

## THE FINANCIAL ADVISER AND THE AICPA STATEMENT ON STANDARDS FOR VALUATION SERVICES

Cory R. Chiovari and Robert F. Reilly

*Financial advisers perform business and stock valuations for numerous purposes. These purposes include: ESOP formation employer stock purchase analysis, estimating the employer stock redemption prices for ESOP participants who retire or terminate employment, fair value and financial accounting compliance, divestiture and corporate restructuring analysis, merger and acquisition transaction fairness and solvency analysis, not-for-profit entity private inurement analysis, intergenerational wealth transfer planning, gift and estate tax planning and compliance, income tax deduction substantiation, creating and implementing buy/sell agreement provisions, bankruptcy and reorganization analysis, shareholder oppression and shareholder rights litigation, and other commercial litigation matters. This discussion summarizes the new AICPA professional standards related to the valuation of businesses, securities, and intangible assets.*

### INTRODUCTION

CPA valuation analysts often serve as “trusted advisers” to valuation clients. In June 2007, the American Institute of Certified Public Accountants (AICPA) issued Statement on Standards for Valuation Services No. 1 (the “Statement”). The Statement is titled Statement on Standards for Valuation Services No. 1 “Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset.”

The Statement is effective for all valuation engagements accepted by any AICPA member (CPA) after January 1, 2008. Of course, earlier adoption of the Statement is encouraged.

Accordingly, CPAs who perform valuation consulting services should be aware of the Statement requirements. In addition, non-CPA valuation analysts who provide valuation consulting services should also be familiar with the professional valuation guidance provided by the Statement.

The Statement professional guidance represents the current consensus with regard to generally accepted practices and procedures within the valuation profession. And, the Statement provides valuable supplemental professional guidance to the valuation guidelines encompassed in the Uniform Standards of Professional Appraisal Practice (USPAP) and in other recognized valuation standards.

The Statement provides professional guidance in these four related areas:

1. valuation client acceptance and engagement planning considerations

2. valuation analysis, development, and conclusion procedures,
3. valuation workpaper documentation, and
4. valuation reporting requirements.

According to the Statement, a CPA who performs valuation services is referred to as a “valuation analyst.”

Although the application of the Statement provision is only required for CPAs, the Statement is expected to benefit:

1. all CPA valuation analysts,
2. all CPA valuation clients,
3. the business valuation profession in general, and
4. lawyers, judicial finders of fact, government regulators, taxing authorities, investors, financial institutions, and other parties who rely on valuation analyses, and valuation reports.

This list of parties who will benefit from the Statement implementation is based on the premise that any new set of professional standards in the valuation community “raises the bar” for all valuation practitioners.

Even though the application of the Statement is only required for CPA valuation analysts, a general awareness and acceptance of these professional standards will likely

spread through the capital markets, investment banking, commercial banking, private equity, financial accounting, legal, regulatory, federal taxation, and judicial communities.

Sooner or later, all valuation clients may come to expect valuation analyses and/or valuation reports to be of a quality comparable to those prepared in accordance with the Statement. Accordingly, the AICPA adoption of this valuation standard may ultimately cause “all boats to rise when the tide comes in” in the professional valuation community.

The first part of this discussion will summarize the valuation engagement considerations, valuation development/analysis requirements, and valuation documentation/reporting requirements of the Statement. In addition, the first part of this discussion will summarize the application—and the implications—of the Statement to various types of valuation engagements.

## THE PURPOSE AND OBJECTIVE OF THE STATEMENT

For years, securities markets regulators, investors, and taxing authorities have called for the issuance of a codified set of generally accepted valuation standards. In addition, the Pension Protection Act of 2006 (PPA 2006) calls for valuation analysts who perform certain tax-related valuations to comply with “generally accepted appraisal standards.”

In response to this market demand for codified valuation standards, the AICPA issued the Statement in order to:

1. provide CPAs with professional guidance with regard to valuation theory and practice,
2. represent the current professional best practices in the performance of valuation professional services,
3. improve the consistency of CPAs’ valuation practice,
4. improve the quality of CPAs’ valuation practice,
5. enhance the transparency of valuation analyses and valuation reports,
6. encourage the standardization of the valuation reporting content and format,
7. encourage the reliance on the valuation process in the part of clients, report readers, judicial finders of fact, the capital market investment community, regulatory agencies and taxing authorities, and others, and
8. encourage well-documented and unambiguous valuation engagement expectations between the CPA and the valuation client.

*“Both CPA and non-CPA valuation analysts generally perform valuation services for numerous purposes. . . .”*

Both CPA and non-CPA valuation analysts generally perform valuation services for numerous purposes, including: business or security purchase/sale transactions, leveraged M&A transaction financings, planning and compliance, ESOP formation and sponsor company purchases of ESOP-owned employer stock, buy/sell agreement structuring and implementation, transaction fairness, financial accounting and public reporting, debtor company bankruptcy and reorganization, regulatory disclosure and compliance, management information and planning, intergenerational wealth transfer, dissenting shareholder appraisal rights, litigation support, and many others.

Valuations are performed by CPAs from various technical disciplines with the AICPA, including management consulting, litigation services, personal financial planning, tax, and audit.

All CPAs, regardless of their technical discipline, have to comply with the Statement when they perform an engagement to estimate value that results in an expression of either:

1. a conclusion of value or
2. a calculated value.

## THE APPLICATION OF THE STATEMENT

The Statement applies when any CPA is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (collectively called the “subject interest in the statement”). The Statement applies when that CPA:

1. applies valuation approaches and valuation methods (as described in the Statement), and
2. uses professional judgment as an essential component of estimating value.

In fact, the Statement states that “the use of professional judgment is an essential component of estimating value.”

And, it is noteworthy that the Statement is not just a “business valuation standard.” Rather, the Statement applies to the valuation of:

1. a business,
2. a business ownership interest,
3. a security, or
4. an intangible asset.

Clearly, the Statement would apply to any type of security interest encompassed in a transaction, taxation,

financing, corporate planning, financial accounting, or litigation support valuation assignment.

However, the Statement does not apply to a CPA in the following engagement situations:

- The value of the subject interest is provided to the CPA by the member's client or by a third party and (1) the CPA does not apply valuation approaches and methods to calculate a value or to estimate a value and (2) the CPA does not report on the value of the subject interest.
- The CPA performs an engagement to calculate value as part of an audit or review engagement. This exception to the Statement applies because other professional standards cover the work of a CPA during an audit or review engagement.
- The CPA performs an internal use assignment from an employer to an employee CPA who is not working in the practice of public accounting.
- The CPA performs an engagement that is exclusively for the purpose of determining economic damages (unless such a determination is used to estimate the value of a subject interest).
- The CPA performs mechanical computations that do not rise to the level of engagement to estimate value (i.e., where the CPA (1) does not apply valuation approaches and methods and (2) does not use professional judgment).
- Where it is not practical or reasonable for the CPA to obtain or use relevant information and, therefore, the CPA is unable to apply valuation approaches and methods.
- Where a jurisdictional exemption applies, that is, when the Statement differs from published governmental, judicial, or accounting authority.

*"Before accepting the engagement, the valuation analysts should establish an understanding with the client."*

## VALUATION ENGAGEMENT ACCEPTANCE AND PLANNING CONSIDERATIONS

In determining his or her professional competence to perform a particular valuation engagement, the Statement indicates that the CPA should consider the following factors:

1. the subject entity and the subject industry
2. the subject interest
3. the valuation date
4. the scope of the valuation engagement, including:

- the purpose of the engagement
  - any assumptions and limiting conditions
  - the applicable standard of value
  - the type of report to be issued
  - the intended use and users of the report
  - any restrictions on the use of the report
5. any governmental regulations or other professional standards that may apply to the engagement.

Before accepting the engagement, the valuation analyst should establish an understanding with the client. The Statement indicates that the client understanding can be oral (with workpaper documentation) or written.

However, the Statement expresses a strong preference for a written engagement understanding between the valuation analyst and the valuation client.

The Statement indicates that any scope restrictions on the valuation analyst's work or on the subject entity data availability should be disclosed in the valuation report.

According to the Statement, the valuation analyst may rely on third-party specialists (such as a real estate appraiser or an equipment appraiser) in the valuation. However, the valuation analyst must disclose, in the assumptions and limiting conditions section of the report, the level of responsibility (if any) that the CPA assumes for the work of any third-party specialists.

## TWO TYPES OF ENGAGEMENTS

The Statement describes two types of engagements:

1. a valuation engagement and
2. a calculation engagement.

A valuation engagement calls for the valuation analyst to estimate the value of the subject interest. In a valuation engagement, the CPA:

1. must follow the valuation analysis and development section of the Statement and
2. is free to select and apply the appropriate valuation approaches and methods.

In a valuation engagement, the quantitative results of the analysis are expressed as a "conclusion of value"—either as a single amount or as a range of values.

In a calculation engagement, the valuation analyst and the client agree on (1) which valuation approaches and methods are to be used and (2) the extent to which these valuation procedures are to be performed. In a calculation engagement, the CPA calculates the value using these agreed upon procedures.

In a calculation engagement, the quantitative results of the analysis are expressed as a “calculated value”—either as a single amount or as a range of values.

## VALUATION ENGAGEMENT DATA REQUIREMENTS

In a valuation engagement, the Statement indicates that the minimum information the valuation analyst needs in order to analyze the subject interest depends on the following factors:

1. the nature of the subject interest
2. the scope of the subject valuation engagement
3. the valuation date
4. the intended use of the valuation
5. the applicable standard of value
6. the applicable premise of value
7. any applicable assumptions and limiting conditions
8. any applicable government regulations or other professional standards

According to the Statement, the valuation analyst should obtain and analyze ownership information regarding the subject interest. The valuation analyst should consider this ownership information in order to:

1. determine (a) the type of the subject ownership interest and (b) whether the ownership interest is a controlling ownership interest or a noncontrolling ownership interest;
2. analyze (a) the ownership interests of the other subject interest owners and (b) the impact of that other ownership on the value of the subject interest;
3. understand (a) the various outstanding classes of ownership interest and (b) the legal rights assigned thereto; and
4. understand the rights included in—or excluded from—each subject intangible asset.

In reaching the conclusion of value in a valuation engagement, the valuation analyst is required to:

1. correlate, reconcile, and assess the reliability of the various value indications from the different valuation approaches and methods used in the analysis, and
2. determine whether the value conclusion should be based on a single valuation method only or on a combination of valuation methods.

The Statement defines a “subsequent event” as an event that occurs (1) subsequent to the valuation date but (2) prior to the date of issuance of the valuation report. According to the Statement, the valuation analyst should distinguish between two types of subsequent events.

In the first type of subsequent event, the analyst should consider in the valuation analysis those events that are indicative of conditions that were known or knowable as of valuation date.

In the second type of subsequent event, the analyst should not consider in the valuation analysis (but the valuation analyst may disclose in the valuation report) any subsequent event that is not indicative of conditions that were known or knowable as of the valuation date.

According to the Statement, the valuation analyst’s considerations with regard to a calculation engagement should include the following factors, at a minimum:

1. the identity of the client
2. the identity of the subject interest
3. the ownership control and the marketability elements of the subject interest
4. the purpose and the intended use of the calculated value
5. the intended users of report and any limitations on the report use
6. the valuation date
7. the applicable standard of value
8. the applicable premise of value
9. the sources of information used in the calculation
10. any valuation approaches and methods agreed on with the client
11. the disclosure of any subsequent events.

## VALUATION APPROACHES AND METHODS

According to the Statement, the valuation analyst should use all valuation approaches and methods that are appropriate to the subject engagement. Accordingly, the Statement indicates that the valuation analyst should consider (but not necessarily use) each of the three generally accepted valuation approaches.

That is, for a business, business ownership interest, or security valuation, the valuation analyst should consider:

1. the income approach,
2. the market approach, and
3. the asset-based approach.

For an intangible asset valuation, the valuation analyst should consider:

1. the income approach,
2. the market approach, and
3. the cost approach.

It is noteworthy that the Statement does not require the analyst to use all three valuation approaches. Rather, the Statement does require the valuation analyst to consider the use of all three valuation approaches.

The use of a “rule of thumb” pricing multiple or other rule of thumb mechanism is not considered an appropriate valuation method under the Statement. However, a “rule of thumb” may be used as a reasonableness check in the valuation analysis.

According to the Statement, a rule of thumb generally should not be the only method that is used to value the subject interest.

The Statement indicates that, in a business or security valuation, the valuation analyst should consider whether any valuation adjustment should be made to the pre-adjustment value indication, including:

1. a discount for lack of marketability,
2. a discount for lack of ownership control, or
3. a premium for ownership control.

And, in a business or security valuation, the valuation analyst should specifically consider the existence of non-operating assets, nonoperating liabilities, and any excess/deficient operating assets. In addition, the valuation analyst should specifically consider the impact of a lack of ownership control (if any) on the value of such assets/liabilities.

## TYPES OF VALUATION REPORTS

According to the Statement, a valuation report is any communication to a client containing the conclusion of value or

the calculated value of the subject interest. The Statement allows that valuation reports may be either written or oral.

There is an exemption from the Statement reporting provisions for valuations prepared for certain controversy proceedings. This reporting requirement exception is applicable whether the matter proceeds to trial or it settles before trial.

For a valuation engagement resulting in a conclusion of value, the Statement allows for two types of reports:

1. the detailed report
2. the summary report

For a calculation engagement resulting in a calculated value, the Statement only allows for one type of report: the calculation report.

For both types of engagements (i.e., a valuation engagement or a calculation engagement), the Statement allows for oral reports.

## The Detailed Report

According to the Statement, the valuation engagement detailed report should provide sufficient information to permit the report user to understand the data, reasoning, and analyses underlying the indicated value conclusion.

According to the Statement provisions, a detailed report should include the following sections:

1. a letter of transmittal
2. a table of contents
3. an introduction
4. the sources of information used in the valuation
5. an analysis of the subject entity and of the related non-financial information
6. a financial statement/financial information analysis
7. the valuation approaches and methods considered
8. the valuation approaches and methods used
9. any valuation adjustments made
10. any nonoperating assets and liabilities; and any excess/deficient operating assets
11. the representation of the valuation analyst
12. the reconciliation of the value estimates and the conclusion of value
13. the professional qualifications of the valuation analyst

*“According to the Statement, a valuation report is any communication to a client containing the conclusion of value or the calculated value of the subject interest.”*

## The Summary Report

According to the Statement, the valuation engagement summary report should provide a summary of the information that would otherwise be provided in a detailed report.

According to the Statement provisions, a summary report should include the following information:

1. the identity of the client
2. the purpose and the intended use of the valuation
3. the intended users of the valuation
4. the identity of the subject entity
5. a description of the subject interest
6. the subject interest ownership characteristics and the degree of marketability
7. the valuation date
8. the valuation report date
9. the type of report issued (i.e., a summary report)
10. the applicable standard of value
11. the applicable premise of value
12. the sources of information used in the valuation
13. any applicable assumptions and limiting conditions
14. any restrictions or limitations on scope of work or on the data availability
15. any hypothetical conditions assumed
16. a description of any specialist's work relied on and the level of responsibility (if any) that the valuation analyst assumes for the specialist's work
17. the valuation approaches and methods used
18. a reconciliation of the various value estimates and a conclusion of value
19. a disclosure of any subsequent events
20. any jurisdictional exception
21. the representation of the valuation analyst
22. the signature of the valuation analyst or the valuation analyst's firm

## The Calculation Report

The Statement indicates that a calculation report is the only type of report that should be used to report the results of a calculation engagement. Of course, the report should state that it is a calculation report.

According to the Statement, the calculation report should identify the following items, as a minimum:

1. any hypothetical conditions used
2. any jurisdictional exception
3. any assumptions and limiting conditions

4. a description of any specialist's work relied on and the level of responsibility (if any) that the valuation analyst assumes for the specialist's work
5. a disclosure of any subsequent events

In addition, the Statement provides that the calculation report should summarize the calculated value, including the following:

1. an identification of the subject interest
2. an identification of the calculation date
3. the valuation report date
4. a statement that the valuation analyst is not obligated to update the calculation
5. a description of the calculation procedures
6. a statement that the calculation was performed in accordance with the Statement
7. a description of the subject interest characteristics, including the characteristics of ownership control and marketability
8. a statement that the estimated value is a calculated value
9. a general description of the calculation engagement
10. the calculated value
11. the signature of the valuation analyst or the valuation analyst's firm

## The Oral Report

The Statement allows for an oral report to be used in either (1) a valuation engagement or (2) a calculation engagement. The Statement indicates that an oral report should include all information necessary to relate the scope, assumptions, limitations, and results of the engagement.

Of course, the oral report should be made in a way so as to limit any misunderstanding between the valuation analyst and the oral report recipient. And, the valuation analyst should document the substance of the oral report in the engagement workpapers.

## SUMMARY

The Statement applies to all CPAs who perform valuation services, including valuation services related management information and strategic planning engagements. The Statement is effective for any valuation engagement accepted by a CPA after January 1, 2008. Of course, early adoption of the Statement is encouraged.

The application of the Statement is expected to provide benefits to CPA valuation analysts, to their valuation

clients, to parties who rely on CPA-prepared valuation reports, and to the general valuation profession. This is because all valuation analysts (CPA or otherwise) may be able to benefit from the professional guidance provided by a new set of authoritative valuation standards.

The Statement allows for two types of engagements: (1) a valuation engagement and (2) a calculation engagement. And, the Statement allows for several types of valuation reports.

For a valuation engagement, the Statement permits two types of reports:

1. a detailed report and
2. a summary report.

For a calculation engagement, the Statement only permits one type of report: a calculation report.

And, for all engagements, the Statement allows for oral reports.

The Statement applies to all engagements to estimate value when the CPA:

1. applies valuation approaches and methods and
2. uses professional judgment in that application.

Based on years of deliberation and debate encompassing numerous groups within the AICPA, this Statement is expected to provide authoritative professional guidance, greater practice consistency, enhanced analytical transparency, improved client communication, structured engagement service levels, and well-defined valuation reporting options.

The benefits of the Statement should accrue not only to CPA valuation clients, but to other parties who rely on valuation reports prepared in accordance with the Statement. These parties include: commercial and investment banks, lawyers and judges, taxing authority auditors, regulatory authority examiners, and others who rely on valuations prepared in accordance with the Statement provisions.

Perhaps more importantly, the Statement may ultimately benefit (1) the general valuation profession and (2) all parties who rely on valuation reports. As the Statement professional guidance becomes generally accepted practice among valuation analysts (whether they are CPAs or not), the general quality, consistency, transparency, and “best practices” aspects of this authoritative valuation guidance will accrue to all valuation analysts—and to all valuation clients.

## IMPLEMENTATION OF THE STATEMENT PROVISIONS

The second part of this discussion relates to the implementation of the Statement provisions and requirements. The parties who may implement the Statement include the valuation services practice of a CPA firm or the valuation consulting practice of a non-CPA financial advisory services firm.

Of course, only CPA valuation analysts are obligated to comply with any AICPA professional standard, including the Statement. Nonetheless, non-CPA financial advisers should also be aware of:

1. the provisions of the Statement and
2. the implementation guidance with regard to the Statement.

Even non-CPA financial advisers have an interest in the Statement professional guidance for several reasons.

First, the Statement was the product of a rigorous and comprehensive professional standards development process. Accordingly, whether the valuation analyst is a CPA or not, the Statement does contain the collective thinking of the AICPA, a 350,000+ member professional organization.

Second, CPAs are regularly identified in surveys of business owners and corporate executives as the “most trusted” professional adviser. Accordingly, parties who rely on valuations, particularly valuations prepared for management information and strategic planning purposes, will give a lot of creditability to AICPA professional standards.

Third, the Statement is a clear and cogent statement of the current “best practices” within the business/intangible asset valuation profession.

Therefore, while the adoption of the Statement is only required for CPA valuation analysts, all valuation analysts should consider how they (and their clients) can benefit from this Statement.

## RECOMMENDED PROCEDURES FOR THE IMPLEMENTATION OF THE STATEMENT

The following list provides ten recommended procedures for the implementation of the Statement requirements into a financial advisory services/valuation practice. It is noteworthy that the Statement applies to CPAs from all technical disciplines (e.g., audit, accounting, tax, consulting,

*“. . . all valuation analysts (CPA or otherwise) may be able to benefit from the professional guidance provided by a new set of authoritative valuation standards.”*

personal financial planning, litigation services, etc.) who perform valuation services.

However, like the Uniform Standards of Professional Appraisal Practice (USPAP), the Statement provides valuable professional guidance to all valuation analysts—whether or not those analysts are required to comply with that guidance.

These recommended implementation procedures are directly applicable to CPA valuation analysts who provide business, security, and intangible asset valuation services. However, these procedural recommendations also have general application to non-CPA valuation analysts who provide business, security, and intangible asset valuation services.

### Procedure No. 1

The valuation analysts should designate one analyst as the firm's resident expert on the Statement. Of course, each valuation analyst who provides business, security, and intangible asset valuation services should read and be familiar with the Statement. However, the one analyst may serve as the firm's "go to" person on the training, implementation, interpretation, and quality control issues related to the Statement.

This procedure should help the firm to (1) develop its expertise with regard to the Statement requirements and (2) ensure consistency among valuation analysts with regard to the application of the Statement professional guidance.

### Procedure No. 2

Each valuation analyst who performs valuation services should have his or her own copy of the Statement. Obviously, each firm should have a copy of the Statement in its library, along with copies of all other authoritative valuation-related professional standards.

These other valuation professional standards may include (1) USPAP and (2) the professional standards promulgated by the various valuation membership organizations.

These membership organizations include: (1) the American Society of Appraisers (ASA), (2) the Institute of Business Appraisers (IBA), and (3) the National Association of Certified Valuation Analysts (NACVA).

In addition, the subject financial advisory services firm should have a sign-off procedure confirming that each valuation analyst has received—and read—his or her individual copy of the Statement.

### Procedure No. 3

All of the firm's valuation analysts should meet (in person, if possible) to discuss the implementation of the Statement. The purposes of this valuation analyst Statement implementation meeting are:

1. to review the engagement acceptance/valuation development, engagement workpaper documentation, value reporting requirements of the Statement and
2. to discuss the firm's proposed implementation procedures with regard to the application of the Statement.

This implementation meeting procedure should help ensure both communication and consistency among all of the firm's valuation analysts.

### Procedure No. 4

*" . . . the subject financial advisory services firm should have a sign-off procedure confirming that each valuation analyst has received—and read—his or her individual copy of the Statement."*

The firm's valuation analysts should inform all of the firm management and members about the issuance of the Statement. These valuation analysts may offer internal training regarding the provisions of the Statement to all firm members who are interested.

This internal communication should reinforce the awareness of all the firm management and members as to:

1. the professionalism of the firm's valuation analysts and
2. the breadth of the firm's business, security, and intangible asset valuation services practice.

### Procedure No. 5

Valuation analysts should communicate the content and the intent of the Statement to the firm's recurring valuation clients and valuation referral sources. This communication should describe any expected changes in the firm's valuation services, procedures, reports, and so forth. While enhancing the subject firm's reputation for valuation services professionalism and quality, this communication should also reinforce the firm's valuation services marketing messages to its valuation clients and its valuation referral sources.

If the firm's valuation clients and referral sources are local, then the valuation analysts may also offer to provide a client training program with regard to the provisions of the Statement.

### Procedure No. 6

Valuation analysts should prepare a list of expected client benefits related to the adoption of the Statement provisions. In addition to the valuation analysts, all the firm's management and members should be familiar with this list of the benefits that valuation clients should expect from the implementation of the Statement.

All of the firm's members should use this list to respond to any real or perceived client concerns (e.g., regarding potential increases in valuation services fees, potential increases in valuation report delivery time, etc.). This list will help both the firm and the firm's valuation clients to understand that the benefits related to the Statement adoption far exceed any costs related to the Statement adoption.

### Procedure No. 7

Valuation analysts should develop (1) a new firm client acceptance checklist or protocol for employer corporation stock valuation engagements and (2) new firm engagement letter language for business, security, or intangible asset valuation engagements.

Such a client acceptance checklist and/or engagement letter language should incorporate the engagement considerations, terminology, valuation service descriptions, and valuation report definitions included in the Statement.

### Procedure No. 8

Valuation analysts should develop a new firm valuation engagement work program or procedures checklist for the business, security, or intangible asset valuation analysis. This work program and/or procedures checklist should encompass all of the Statement valuation engagement performance/documentation requirements.

This work program or procedures checklist should also incorporate the Statement terminology and required considerations related to: type of engagement, necessary subject entity financial information, necessary subject entity nonfinancial information, generally accepted valuation approaches and methods, and so on.

### Procedure No. 9

Valuation analysts should develop new firm valuation engagement report formats and valuation report checklists. These formats and checklists should incorporate the valua-

tion report types, report content requirements, and report disclosure requirements of the Statement.

Valuation analysts should also review and update (as necessary) all of their firm's current business, security, or intangible asset valuation report "boilerplate" language for purposes of compliance with the Statement requirements.

### Procedure No. 10

At the time of the adoption of the Statement, all financial advisers and valuation analysts should realize that they must also comply with the professional requirements and practices of any other professional valuation organizations of which they are members (e.g., ASA, IBA, NACVA, etc.).

Valuation analysts (and their valuation clients) should realize that the requirements of the Statement do not contradict any requirements of these other professional organizations.

For example, the application of the Statement will not prevent a valuation analyst from complying with other published standards—such as USPAP or other promulgated valuation standards.

*"Valuation analysts (and their valuation clients) should realize that the requirements of the Statement do not contradict any requirements of these other professional organizations."*

## EXPECTED BENEFITS FROM THE ADOPTION OF THE STATEMENT

There are numerous benefits expected from the implementation of the Statement. Some of these benefits will accrue principally to the CPA valuation analysts who are required to implement the Statement. Some of these benefits will also accrue to any valuation analyst (CPA or not) who follows the professional guidance offered by the Statement.

In addition, some of the benefits related to the implementation of the Statement will accrue principally to valuation clients. And, some of the benefits will be recognized by the general valuation profession and by any party who relies on valuation reports.

As mentioned above, the Statement is effective for CPAs who perform engagements to estimate value accepted after January 1, 2008. Earlier application of the Statement is encouraged.

The sooner the Statement becomes generally accepted in the valuation profession at large, the sooner all financial advisers and valuation analysts (and their clients) will recognize the benefits associated with the Statement.

The following list summarizes ten expected benefits (both client benefits and analyst benefits) associated with the implementation of the Statement.

## EXPECTED BENEFITS OF THE STATEMENT TO VALUATION CLIENTS

### Benefit No. 1

Clients should be able to reach a clear understanding with the valuation analyst regarding the level of valuation service to be performed in the subject engagement. This is because the Statement provides for several well-defined types of valuation analyses.

Therefore, both the client and the valuation analyst should have the same specific understanding with respect to the agreed upon level of valuation service that will be provided in the valuation engagement.

### Benefit No. 2

Clients should be able to reach a clear understanding with the valuation analyst regarding the type of valuation report (i.e., valuation engagement deliverable or work product). This is because the Statement provides for several well-defined types of valuation reports.

Therefore, both the client and the valuation analyst should have the same specific understanding with respect to the agreed upon type of valuation report that will be prepared during the valuation engagement.

### Benefit No. 3

As the subject valuation analysis is described in any valuation report prepared in compliance with the Statement, the development of that valuation should be replicable. That is, the client (or another valuation report reader) should be able to (1) replicate the valuation approaches, methods, and procedures performed and (2) duplicate the value conclusion reached.

This benefit should not imply that the client (or any other report reader) will automatically agree with the value conclusion presented in the report. In other words, valuation analysis replicability does not imply that the client/report reader will automatically agree with each and every valuation variable used in the analysis. In fact, valuation report readers may often disagree with the selected valuation variables. This is because the valuation analyst's judgment plays a large part in the selection of the appropriate valuation variables.

However, the client should be able to reconstruct (1) the data sources that were relied on by the valuation analyst and (2) the quantitative analyses that were performed by the valuation analyst. In other words, the client and/or a report reader should be able to reconstruct the selected valuation variables—but not necessarily agree with their selection.

### Benefit No. 4

Clients should expect that there will be transparency in the valuation analysis and in the valuation report. For example, under the Statement, there should be no unexplained valuation variables, undisclosed normalization adjustments, or unidentified valuation discount/premium adjustments. In other words, there should be no unexplained or "mystery" variables.

This valuation analysis report transparency should increase the client's (and any other report reader's) confidence in the analyst's valuation process and in the analyst's reported value conclusion.

For example, the disclosure of (1) all assumptions and limiting conditions and (2) the valuation analyst's degree of responsibility for the work of any third-party specialists should also enhance the client's level of reliance on the subject valuation.

### Benefit No. 5

Clients should benefit from both increased consistency and increased comparability between different analyst's valuation reports. As all CPAs (and, perhaps, all valuation analysts in general) produce valuation reports with the same general content and disclosures (within the three types of reports permitted under the Statement), it will be easier for clients to comprehend and compare different valuation reports.

This valuation report consistency and comparability will be particularly expected with regard to standard valuation report sections, such as the valuation analyst's representation or the statement of assumptions and limiting conditions.

## EXPECTED BENEFITS OF THE STATEMENT TO VALUATION ANALYSTS (CPA OR NOT)

### Benefit No. 6

The Statement provides authoritative professional guidance as to what are (and what are not) considered generally accepted "best practices" within the professional valuation community.

Accordingly, this Statement reduces valuation scope of work uncertainty for the CPA valuation analyst (and for any other valuation analyst who relies on the Statement's guidance). That is, the Statement reduces the scope of work uncertainty related to what level of valuation analyses and/or what content of valuation reports are appropriate for the valuation of the subject business, business ownership interest, security, or intangible asset.

### Benefit No. 7

In defending the valuation work during a contrarian challenge (e.g., by the Internal Revenue Service, the Securities and Exchange Commission, the Department of Labor, an opposing expert witness, an attorney's cross examination in litigation, etc.), the valuation analyst will have the assurance that his or her valuation analysis and valuation report are prepared in accordance with the Statement.

Therefore, the valuation analyst should benefit from the professional confidence that the subject valuation analysis/report was prepared in accordance with the AICPA's professional valuation standards.

### Benefit No. 8

CPA valuation analysts (and all valuation analysts in general) should benefit from the common vocabulary that is adopted in the Statement. The Statement adopts a glossary and a set of valuation terminology that should allow valuation analysts to more effectively and efficiently communicate with (1) each other, (2) non-CPA valuation analysts, (3) valuation clients, and (4) other parties who rely on valuation reports.

The common lexicon adopted in the Statement should mitigate both (1) valuation analyst/client miscommunication regarding the subject valuation engagement and (2) valuation client/valuation report reader misunderstanding regarding the subject value conclusion.

### Benefit No. 9

CPA valuation analysts (and other valuation analysts) may rely on the Statement for professional guidance with regard to what are (and what are not) considered generally accepted valuation approaches and methods.

That is, valuation analysts will not have to rely on less authoritative sources for the justification of what are (and what are not) generally accepted valuation approaches and methods. This professional guidance should result in increased consistency in the valuation services practice among all valuation analysts.

CPA valuation analysts (and other valuation analysts) may also rely on the Statement for professional guidance with regard to the type of documents and the types of documentation (both financial and nonfinancial) that should be considered in the valuation process.

By relying on this professional guidance, valuation analysts can more effectively justify their selection of the types of documents that they considered in their valuation analysis.

### Benefit No. 10

Under the Pension Protection Act of 2006, all valuation analysts who perform certain tax-related valuation services must comply with "generally accepted appraisal standards."

Compliance with the Statement will allow a CPA valuation analyst—or any valuation analyst who complies with the Statement—to meet the new Internal Revenue Service requirements. These new requirements affect who qualifies as a "qualified appraiser" and what qualifies as a "qualified appraisal" with regard to certain tax-related valuation engagements.

### SUMMARY

This part of the discussion presented ten Statement implementation procedures. These procedures as recommendations to facilitate the adoption of the Statement's professional guidance into any firm's financial advisory services and/or valuation consulting practice.

As valuation analysts plan for the implementation of the Statement, it is noteworthy that the Statement applies to all CPAs. That is, the Statement applies to AICPA members in the audit, accounting, tax, consulting, litigation services, personal financial planning, and other disciplines—when those CPAs perform valuation services.

Only CPA valuation analysts are required to comply with the provisions of the Statement. However, non-CPA valuation analysts:

1. should be aware of the Statement analysis, documentation, and reporting procedural requirements and
2. should consider adopting whatever professional guidance from the Statement would benefit their valuation practice areas.

The products of years of development by valuation profession thought-leaders and other professionals within the AICPA, the Statement is intended to represent the profession's consensus regarding current "best practices" within the financial valuation community.

Second, this part of the discussion presented a list of ten expected benefits related to the implementation of the Statement. As the Statement becomes more widely accepted within the general valuation profession, the above-mentioned benefits will be generally available to:

1. all valuation analysts (i.e., not only to CPA valuation analysts) and
2. all valuation clients.

*"CPA valuation analysts (and all valuation analysts in general) should benefit from the common vocabulary that is adopted in the Statement."*

CPA valuation analysts are required to comply with the engagement planning consideration, valuation development, valuation documentation, and value reporting provisions of the Statement. Non-CPA valuation analysts—and their valuation clients—can also benefit from the adoption (however informal) of the professional guidance provided by the Statement.

Over time, the universe of valuation analysts, valuation clients, and other parties who rely on valuation reports (e.g., trustees, legal counsel, investment and commercial bankers, government regulators, judicial finders of fact, IRS examiners, etc.) will become better acquainted with both:

1. the Statement provisions and
2. the Statement benefits.

Over time, all constituents in this valuation universe will come to expect the benefits associated with the application of the Statement.

Accordingly, over time, the financial advisers and the valuation profession may come to informally adopt the valuation professional standards that the AICPA has formally adopted in the form of the Statement.

## CONCLUSION

In June 2007, the AICPA consulting services executive committee issued the Statement on Standards for Valuation Services No. 1. The Statement is entitled “Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset.”

The Statement provides professional guidance to CPAs who provide client services to estimate the value of a business, business ownership interest, security, or intangible asset (called a “subject interest” in the Statement). In the Statement, CPAs who provide valuation services are referred to as “valuation analysts.”

The last issue of Insights provided a summary explanation of those AICPA valuation-related professional standards. The second part of this discussion focused on the practical application of these AICPA professional standards, with respect to both AICPA member valuation analysts and non-CPA valuation analysts.

While early adoption of the Statement is encouraged, the Statement is effective for client engagements to estimate value accepted by a CPA after January 1, 2008.

The culmination of years of discussion and deliberation by numerous technical disciplines within the AICPA organization, the Statement provides authoritative professional guidance to all valuation analysts (CPA and non-CPA) with regard to:

1. valuation engagement acceptance and planning considerations,
2. the development of the valuation analysis and value conclusion,
3. the documentation of the valuation engagement, and
4. the reporting of the value conclusion or the calculated value.

For many valuation analysts who practice in the financial advisory services area, the application of the Statement may simply mean the documentation of valuation engagement procedures that are already being performed at the analyst’s firm or practice. This is because these valuation analysts have extensive experience and expertise with regard to the valuation of businesses securities and intangible assets.

Other valuation analysts have less business, security, or intangible asset valuation experience. For these valuation analysts, the application of the Statement may involve the implementation of a new set of firm or practice valuation engagement procedures and practices.

In any event, both CPA and non-CPA valuation analysts should be familiar with the provisions—and the benefits—of the Statement. This is because the Statement, particularly when considered as a supplement to other promulgated professional valuation standards, provides comprehensive profes-

sional guidance to all valuation analysts who practice in the financial advisory services arena.

*“Non-CPA valuation analysts—and their valuation clients—can also benefit from the adoption (however informal) of the professional guidance provided by the Statement.”*

*“For many valuation analysts who practice in the financial advisory services area, the application of the Statement may simply mean the documentation of valuation engagement procedures that are already being performed . . . .”*

*Cory Chiovari is an associate in our Chicago office. Cory can be reached at (773) 399-4312 or [rcchiovari@willamette.com](mailto:rcchiovari@willamette.com).*

*Robert Reilly is a managing director of the firm, and he is resident in our Chicago office. Robert is a member of the AICPA consulting services executive committee, and he is a member of the AICPA business valuation committee. Robert can be reached at (773) 399-4318 or [rfreilly@willamette.com](mailto:rfreilly@willamette.com).*