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compensation extremely challenging when a valuation analyst is conducting a business valuation, according to Kevin Yeanoplos, CPA/ABV/CFF, ASA, Director of Valuation ...

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Beauty is in the eye of the beholder, as the saying goes, and so apparently is “reasonable compensation” for a business owner.

Many variables can make providing a defensible, rational estimate of reasonable compensation extremely challenging when a valuation analyst is conducting a [business valuation](#), according to Kevin Yeanoplos, CPA/ABV/CFF, ASA, Director of Valuation Services at [Brueggeman and Johnson Yeanoplos](#), P.C. That is because owners of private companies have discretion in terms of the size, timing and payment methods used for compensation and profit distribution, so each owner might handle compensation differently.

However, most valuation analysts would agree that normalizing financials to reflect reasonable compensation for the business owner is critical to avoiding distortion of a business valuation. “There may not be a single adjustment that is more important than the adjustment for reasonable compensation,” Yeanoplos says. “It can make millions of dollars difference [to the business value], depending on that adjustment.”

Using a number for reasonable compensation that results in a valuation that is too high or too low can cause issues when it comes to alimony payments, gift and estate taxes, regulations, etc., according to Yeanoplos. “I’ve got to know what reasonable replacement compensation is to be able to determine the true profit” of the business being valued, he says.

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Below are eight examples of misclassified personal expenses to watch out for, according to Yeanoplos:

1. Rent in excess of market prices paid to a related party
2. Overpaid family member employees
3. Phantom “employees” who are family members
4. Personal usage of company vehicles or other company assets
5. Golf, yacht and social club dues and usage costs, including lessons
6. Loans at below-market interest rates
7. Legal and other professional fees paid for personal matters, such as a divorce
8. Non-business costs of cell phones and internet usage

“If there’s a personal expense that’s been misclassified as a valid business expense, what that does is understates the profit,” Yeanoplos says. “There needs to be an adjustment to increase the profit.”

“All of these things work together,” he says.

Learn more from the recorded webinar, [Keys to the Never-Ending Search for Reasonable Valuation Compensation](#).

Accounting

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