# “New standards for valuation engagements”

**THE MANY PRACTITIONERS** who conduct valuations in the normal course of their practices will shortly be required to follow, for the first time, detailed standards, because the Consulting Services Executive Committee of the American Institute of CPAs has issued a comprehensive professional statement of standards – Statement on Standards for Valuation Services No. 1, Valuation of a Business, Business Ownership Interest, Security or Intangible Asset.

The AICPA developed the valuation standard to improve the consistency and quality of practice among its members who perform engagements that estimate values for various reasons. Congress, governmental agencies and accounting regulators have recently focused their attention on appraisal issues – such activity shown the importance of valuation to the business community and individuals. This standard promotes greater transparency and provides members with a set of guidelines in the unique context of a CPA practice.

It applies to AICPA members who perform any engagement that estimates the value of a business, business interest, security or intangible asset for numerous purposes, including sales transactions, financing, taxation, financial reporting, mergers and acquisitions, management and financial planning, and litigation.

The new standards provide guidelines both for reporting the results. SSVS No. 1 is effective for engagements accepted on or after January. 1, 2008. Earlier adoption is encouraged.

Specifically, SSVS No. 1 establishes standards for AICPA members who are engaged to, or, as part of another engagement, need to, estimate the value of a business, business ownership interest, security or intangible asset. For the purpose of SSVS No. 1, the definition of a business includes not-for-profit entities or activities.

The term “engagement to estimate value” refers to an engagement or any part of an engagement that involves estimating the value culminates in the expression of either a conclusion of value, or a calculated value. An AICPA member who performs an engagement to estimate value is referred to as a valuation analyst under SSVS No. 1.

In the foreword, examples are given where valuation services might arise, including acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans, partner and shareholder buy-ins or buyouts, and stock redemptions. It also is indicated that valuation can occur in litigation relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, and employment and intellectual property disputes.

Compliance-oriented engagements, including financial reporting and tax matters, such as corporate reorganizations; S corporation conversions; income, estate and gift tax compliance; purchase price allocations; and charitable contributions, were also identified as giving rise to value estimates. The fourth group is planning-oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning.

SSVS No. 1 is not applicable to someone who participates in estimating the value of a subject interest as part of performing an attest engagement defined by Rule 101 of the AICPA Code of Professional Conduct (e.g., as part of an audit, review or compilation engagement). SSVS No.1 also doesn’t apply in the following situations:

- When the client or a third party provides the value and the CPA doesn’t apply valuation approaches and methods;
- Internal use assignments from employers to employee members not in the practice of public accounting;

- Engagements exclusively for determining economic damages, unless those determinations include an engagement to estimate value;
- Mechanical computations that don't rise to the level of an engagement to estimate values; and,
- When it isn't practical or reasonable to obtain or use relevant information, and as a result the practitioner is unable to apply approaches and methods described in SSVS No. 1.

A jurisdictional exception is also included. If any part of SSVS No. 1 differs from published governmental, judicial or accounting authority, or the authority specifies valuation development or reporting procedures, then the valuation analyst is to follow the applicable published authority or stated procedures with respect to that part applicable to the valuation in which the valuation analyst is engaged. The other parts of SSVS No. 1 continue in full force and effect.

According to SSVS No. 1, the valuation analyst should establish an understanding with the client, preferable in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document the understanding in a writing. The valuation analyst is required to modify the understanding if circumstances are encountered during the engagement that make it appropriate to do so.

The understanding should include, at a minimum, the nature, purpose and objective of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities the applicable assumptions and limiting conditions, the type or report to be issued, and the standard of value to be used.

There are two types of engagements that are to be used to estimate value: a valuation engagement and a calculation engagement.

The valuation engagement, which requires conducting more procedures than the calculation engagement, and results in a conclusion of value. The calculation engagement results only in a calculated value.

A valuation analyst performs a valuation engagement when the engagement calls for the valuation analyst to estimate the value of a subject interest, and the valuation analyst estimated the value and is free to apply the valuation approaches and methods that they deem appropriate. The analyst expresses the results as a conclusion of value, either as a single amount or as a range.

A valuation analyst performs a calculation engagement when the valuation analyst and the client agree on the valuation approaches and methods that the analyst will use and the extent of procedures the analyst will perform in calculating the subject interest's value, and the valuation analyst calculates the value in compliance with the agreement. The analyst expresses the results as a calculated value, also either as a range or as a single amount.

SSVS No. 1 details the valuation approaches and methods commonly used, including the income-based, the asset-based or cost, and the market-based approaches. Valuation adjustments are discussed, including specific guidance on how to treat non-operating assets, non-operating liabilities, or excess or deficient operating assets when the income approach is used.

A valuation report can either be in writing or oral. There are two types of written reports for communicating the results of a valuation engagement: a detailed report or a summary report.

The determination of which to use is based on the level of reporting detail agreed to by the valuation analyst and the client. For a calculation engagement, there is only one type of written report, a calculation report.

SSVS No. 1 contains detailed information on what should be included in the extensive detailed report (see box below), the summary report and the calculation report. In general, the analyst should indicate in the valuation report the restrictions on the use of the report, which may include restrictions on the users of the report, the used of the report by such users, or both.

There is a reporting exemption when a valuation is performed for a matter before a court, an arbitrator, mediator, facilitator, or a matter in a governmental or administrative proceeding. This exemption applies whether the matter proceeds to trial or there is a settlement. It applies only to the reporting provisions of SSVS No, 1. The developmental provisions still apply whenever the valuation analyst expresses a conclusion or value or a calculated value.

## A well-rounded report

The contents of a detailed valuation report, as mandated by the AICPA's Statement of Standards for Valuation Services No. 1:

"The detailed report is structured to provide sufficient information to permit intended users to understand the data, reasoning and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal;
- Table of contents;
- Introduction;
- Sources of information;
- Analysis of the subject entity and related non-financial information;
- Financial statement/information analysis;
- Valuation approaches and methods considered;
- Valuation approaches and methods used;
- Valuation adjustments;
- Non-operating assets, non-operating liabilities, and excess or deficient operating assets (if any);
- Representation of the valuation analyst; and,
- Appendices and exhibits.

The above listed report sections and the detailed information within the sections may be positioned in the body of the report or elsewhere in the report at the discretion or the valuation analyst"

An oral report should include all information that the valuation analyst believes necessary to relate the scope, assumptions, limitations and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the report. The analyst should document in the working papers the substance of the communicated oral report.

Accompanying SSVS No.1 is Interpretation No.1-01, Scope of Applicable Services of Statement on Standards for Valuation Services No.1, Valuation of a business, Business Ownership Interest, Security or Intangible Asset. It is intended to clarify SSVS No.1, and state that it doesn’t change or elevate any level of conduct prescribed by SSVS No.1. The 20-page interpretation is in a Q&A format.

For example, it details which services relating to a tax engagement do not rise to the level of an engagement to estimate value. They include:

- Computations of a remainder interest under a grant-or-retained annuity trust using actuarial tables;
- Determining the value of relatively small blocks of publicly traded stock whose per-share price is readily ascertainable;
- Preparing a tax return using the valuation of a business provided by a third-party appraiser or by the client; and,
- Calculating cash “hold back” requirements for tax contingencies.

Examples of services relating to a tax engagement that do rise to the level of an engagement to estimate value are listed also. They include:

- Valuing a block of publicly traded stock if the analysis includes consideration of a discount for blockage, lockup, or other contractual or market restrictions, such that valuation approaches and methods are applied and professional judgment is used to determine the fair value, fair market value, or other applicable standard:

- Valuing stock not publicly traded; and,
- Computing the fair market value of assets in a charitable remained trust if the engagement requires the application of valuation approaches and methods and the use of professional judgment to estimate the fair market value.

Appendix A includes a list of typical assumptions and limiting conditions under which valuation engagements are performed. Appendix B is the International Glossary of Business Valuation Terms, jointly developed by the AICPA, the American Society of Appraisers, the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts and the Institute of Business Appraisers.

There is an important caution: "If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement."

There also is the following disclaimer: "Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has need breached." Appendix C provides definitions for terms included in SSVS No.1, but not defined in the IGBVT.

SSVS No.1, along with implementation aids, are online at the institute's Web site, www.aicpa.org/bvstandard. AICPA members can send questions on SSVS No.1 to the AICPA at ssvs@aicpa.org. The Consulting Services Executive Committee of the AICPA doesn't anticipate that it will be issuing valuation standards beyond SSVS No.1.