providing comprehensive business valuations, due diligence and articulate reporting that can withstand third-party scrutiny.

¹The APB was the standards-setting body for accounting principles that issued opinions from November 1962 to June 1973. It was succeeded by the FASB.

²The FASB is a private sector organization designated to establish standards of financial accounting and reporting. FASB's standards are recognized by the SEC and the AICPA as governing the preparation of financial reports.

³Certain circumstances that indicate impairment may require mid-year testing.

For more information about determining goodwill impairment or valuing intangible assets, please contact SP&H at (310) 571-3400 or bizval@sphvalue.com ♦

Continued from Page 2

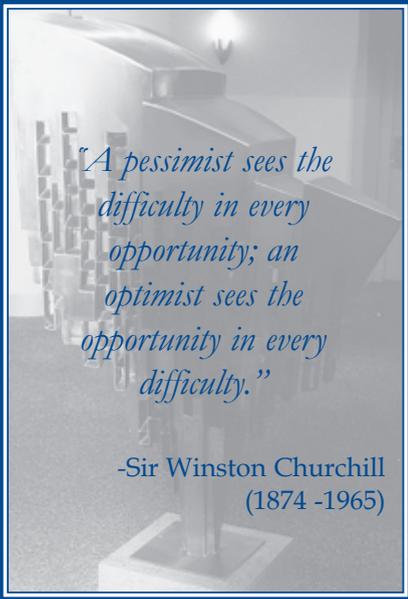
- ♦ Cursory review of market and business transactional data
- ♦ Review of initial results with client and/or counsel

The output provided to the client and counsel by the expert often is an oral opinion or a brief opinion letter with accompanying schedules that outlines the steps taken by the expert to derive the value conclusion. Due to the limited level of diligence performed, a preliminary assessment only should be utilized prior to or during the initial stages of litigation.

INDEPENDENT VALUE OPINION FOR BOTH PARTIES

The parties involved in a business valuation dispute may each decide to retain their own business valuation expert. Alternatively, the parties may decide to jointly retain an expert. In a joint retainer situation, the expert must analyze the issues involved objectively and assist in negotiating a settlement agreement. To accomplish this result, the expert interviews all parties involved and usually performs due diligence procedures to render a complete opinion of value. A complete opinion entails a level of diligence above and beyond that of the preliminary assessment described above, and is prepared to withstand third-party scrutiny in deposition and trial. Depending on the level of reporting desired, the expert's results may be provided to both parties as an oral opinion, letter opinion, a short format

report, or a full narrative report. Jointly hiring a single valuation expert to resolve a dispute outside of the courtroom can create numerous benefits to the shareholders. When a single expert is used, the shareholders bear substantially lower professional fees, management and staff do not have to commit as much time to provide the necessary due diligence items to the expert, and the valuation results are provided expeditiously.



VALUATION OPINIONS FOR LITIGATION

If the dissenting shareholders cannot reach a settlement, proceeding with

litigation may be the only alternative. Once the dispute is taken to court, a business valuation expert should be retained to perform a complete opinion of value, as described above.

To provide a complete opinion of value for litigation, the expert analyzes the company and its operations, industry, market, competitive, and economic factors. In addition, the expert typically interviews key employees and management and reviews any other pertinent appraisals, such as real estate appraisals. The level of reporting (oral, letter or full report) often depends on the case's court jurisdiction.

CONCLUSION

Retaining a business valuation expert during the pre-litigation phase of a business valuation dispute often results in an economical resolution to the dispute. If, however, the matter fails to settle and proceeds to trial, a business valuation expert can assist by performing a full due diligence valuation to present crucial evidence in the court proceedings.

For more information on resolving disputes involving business valuation issues, please contact Tom Pastore at (310) 571-3400 or tpastore@sphvalue.com ♦

Davis, Fox & Berke, LLP, based in Century City, was founded by Calvin Davis, Steven Fox and Ken Berke about eight years ago. The three partners unite diverse backgrounds, including experience with large law firms and Fortune 100 companies. They pride themselves on providing sophisticated, cost-effective legal services to their clients while maintaining a small firm's focus on customer service.

VP: What are DFB's areas of practice?

DFB: We offer both litigation and transactional services to our clients, handling business, real estate, entertainment and employment litigation, as well as insurance coverage disputes. Our corporate and real estate transactional practice focuses on mergers and acquisitions, securities offerings, business formations and joint ventures, real estate leasing and environmental law. Environmental law is a good example of where we combine our transactional, litigation and insurance expertise for our clients' benefit.

VP: SP&H has enjoyed working with DFB on a variety of dispute resolution cases where our mutual clients walked away extremely happy. What characteristics of your firm's culture result in positive outcomes in such contentious situations?

DFB: Our team approach is the key to successfully resolving cases. While Calvin, a seasoned trial lawyer, is preparing a case for trial in a manner that clearly communicates to the opposing party that he is ready and able to try the case, Steve is combining his litigation and insurance expertise with his background in counseling and mediation to negotiate a settlement. Even if Calvin has answered ready for trial or has given his opening statement, Steve never gives up trying to bring the parties to a reasonable settlement. Most importantly, Calvin has a proven track record of successfully trying those cases that simply will not settle.

VP: What about DFB keeps your transactional clients coming back, deal after deal?

DFB: Ken offers our clients a unique perspective - he has been the "client". For 7½ years, Ken was an in-house attorney, including serving as the general counsel of a \$700 million division of AlliedSignal Inc. (now Honeywell International Inc.). As such, he brings a cost-effective, results oriented approach to business matters. Simply put, we understand that our job is to ensure that our clients understand the legal aspects and implications of all deal points so that they can accomplish their goals of making well-informed business decisions; our job is to not get in the way of the deal.

VP: DFB is a young firm. What are your growth plans over the near term?

DFB: Currently, we are seeking to add more business-contingency litigation to our practice and increase our business/real estate transactional work. Many plaintiffs seek a law firm like ours, which combines traditional litigation services with a business attorney's perspective. We are fortunate to have a loyal client base and outstanding referral relationships with other counsel who ask us to handle breach of contract, fraud, employment, business dissolution and bad faith cases on a contingency fee or on a mixed hourly rate plus contingency fee basis. In the business and real estate transactional area, we would like to continue to represent high net worth individuals and act as outside general counsel to middle market companies having annual revenues of \$5 million to \$300 million.

VP: Your clients enjoy accessibility to senior legal counsel. How will you maintain this culture as you grow?

Conclusion on Page 4

MCLE CREDITS

GOODWILL LOSS SEMINARS

Do you desire a better understanding of goodwill loss analysis?

For more information, please contact
Christine Albino at (310) 571-3400 or
calbino@sphvalue.com



Fairness Opinions for Public-Private Partnerships

SP&H pioneered the use of Fairness Opinions by public agencies to ensure that Projects can withstand third-party scrutiny. Let us help you by providing expert analysis to answer such questions as:

- ◆ Is the Partnership "fair" from a financial perspective for the Agency?
- ◆ Can this Project be considered a gifting of public funds?
- ◆ Is the Agency using public funds in a financially sound manner?
- ◆ Are there any conflicts of interest inherent in the transaction?
- ◆ How can Project completion risks and conflicts of interest be mitigated?

*For more information, please contact Nevin Sanli at
(310) 571-3400 or nsanli@sphvalue.com ◆*

San Diego Expansion

SP&H is pleased to announce the expansion and relocation of our San Diego operations!

Sanli Pastore & Hill, Inc.
402 West Broadway, Suite 1220
San Diego, California 92101
619/233-1801 Main
619/233-1803 Fax

*Contact: Peter J. Butler, Manager
San Diego Operations
pbutler@sphvalue.com ◆*

Continued from Page 3

- DFB:** Our clients always have direct access to us, whether we are in the office, at home or out of town. We take great pride in our responsiveness to our clients, and many of them are good friends. Also, we believe in hiring experienced attorneys as part of our team. Among the eight lawyers in the firm, only one has less than 14 years' experience. We intend to maintain this level of sophistication as we grow, even if it means slower growth.
- VP:** Are there any other major differentiating characteristics of DFB?
- DFB:** We believe it is important to be part of the community and to give back to the community. The firm represents a number of non-profit organizations and actively provides pro bono services. For instance, Steve represents clergy (primarily rabbis) in contract negotiations and other matters in their relationship with their churches and synagogues. He also mediates disputes between professional staff and religious organizations. Ken is the former Chair of the Corporate Law Departments Committee of the Business Law Section of the State Bar and currently is on the Board of Directors of two nonprofit organizations: the Eisner Pediatric and Family Medical Center and the Streetlights Production Assistant Program. Many of the other attorneys in the firm also volunteer their time to help non-profit organizations.

Davis, Fox & Berke, LLP is located in Century City and can be reached at (310) 286-2915 or at info@dfblawfirm.com ♦

RECENT & UPCOMING EVENTS

January 24th - 25th - Downtown, Los Angeles

CLE International's 2nd Annual Choice of Entity Conference

Thomas Pastore presented "Succession Planning and Valuation issues".

January 30th - San Diego

San Diego Bar Association Eminent Domain Luncheon

Nevin Sanli presented "Goodwill Loss Valuation for Eminent Domain".

February 27th - March 1st - Anaheim

2002 CRA EXPO

SP&H will be a Presidential Exhibitor

March 14th - 15th - Los Angeles

CLE International Regulatory Takings Conference

Nevin Sanli will be presenting "Calculating Damages & Analyzing Liability in Inverse Condemnation".

March 21st - Santa Monica

MAI's Western Region Appraisal Institute

Nevin Sanli will be presenting "How and when to use a Business Valuation Expert".

March 26th - Orange County

Orange County Bar Association - Real Estate Section Luncheon

Nevin Sanli will be presenting "Analysis of Goodwill Loss for Condemnation".

April 22nd - 26th - San Ramon

CRA Redevelopment Institute Northern California Session

Nevin Sanli will be presenting "Property Acquisition & Relocation".

Published by SANLI PASTORE & HILL, INC.

1990 S. Bundy Drive, Suite 800, Los Angeles, CA 90025

Telephone: Los Angeles 310/571-3400 Fax: 310/571-3420
San Francisco 415/955-2699
San Diego 619/233-1801
Sacramento 916/614-0530

E-mail: bizval@sphvalue.com

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Articles, letters, comments and suggestions are welcome. Please contact Christine Albino at 310/571-3400 or calbino@sphvalue.com ♦