THE **Mangold Group Messenger**

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Hello,

Some people love to be self–sufficient. Lately, for example, seed companies and sewing machine manufacturers are experiencing a boom, as more people are cutting costs by growing their own vegetables and making their own clothes.

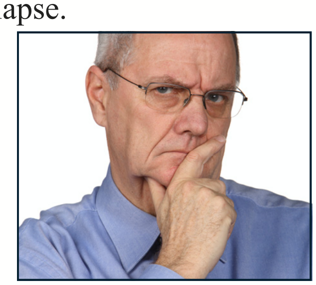
But there are limits to doing things yourself: even if you own a first aid kit, you won't want to do your own surgery.

The same applies to buying or starting a business. In this issue, we look at how getting expert advice to determine a business's true value, look for potential income opportunities and avoid tax penalties can make a huge difference in profitability and growth.

Thomas Mangold, CPA

What's It Really Worth?

The recent meltdown in the housing and stock markets shows how important it is to accurately price assets. Overpriced homes, coupled with easy credit, led to overpriced financial instruments and an eventual credit collapse.



It can be hard enough to determine an accurate price when dealing with a physical object like a house or used car. It is much harder to determine the value of a business, with the multitude of tangible and intangible aspects involved.

When to Value

Just as you would seek an independent appraisal before buying a house, so should you get an independent assessment before agreeing to the value of a business entity. According to the National Association of Certified Valuation Analysts, "it is estimated that $10 trillion dollars in privately owned business capital will pass to a new generation over the next ten years as the baby boomers retire."

Cashing out for retirement and passing business control to heirs are two reasons to have a business valued, but there are many others, including:

Litigation – Determining the value of a company's assets for enforcing a judgment or to show how a tort impaired the value.

Buying Insurance – The value of both the tangible and intangible assets changes every few years, which affects the size of the policy the business needs to carry. If you put

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Buying a Business

Laurel Johnson, Managing Director
Sunbelt Business Brokers of Austin

Laurel Ann Johnson worked in sales and marketing for several large companies before owning her own company in the telecommunications equipment industry. Now, as owner and managing director of Sunbelt Business Brokers of Austin, she has spent the past decade helping others become business owners. She acts as the intermediary between individuals who are looking to sell their business and potential buyers. When she has someone who is interested in purchasing one of the businesses, after the initial agreement is reached, she advises that they get independent financial advice before finalizing the agreement.

"It is wise to have a competent professional look at the business financials with you, so you go into a business acquisition with your eyes wide open," she says. "Every business is different, and you need someone who knows how to find and interpret the relevant information."

Earlier this year, Johnson facilitated the sale of a Furniture Medic franchise to Gunnar Lovblom. He had spent the last ten years in network software development, working for a Fortune 100 company, but decided it was time for a change.

"I was tired of high tech work and wanted to do something with my hands," he says.

In addition to writing software, Lovblom had been building furniture, as well as doing ceramics and painting. When he saw that Sunbelt had a listing for a Furniture Medic franchise, that seemed like a perfect match. Since he had never owned a business before, Johnson recommended that he have The Mangold Group advise him on the purchase.

"It is wise to have a competent professional look at the business financials with you, so you go into a business acquisition with your eyes wide open." - Laurel Johnson

"The Mangold Group is really suited for doing that," she says. "They know business. It is not just a matter of making sure all the numbers add up, but also knowing where the trouble spots might be as well as what opportunities exist for growing the business."

Marlene Van Sickle, CPA, went over the cash flow and financial records with him so he could gain a fuller understanding of the business's current health. He also had her prepare an income projection, so he could see what income he was likely to make as a business owner, taking into account fluctuating business conditions.

"They were very accessible, very quick to respond and very professional," says Lovblom. "Marlene was also good at networking and put me in contact with others who can help me expand the business."

Following the discussions, the sale of the business closed in March. Now, instead of spending his time in front of a computer, Lovblom is busy restoring pianos, renovating law offices, and installing kitchen cabinets.

Johnson says that, since the economy is down, it is a good time to buy a business.

"There are a lot of really great deals out there," says Johnson. "But it is even more important when times are tough and businesses may have suffered a bit, to have a competent advisor review the finances with you."

Gunnar Lovblom, Owner, Furniture Medic, Cedar Park

What's It Really Worth?

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the value too high, you are wasting money paying for excessive coverage. But if you set the value too low, an illness, natural disaster, business claim or partnership dissolution can force the company out of business since the insurance is inadequate to cover the losses.

Buy/Sell Agreements – Current assessments of the value of the business are needed to make it worthwhile to keep the business intact after the dissolution of a partnership.

Taxation – This includes living wills, estate planning, or any other transactions that have tax consequences.

Divorce – An accurate valuation is needed to properly distribute the marital assets.

Sale or Purchase of a Business – Both sides may want to conduct their own valuation before finalizing negotiations.

Mergers and Acquisitions – To determine what portion of the merged company will be held by the owners of the previous entities.

How to Value

The purpose of a business valuation is to determine its fair market value (FMV) or fair value (FV). For tax purposes, the federal government defines FMV as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

Conducting a valuation starts with determining which is the best methodology to use. Three commonly accepted methods are the asset-based approach (determining the price for each of the assets and then totaling up the figures), the market approach (what a similar company would sell for on the open market) and the income approach (giving a present value to the future income stream generated by the company).

The next step is to use that method to determine the value of the company by looking at, among other items, the past financial statements, market conditions, the physical assets, the risk involved and the competition.

Finally, all the steps that went into determining the value must be fully documented so they can withstand a challenge by the IRS, by the other parties in the transaction, or by the oposing parties in an arbitration or lawsuit.

In order for it to be accurate and defensible, the valuation

should be conducted by someone who has extensive experience in business accounting. Not only can this person determine the current value of the business, but can advise you on hidden pitfalls or opportunities to increase the value of the business. Key to this is establishing the future cash flow that you can expect from the business. Depending on the type of business, you may not be able to make as much in the beginning as the current owner. Or you may be able to make considerably more by taking simple actions to improve its operations.

If you are considering buying or starting a business, give us a call. We can help you get it off to a good start.

Help a Friend!

Do you know someone who is:

Worried about their taxes?

Uncertain about their finances?

Drowning in paperwork?

Send them to our office. We will help them achieve the peace of mind that comes with having their finances under control. We will help you have a night on the town by sending you two free movie tickets.

Financing a Business with your 401(k)

If you are looking at starting or buying your own business, borrowing the necessary start-up capital can be prohibitively expensive. A better option may be to use the money you have saved in an Individual Retirement Account (IRA) or 401(k) instead.

The downside is that cashing out a retirement account can cost you nearly half of the money you withdraw. First of all, if you are below retirement age, there is the 10% penalty for early withdrawal. On top of that, since the entire withdrawal is counted as income in the current year, this can mean paying as much as an additional 35% in federal income taxes.

One way to avoid paying these penalties and taxes is to set up an Employee Stock Ownership Plan (ESOP) and purchase the ESOP stock using your retirement funds. It does require some time to set up the ESOP, and also requires the services of an accountant, an attorney and a stock brokerage firm. But if you and your business partners are investing enough money in the new business, those fees can be much less than what you would pay the IRS or what you would pay to borrow the startup funds. For more information on setting up and ESOP and to find out if it is right for your situation, call to schedule an appointment with one of our accountants.

OOPS —THERE'S A TYPO

We have hidden a typo in our newsletter. Be the first to find it and email us at newsletter@mangoldcpa.com.
You will **WIN 4 Movie Tickets**

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