



Divorce Valuation: Theory vs Practice
A Forensic Accountant's Perspective

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- Forensic and Chartered Accountants since 1980
- Commercial disputes, divorce matters, personal injury and clinical negligence, and fraud and proceeds of crime
- Expert witness (including SJE), expert determination and advisory



Topics To Be Covered



International Valuation Standards



Valuation Bases



Valuation Approaches



Valuation Methods



Enterprise and Equity Values



Issues in Divorce Cases

International Valuation Standards (“IVS”)

- Issued by The International Valuation Standards Council
<https://ivsc.org/>
- *“an independent, not-for profit organisation committed to advancing quality in the valuation profession”*
- 7 General Standards and 8 Asset Standards
- Not mandatory, but best practice

Bases of Valuation (IVS 102)

- **No Basis = No valuation – every valuation requires a Valuation Basis just as every valuation must specify precisely what is to be valued and at what date it is to be valued**
- **Describes the fundamental premises or requirements on which the valuation will be based**
- **Reflects assumptions about participants to a transaction and their attributes**
- **Must be appropriate to the intended use of the valuation**



Market Value Basis

- ***“the estimated amount for which an asset and/or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion” (IVS 102 Appendix)***
- **The best price reasonably obtainable excluding any element of value available only to a specific owner or purchaser**
- **Reflects the market and the circumstances as at the valuation date (i.e. without the benefit of hindsight)**
- **Reflects the asset’s highest and best use, be that its existing use or an alternative use. The uses the market participants have in mind when formulating their bid prices will determine this**



Equitable Value Basis

- *“the estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties” (IVS 102 Appendix)*
- Requires the assessment of the price that is fair between two specific, identified parties considering the respective advantages or disadvantages that each will gain from the transaction
- Can involve taking into account matters that have to be disregarded in the assessment of Market Value
- Used to be termed “Fair Value” – beware confusion!

Other IVS defined Bases

- Liquidation Value - the seller being compelled to sell as of a specific date
- Synergistic Value - where the combined value is more than the sum of the separate values
- Investment Value - the value to a particular owner or prospective owner for individual investment or operational objectives
- Market Rent - applies to real property



Valuation Approaches (IVS 103)

The analytical framework applied to estimate value based on the nature of the asset and the available information

- Market Approach - comparing the asset and/or liability with identical or comparable asset and/or liability for which price information is available
- Income Approach - converting projected cash flows to a single current value
- Cost Approach - calculating the current replacement or reproduction cost of an asset and making deductions for all relevant forms of obsolescence



Valuation Methods (IVS 103 Appendix)

A specific technique or process used to apply a chosen valuation Approach

Market Approach Methods

- **Comparable transactions**
- **Guideline publicly traded comparables**

Income Approach Methods

- **Discounted Cash Flow (“DCF”)**
- **Dividend Yield**

Cost Approach Methods

- **Replacement Cost (buy an asset of similar utility)**
- **Reproduction Cost (recreate it)**
- **Summation Method (sum of the parts)**

Most often seen in divorce cases?

- Basis - Market Value (but beware the Court's need to be "fair" in all the circumstances!)
- Approach – Market, using metrics from deals and listed data and the EV x EBITDA Method
- Approach – Income, using DCF Method cross checked to EV x EBITDA Method if the information is available and if the budget allows (not the case for most SMEs and for most divorces)



Enterprise Value (“EV”) 1 of 2

- **Total value - the theoretical cost to purchase the entire business, i.e. both the equity and the debt**
- **A capital structure neutral valuation metric - potentially allows for comparisons of businesses within the same industry, regardless of differences in capital expenditure levels and the utilisation of debt**



Enterprise Value (“EV”) 2 of 2

- Calculate in more than one way e.g. using a multiple x multiplier Method or a DCF Method, discounting the cash flows available to equity and debt holders (after making allowance for capital expenditure and tax costs related to operating activities) to a present value, or directly from equity and net debt data
- It is often the headline price announced for a transaction - adjusted at closing for the actual cash and debt and for other items (e.g. surplus assets, movements between targeted and actual working capital etc.) to arrive at the Equity Value paid to the seller

Equity Value (“EqV”) 1 of 2

- EqV is the value of the equity, i.e. of the shares alone
- Often calculated from the starting point of EV, but can be calculated directly e.g. by adopting:
 - a Market Approach using a Price Earnings Multiple x Earnings Per Share Method; or
 - an Income Approach and a DCF Method to discount forecast free cash flows to equity at the cost of equity



Equity Value (“EqV”) 2 of 2

- **Whether you wish to estimate EV and work towards EqV or estimate EqV directly, always apply “apples to apples” multipliers and discount rates**
- **Apply EV multiples/the weighted average cost of capital to core earnings metrics/cash flows available to debt and equity**
- **Apply EqV multiples/the cost of equity to earnings metrics/cash flows available only to equity**



From Enterprise Value (“EV”) to Equity Value (“EqV”)

1 of 2

- EV is the current value of the future net cash flows, whether these will flow to equity or debt
- It includes the element that will be used to repay the debt
- It does not include a positive figure for cash on hand any more than it includes a deduction for debt already due
- It ignores the cash outflow that will result from repaying current debt and the cash inflow to equity that would result from extracting the current cash (or from the effect of using the cash to reduce the debt)
- $EV - Debt + Cash = EqV$



From Enterprise Value (“EV”) to Equity Value (“EqV”)

2 of 2

- Moving in the other direction, $\text{EqV} - \text{Cash} + \text{Debt} = \text{EV}$
- Cash and Debt may be combined in a “Net Debt/Net Cash” adjustment
- The debt adjustment tends to be readily understood; the role of cash is sometimes less well understood. The following slides may aid in understanding why cash is included in the EqV but not in EV



The Role of Cash in moving from EV to EqV (1 of 2)

- EV comprises the value of equity (the market capitalisation of a listed company, which reflects the cash position of the entity) plus its debt less its cash (i.e. EV does not include cash, and cash will be included in the value of equity and so must be removed to arrive at EV); and
- Cash is reflected in the market capitalisation. It is available to equity, either for dividends or to repay debt and thus leave equity with a higher share of the EV than would be the case if they took dividends but the debt was then repaid without the benefit of the cash; hence
- All other things being equal (i.e. identical market capitalisations and debt balances), a higher cash balance indicates a lower EV and vice versa



The Role of Cash in moving from EV to EqV (2 of 2)

- You might see only part of the cash being adjusted, as “surplus cash” (i.e. after an allowance for cash “needed in the business”). This is incorrect; cash should be adjusted for in its entirety. If the company requires cash post-acquisition, this can be introduced by borrowing, which is neutral as regards EqV because cash increases but so too does debt
- Having said this, there are situations in which not all the cash should be adjusted, e.g. when the working capital position has been manipulated to produce an unsustainably high cash balance (for instance by delaying payments to creditors) or when cash is trapped (e.g. held in a foreign jurisdiction from which it cannot be extracted)

Issues in Divorce Cases (1 of 3)

- Many complications arise from the Family Court's need to achieve a financial settlement that is fair in all the circumstances
- Potential for tension between a theoretical Market Value and the practical reality of the business's continued ownership by one of the spouses
- The business may be so reliant on the spouse who runs it that it is unsaleable. In such a case, information as to the ability to extract capital from the business and the potential earning capacity it provides may be of more help than a Market Value Basis valuation

Issues in divorce cases (2 of 3)

- The Market Value of a non-controlling interest will almost always stand at a discount to its pro rata share of the Market Value of the whole. While the Court may determine that for its purposes a minority discount is inappropriate, this does not change the Market Value.
- A valuation should show the value of the company and of the pro rata share in question and then apply a market discount, whereby the Court should readily see the value it considers it wishes to apply.

Issues in divorce cases (3 of 3)

- Shares may have been introduced at the start of or inherited during the marriage, raising questions about what is included in the marital acquest
- It may be argued that a significant element of current value was created after the parties separated
- Are valuations required at different dates? While each case turns on its own facts, bear in mind Peel J's views in *GA v EL [2023] EWFC 187 (31 October 2023)* and those of Mostyn J in *E v L [2021] EWFC 60*. If so, is a Market Value Basis valuation required? If competently undertaken, it will be a “present day approach” not a “hindsight approach” to use Peel J's terms



The solution to most complications?

- **Consult a forensic accountant sooner rather than later**
- **Be very clear what valuation Basis is to apply (plus what other issues are to be considered)**
- **Allow sufficient time between instruction and reporting (typically, at least 8 weeks)**

Questions?

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