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Statement on Standards for Valuation Services

Issued by the AICPA Consulting Services Executive Committee



AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset



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Foreword

Why Issued

Valuations of businesses, business ownership interests, securities, or intangible assets (hereinafter collectively referred to in this foreword as *business valuations*) may be performed for a wide variety of purposes including the following:

1. Transactions (or potential transactions), such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions.
2. Litigation (or pending 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.
3. Compliance-oriented engagements, including (a) financial reporting and (b) tax matters such as corporate reorganizations; S corporation conversions; income, estate, and gift tax compliance; purchase price allocations; and charitable contributions.
4. Planning oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning.

In recent years, the need for business valuations has increased significantly. Performing an engagement to estimate value involves special knowledge and skill.

Given the increasing number of members of the AICPA who are performing business valuation engagements or some aspect thereof, the AICPA Consulting Services Executive Committee has written this standard to improve the consistency and quality of practice among AICPA members performing business valuations. AICPA members will be required to follow this standard when they perform engagements to estimate value that culminate in the expression of a conclusion of value or a calculated value.

The Consulting Services Executive Committee is a body designated by AICPA Council to promulgate technical standards under Rule 201, *General Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 201.01), and Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202.01), of the *AICPA Code of Professional Conduct*.

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset

Introduction and Scope

1. This Statement establishes standards for AICPA members (hereinafter referred to in this Statement as *members*) who are engaged to, or, as part of another engagement, estimate the value of a **business**,¹ **business ownership interest**, **security**, or **intangible asset** (hereinafter collectively referred to in this Statement as **subject interest**). For purposes of this Statement, the definition of a *business* includes not-for-profit entities or activities.

2. As described in this Statement, the term **engagement to estimate value** refers to an engagement or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement) that involves estimating the value of a subject interest. An engagement to estimate value culminates in the expression of either a **conclusion of value** or a **calculated value** (see paragraph 21). A member who performs an engagement to estimate value is referred to, in this Statement, as a **valuation analyst**.

3. Valuation analysts should be aware of any governmental regulations and other professional standards applicable to the engagement, including the AICPA *Code of Professional Conduct* and the Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*, vol. 2, CS sec. 100), and the extent to which they apply to engagements to estimate value. Compliance is the responsibility of the valuation analyst.

¹ This Statement includes two glossaries. Appendix B is the International Glossary of Business Valuation Terms (IGBVT), jointly developed by the AICPA, the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and the Institute of Business Appraisers. The IGBVT is reproduced verbatim in Appendix B, "International Glossary of Business Valuation Terms." Appendix C provides definitions for terms included in this Statement, but not defined in the IGBVT. The terms defined in Appendix B are in boldface type the first time they appear in this Statement; the terms defined in Appendix C are in italicized boldface type the first time they appear in this Statement.

4. In the process of estimating value as part of an engagement, the valuation analyst applies **valuation approaches** and **valuation methods**, as described in this Statement, and uses professional judgment. The use of professional judgment is an essential component of estimating value.

Exceptions from this Statement

5. This Statement is not applicable to a member 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 (for example, as part of an audit, review, or compilation engagement).

6. This Statement is not applicable when the value of a subject interest is provided to the member by the client or a third party, and the member does not apply valuation approaches and methods, as discussed in this Statement.

7. This Statement is not applicable to internal use assignments from employers to employee members not in the *practice of public accounting*, as that term is defined in the AICPA *Code of Professional Conduct* (AICPA, *Professional Standards*, vol. 2, ET sec. 92.25). (Interpretation No. 1, “Scope of Applicable Services” of *Statement on Standards for Valuation Services*, Illustrations 24 and 25).

8. This Statement is not applicable to engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) unless those determinations include an engagement to estimate value. See also Interpretation No. 1, Illustrations 1, 2, and 3.

9.(a) This Statement is not applicable to mechanical computations that do not rise to the level of an engagement to estimate value; that is, when the member does not apply valuation approaches and methods and does not use professional judgment. See Interpretation No. 1, Illustration 8.

(b) This Statement is not applicable when it is not practical or not reasonable to obtain or use relevant information; as a result, the member is unable to apply valuation approaches and methods that are described in this Statement.²

² Unless prohibited by statute or by rule, a member may use the client’s estimates for compliance reporting to a third party if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member). See Interpretation No. 1, “Scope of Applicable Services” of *Statement on Standards for Valuation Services* and *Statement for Standards on Tax Services* No. 4.

Jurisdictional Exception

10. If any part of this Statement differs from published governmental, judicial, or accounting authority, or such authority specifies valuation development procedures or valuation reporting procedures, then the valuation analyst should follow the applicable published authority or stated procedures with respect to that part applicable to the valuation in which the member is engaged. The other parts of this Statement continue in full force and effect (Valuation Services Interpretation No. 1).

Overall Engagement Considerations

Professional Competence

11. Rule 201A, *Professional Competence*, of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET. sec. 201.01), states that a member shall “undertake only those professional services that the member or the member’s firm can reasonably expect to be completed with professional competence.” Performing a valuation engagement with professional competence involves special knowledge and skill. A valuation analyst should possess a level of knowledge of valuation principles and theory and a level of skill in the application of such principles that will enable him or her to identify, gather, and analyze data, consider and apply appropriate valuation approaches and methods, and use professional judgment in developing the estimate of value (whether a single amount or a range). An in-depth discussion of valuation theory and principles, and how and when to apply them, is not within the scope of this Statement.

12. In determining whether he or she can reasonably expect to complete the valuation engagement with professional competence, the valuation analyst should consider, at a minimum, the following:

- a. Subject entity and its industry
- b. Subject interest
- c. **Valuation date**
- d. Scope of the valuation engagement
 - i. Purpose of the valuation engagement

- ii. **Assumptions and limiting conditions** expected to apply to the valuation engagement (paragraph 18)
- iii. Applicable **standard of value** (for example, **fair value** or **fair market value**), and the applicable **premise of value** (for example, going concern)
- iv. Type of valuation report to be issued (paragraph 48), intended use and users of the report, and restrictions on the use of the report
- e. Governmental regulations or other professional standards that apply to the subject interest or to the valuation engagement

Nature and Risks of the Valuation Services and Expectations of the Client

13. In understanding the nature and risks of the **valuation services** to be provided, and the expectations of the client, the valuation analyst should consider the matters in paragraph 12, and in addition, at a minimum, the following:

- a. The proposed terms of the valuation engagement
- b. The identity of the client
- c. The nature of the interest and ownership rights in the business, business interest, security, or intangible asset being valued, including **control** characteristics and the degree of **marketability** of the interest
- d. The procedural requirements of a valuation engagement and the extent, if any, to which procedures will be limited by either the client or circumstances beyond the client's or the valuation analyst's control
- e. The use of and limitations of the report, and the conclusion or calculated value
- f. Any obligation to update the valuation

Objectivity and Conflict of Interest

14. The AICPA *Code of Professional Conduct* requires objectivity in the performance of all professional services, including valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. If necessary, where

a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent as required under Interpretation No. 102-2, “Conflicts of Interest,” under Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102.03).

Independence and Valuation

15. If valuation services are performed for a client for which the valuation analyst or valuation analyst’s firm also performs an attest engagement (defined by Rule 101 of the AICPA Code of Professional Conduct), the valuation analyst should meet the requirements of Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), so as not to impair the member’s independence with respect to the client.

Establishing an Understanding with the Client

16. The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers. (If the engagement is being performed for an attest client, AICPA Ethics Interpretation 101-3 requires the engagement understanding to be in writing.) Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she encounters circumstances during the engagement that make it appropriate to modify that understanding.

17. The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. 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 of report to be issued, and the standard of value to be used.

Assumptions and Limiting Conditions

18. Assumptions and limiting conditions are common to valuation engagements. Examples of typical assumptions and limiting

conditions for a business valuation are provided in Appendix A, “Illustrative List of Assumptions and Limiting Conditions for a Business Valuation.” The assumptions and limiting conditions should be disclosed in the valuation report (paragraphs 52(1), 68(g), and 71(m)).

Scope Restrictions or Limitations

19. A restriction or limitation on the scope of the valuation analyst’s work, or the data available for analysis, may be present and known to the valuation analyst at the outset of the valuation engagement or may arise during the course of a valuation engagement. Such a restriction or limitation should be disclosed in the valuation report (paragraphs 52(m), 68(e), and 71(n)).

Using the Work of Specialists in the Engagement to Estimate Value

20. In performing an engagement to estimate value, the valuation analyst may rely on the work of a third party specialist (for example, a real estate or equipment appraiser). The valuation analyst should note in the assumptions and limiting conditions the level of responsibility, if any, being assumed by the valuation analyst for the work of the third party specialist. At the option of the valuation analyst, the written report of the third party specialist may be included in the valuation analyst’s report.

Development

Types of Engagement

21. There are two types of engagements to estimate value—a **valuation engagement** and a **calculation engagement**. The valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client (paragraphs 16 and 17):

- a. **Valuation engagement**—A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value (as outlined in paragraphs 23–45)

and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.

- b. *Calculation engagement*—A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement (paragraph 46).

Hypothetical Conditions

22. Hypothetical conditions affecting the subject interest may be required in some circumstances. When a valuation analyst uses hypothetical conditions during a valuation or calculation engagement, he or she should indicate the purpose for including the hypothetical conditions and disclose these conditions in the valuation or calculation report (paragraphs 52(n), 71(o), and 74).

Valuation engagement

23. In performing a valuation engagement, the valuation analyst should:

- Analyze the subject interest (paragraphs 25–30)
- Consider and apply appropriate valuation approaches and methods (paragraphs 31–42)
- Prepare and maintain appropriate documentation (paragraphs 44–45)

24. Even though the list in paragraph 23 and some requirements and guidance in this Statement are presented in a manner that suggests a sequential valuation process, valuations involve an ongoing process of gathering, updating, and analyzing information. Accordingly, the sequence of the requirements and guidance in this

Statement may be implemented differently at the option of the valuation analyst.

Analysis of the Subject Interest

25. The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable **premise of value**
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

26. In analyzing the subject interest, the valuation analyst should consider financial and nonfinancial information. The type, availability, and significance of such information vary with the subject interest.

Nonfinancial information

27. The valuation analyst should, as available and applicable to the valuation engagement, obtain sufficient nonfinancial information to enable him or her to understand the subject entity, including its:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of **equity** ownership interests and rights attached thereto
- Products or services, or both
- Economic environment
- Geographical markets

- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**
- Strategy and future plans
- Governmental or regulatory environment

Ownership Information

28. The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to:

- Determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics
- Analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest
- Understand the classes of equity ownership interests and rights attached thereto
- Understand the rights included in, or excluded from, each intangible asset
- Understand other matters that may affect the value of the subject interest, such as:
 - *For a business, business ownership interest, or security:* shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest
 - *For an intangible asset:* legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations

Financial Information

29. The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years

- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding:
 - Advantageous or disadvantageous contracts
 - Contingent or off-balance-sheet assets or liabilities
 - Information on prior sales of company stock

30. The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

Valuation Approaches and Methods

31. In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (Income-based) approach**
- **Asset (Asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (Market-based) approach**

32. The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs 33–41, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this Statement.

33. *Income Approach.* Two frequently used valuation methods under the income approach include the **capitalization of benefits**

method (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows). When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

a. *Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:

- **Normalization** adjustments
- Nonrecurring revenue and expense items
- Taxes
- **Capital structure** and financing costs
- Appropriate capital investments
- Noncash items
- Qualitative judgments for risks used to compute discount and **capitalization rates**
- Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)

b. *Discounted future benefits method (for example, earnings or cash flows).* In addition to the items in item a above, the valuation analyst should consider:

- Forecast/projection assumptions
- Forecast/projected earnings or cash flows
- **Terminal value**

c. For an intangible asset, the valuation analyst should also consider, when relevant:

- Remaining useful life
- Current and anticipated future use of the intangible asset
- Rights attributable to the intangible asset
- Position of intangible asset in its life cycle
- Appropriate discount rate for the intangible asset
- Appropriate **capital or contributory asset charge**, if any
- Research and development or marketing expense needed to support the intangible asset in its existing state
- Allocation of income (for example, **incremental income**, **residual income**, or **profit split income**) to intangible asset

- Whether any tax amortization benefit would be included in the analysis
- Discounted multi-year excess earnings
- Market royalties
- Relief from royalty

Asset Approach and Cost Approach

34. A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

35. When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

Market Approach

36. Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are:

- **Guideline public company method**
- ***Guideline company transactions method***
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)
- Comparable profit margin method (which is based on comparison of the profit margin earned by the subject entity that owns or

operates the intangible asset to profit margins earned by guideline companies)

- **Relief from royalty method** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

37. In applying the methods listed in paragraph 36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

38. The valuation analyst should set forth in the report the rationale and support for the valuation methods used (paragraph 47).

39. *Rules of Thumb.* Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as **rules of thumb**) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

Valuation Adjustments

40. During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

41. When valuing a controlling ownership interest under the income approach, the value of any **nonoperating assets**, nonoperating liabilities, or **excess or deficient operating assets** should be excluded from the computation of the value based on the operating assets and should be added to or deleted from the value of the operating entity. When valuing a noncontrolling ownership interest under the income approach, the value of any nonoperating assets, nonoperating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the noncontrolling interest. In the asset-based or cost approach, it may not be necessary to separately consider nonoperating assets, nonoperating liabilities, or excess or deficient operating assets.

Conclusion of Value

42. In arriving at a conclusion of value, the valuation analyst should:

- a. Correlate and reconcile the results obtained under the different approaches and methods used.
- b. Assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
- c. Determine, based on items *a* and *b*, whether the conclusion of value should reflect (1) the results of one valuation approach and method or (2) a combination of the results of more than one valuation approach and method.

Subsequent Events

43. The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a **subsequent event**. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not

include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (paragraphs 52(p), 71(r), and 74). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

Documentation

44. Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs 25–30)
- Assumptions and limiting conditions (paragraph 18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph 19)
- Basis for using any **valuation assumption** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph 43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph 39)
- Other documentation considered relevant to the engagement by the valuation analyst

45. The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

Calculation engagement

46. In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

- a.* Identity of the client
- b.* Identity of the subject interest
- c.* Whether or not a business interest has ownership control characteristics and its degree of marketability
- d.* Purpose and intended use of the calculated value
- e.* Intended users of the report and the limitations on its use
- f.* Valuation date
- g.* Applicable premise of value
- h.* Applicable standard of value
- i.* Sources of information used in the calculation engagement
- j.* Valuation approaches or valuation methods agreed upon with the client
- k.* Subsequent events, if applicable (paragraph 43)

In addition, the valuation analyst should comply with the documentation requirements listed in paragraphs 44 and 45. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

The Valuation Report

47. A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. Reports issued for purposes of certain controversy proceedings are exempt from this reporting standard (paragraph 50).

48. The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are: for a valuation engagement, a detailed report or a summary report; and for a calculation engagement, a calculation report.

For a Valuation Engagement

- a. *Detailed Report*: This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph 51).
- b. *Summary Report*: This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph 71).

For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.

For a Calculation Engagement

- c. *Calculation Report*: This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate the results of a valuation engagement (conclusion of value) (paragraph 73).

49. The valuation 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 uses of the report by such users, or both) (paragraph 65(d)).

Reporting Exemption for Certain Controversy Proceedings

50. A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this Statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this Statement (paragraphs 47–49 and 51–78). The developmental provisions of the Statement (paragraphs 21–46) still apply whenever the valuation analyst expresses a conclusion of value or a calculated value (Valuation Services Interpretation No. 1).

Detailed Report

51. 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 nonfinancial information
- Financial statement/information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments
- Nonoperating assets, nonoperating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendices and exhibits

The above listed report sections and the detailed information within the sections described in the following paragraphs 52–77 may be positioned in the body of the report or elsewhere in the report at the discretion of the valuation analyst.

Introduction

52. This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

- a.* Identity of the client
- b.* Purpose and intended use of the valuation
- c.* Intended users of the valuation
- d.* Identity of the subject entity
- e.* Description of the subject interest

- f. Whether the business interest has ownership control characteristics and its degree of marketability
- g. Valuation date
- h. Report date
- i. Type of report issued (namely, a detailed report) (paragraph 51)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Assumptions and limiting conditions (alternatively, these often appear in an appendix) (paragraph 18)
- m. Any restrictions or limitations in the scope of work or data available for analysis (paragraph 19)
- n. Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph 22)
- o. If the work of a specialist was used in the valuation engagement, a description of how the specialist's work was relied upon (paragraph 20)
- p. Disclosure of subsequent events in certain circumstances (paragraph 43)
- q. Any application of the jurisdictional exception (paragraph 10)
- r. Any additional information the valuation analyst deems useful to enable the user(s) of the report to understand the work performed

If the above items are not included in the introduction, they should be included elsewhere in the valuation report.

Sources of Information

53. This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

- a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited
- b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected
- c. Names, positions, and titles of persons interviewed and their relationships to the subject interest

- d.* Financial information (paragraphs 54 and 56)
- e.* Tax information (paragraph 55)
- f.* Industry data
- g.* Market data
- h.* Economic data
- i.* Other empirical information
- j.* Relevant documents and other sources of information provided by or related to the entity

54. If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the Statements on Standards for Attestation Engagements [SSAEs]) by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs to the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

55. The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information (paragraph 53(e)), the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs to any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.

56. If the financial information used was derived from financial statements prepared by management that were not the subject of an audit, review, compilation, or attest engagement performed under the SSAEs, the valuation report should:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest under the SSAEs to the financial information and assumes no responsibility for that information

Analysis of the Subject Entity and Related Nonfinancial Information

57. The valuation analyst should include a description of the relevant nonfinancial information listed and discussed in paragraph 27.

Financial Statement / Information Analysis

58. This section should include a description of the relevant information listed in paragraph 29. Such description may include:

- a. The rationale underlying any normalization or **control adjustments** to financial information
- b. Comparison of current performance with historical performance
- c. Comparison of performance with industry trends and norms, where available

Valuation Approaches and Methods Considered

59. This section should state that the valuation analyst has considered the valuation approaches discussed in paragraph 31.

Valuation Approaches and Methods Used

60. In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

61. This section should also identify the following for each of the three approaches (if used):

- a. Income approach:
 - Composition of the representative benefit stream
 - Method(s) used, and a summary of the most relevant risk factors considered in selecting the appropriate **discount rate**, the capitalization rate, or both
 - Other factors as discussed in paragraph 33
- b. Asset-based approach or cost approach:
 - *Asset-based approach*: Any adjustments made by the valuation analyst to the relevant balance sheet data
 - *Cost approach*: The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated

c. Market approach:

- For the guideline public company method:
 - o The selected guideline companies and the process used in their selection
 - o The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions

62. When a rule of thumb is used in combination with other methods, the valuation report should disclose the source(s) of data used and how the rule of thumb was applied (paragraph 39).

Valuation Adjustments

63. This section should (a) identify each valuation adjustment considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied (paragraph 40).

Nonoperating Assets and Excess Operating Assets

64. When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related nonoperating assets, nonoperating liabilities, or excess or deficient operating assets and their effect on the valuation (paragraph 41).

Representation of the Valuation Analyst

65. Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

- a. The analyses, opinions, and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph 18), and they are the personal analyses, opinions, and conclusion of value of the valuation analyst.
- b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.
- c. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties (paragraph 49).
- e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation.
- f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.
- g. The valuation analyst has no obligation to update the report or the opinion of value for information that comes to his or her attention after the date of the report.
- h. The valuation analyst and the person(s) assuming responsibility for the valuation should sign the representation in their own name(s). The names of those providing significant professional assistance should be identified.

Representations Regarding Information Provided to the Valuation Analyst

66. It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of his or her performing the valuation engagement. The decision whether to

obtain a representation letter is a matter of judgment for the valuation analyst.

Qualifications of the Valuation Analyst

67. The report should contain information regarding the qualifications of the valuation analyst.

Conclusion of Value

68. This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

- a. A valuation engagement was performed, including the subject interest and the valuation date.
- b. The analysis was performed solely for the purpose described in this report, and the resulting estimate of value should not be used for any other purpose.
- c. The valuation engagement was conducted in accordance with the Statement(s) on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- d. A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.
- e. The scope of work or data available for analysis is explained, including any restrictions or limitations (paragraph 19).
- f. A statement describing the conclusion of value, either a single amount or a range.
- g. The conclusion of value is subject to the assumptions and limiting conditions (paragraph 18) and to the valuation analyst's representation (paragraph 65).
- h. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- i. The date of the valuation report is included.
- j. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

69. The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a *valuation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants, of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date]. This valuation was performed solely to assist in the matter of [purpose of the valuation]; the resulting estimate of value should not be used for any other purpose or by any other party for any purpose. This valuation engagement was conducted in accordance with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

[If applicable] We were restricted or limited in the scope of our work or data available for analysis as follows: [describe restrictions or limitations].

Based on our analysis, as described in this valuation report, the estimate of value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [value, either a single amount or a range]. This conclusion is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Appendices and Exhibits

70. Appendices or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the detailed report.

Summary Report

71. A summary report is structured to provide an abridged version of the information that would be provided in a detailed report,

and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

- a.* Identity of the client
- b.* Purpose and intended use of the valuation
- c.* Intended users of the valuation
- d.* Identity of the subject entity
- e.* Description of the subject interest
- f.* The business interest's ownership control characteristics, if any, and its degree of marketability
- g.* Valuation date
- h.* Valuation report date
- i.* Type of report issued (namely, a summary report) (paragraph 48)
- j.* Applicable premise of value
- k.* Applicable standard of value
- l.* Sources of information used in the valuation engagement
- m.* Assumptions and limiting conditions of the valuation engagement (paragraph 18)
- n.* The scope of work or data available for analysis including any restrictions or limitations (paragraph 19)
- o.* Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph 22)
- p.* If the work of a specialist was used in the valuation (paragraph 20), a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work
- q.* The valuation approaches and methods used
- r.* Disclosure of subsequent events in certain circumstances (paragraph 43)
- s.* Any application of the jurisdictional exception (paragraph 10)
- t.* Representation of the valuation analyst (paragraph 65)
- u.* The report is signed in the name of the valuation analyst or the valuation analyst's firm
- v.* A section summarizing the reconciliation of the estimates and the conclusion of value as discussed in paragraphs 68 and 69

w. A statement that the valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the valuation report

72. Appendices or exhibits may be used for required information (paragraph 70) or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendices to the summary report.

Calculation Report

73. As indicated in paragraph 48, a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in paragraph 65, but adapted for a calculation engagement.

74. The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use (paragraph 22), any application of the jurisdictional exception (paragraph 10), and any assumptions and limiting conditions applicable to the engagement (paragraph 18). If the valuation analyst used the work of a specialist (paragraph 20), the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The calculation report may also include a disclosure of subsequent events in certain circumstances (paragraph 43).

75. Appendices or exhibits may be used for required information (paragraph 72) or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the calculation report.

76. The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

a. Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.

- b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
- c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
- d. The calculation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
- f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.
- g. A general description of a calculation engagement is given, including that (1) a calculation engagement does not include all of the procedures required for a valuation engagement and (2) had a valuation engagement been performed, the results may have been different.
- h. The calculated value, either a single amount or a range, is described.
- i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- j. The date of the valuation report is given.
- k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.

77. The following is an example of report language that could be used, but is not required, in reporting a calculation engagement:

We have performed a *calculation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in para-

graphs [*reference to paragraph numbers*] of our calculation report. The calculation procedures were performed solely to assist in the matter of [*purpose of valuation procedures*], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a *valuation engagement*, as that term is defined in the SVSS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as referred to above, the resulting calculated value of [*DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company*] as of [*valuation date*] was [*calculated value, either a single amount or a range*]. This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in [*reference to applicable section of valuation report*] and to the Valuation Analyst's Representation found in [*reference to applicable section of valuation report*]. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[*Signature*]

[*Date*]

Oral Report

78. An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information 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 oral report. The member should document in the working papers the substance of the oral report communicated to the client.

Effective Date

79. This Statement applies to engagements to estimate value accepted on or after January 1, 2008. Earlier application is encouraged.

APPENDIX A

Illustrative List of Assumptions and Limiting Conditions for a Business Valuation

The valuation report or calculation report should include a list of assumptions and limiting conditions under which the engagement was performed. This appendix includes an illustrative list of assumptions and limiting conditions that may apply to a business valuation.

Illustrative List of Assumptions and Limiting Conditions

1. The conclusion of value arrived at herein is valid only for the stated purpose as of the date of the valuation.
2. Financial statements and other related information provided by [ABC Company] or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. [Valuation Firm] has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. We do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.
5. The conclusion of value arrived at herein is based on the assumption that the current level of management expertise and effectiveness would continue to be maintained, and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.

6. This report and the conclusion of value arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The conclusion of value represents the considered opinion of [*Valuation Firm*], based on information furnished to them by [*ABC Company*] and other sources.
7. Neither all nor any part of the contents of this report (especially the conclusion of value, the identity of any valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without the prior written consent and approval of [*Valuation Firm*].
8. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of [*Valuation Firm*] unless previous arrangements have been made in writing.
9. [*Valuation Firm*] is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. [*Valuation Firm*] does not conduct or provide environmental assessments and has not performed one for the subject property.
10. [*Valuation Firm*] has not determined independently whether [*ABC Company*] is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. [*Valuation Firm*]'s valuation takes no such liabilities into account, except as they have been reported to [*Valuation Firm*] by [*ABC Company*] or by an environmental consultant working for [*ABC Company*], and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, [*Valuation Firm*] has relied

on it without verification and offers no warranty or representation as to its accuracy or completeness.

11. [*Valuation Firm*] has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
12. [Sample wording for use if the jurisdictional exception is invoked.] The conclusion of value (or the calculated value) in this report deviates from the Statement on Standards for Valuation Services as a result of published governmental, judicial, or accounting authority.
13. No change of any item in this appraisal report shall be made by anyone other than [*Valuation Firm*], and we shall have no responsibility for any such unauthorized change.
14. Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.
15. If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.
16. We have conducted interviews with the current management of [*ABC Company*] concerning the past, present, and prospective operating results of the company.
17. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.

APPENDIX B

International Glossary of Business Valuation Terms*

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

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.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

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 been breached.

American Institute of Certified Public Accountants
American Society of Appraisers
Canadian Institute of Chartered Business Valuators
National Association of Certified Valuation Analysts
The Institute of Business Appraisers

* Reproduced verbatim from the International Glossary of Business Valuation Terms (the Glossary), which appears at <http://bvfls.aicpa.org/Resources/Business+Valuation/Tools+and+Aids/Definitions+and+Terms/International+Glossary+of+Business+Valuation+Terms.htm>. Note that the phrase, “we discourage the use of this term,” that appears herein is also reproduced verbatim.

Adjusted Book Value Method—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. {NOTE: In Canada on a going concern basis}

Adjusted Net Asset Method—see **Adjusted Book Value Method**.

Appraisal—see **Valuation**.

Appraisal Approach—see **Valuation Approach**.

Appraisal Date—see **Valuation Date**.

Appraisal Method—see **Valuation Method**.

Appraisal Procedure—see **Valuation Procedure**.

Arbitrage Pricing Theory—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

Asset (Asset-Based) Approach—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount—an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Book Value—see **Net Book Value**.

Business—see **Business Enterprise**.

Business Enterprise—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk—the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

Business Valuation—the act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM)—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization—a conversion of a single period of economic benefits into value.

Capitalization Factor—any multiple or divisor used to convert anticipated economic benefits of a single period into value.

Capitalization of Earnings Method—a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

Cash Flow—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, “discretionary” or “operating”) and a specific definition in the given valuation context.

Common Size Statements—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control—the power to direct the management and policies of a business enterprise.

Control Premium—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a noncontrolling interest in a business enterprise to reflect the power of control.

Cost Approach—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital—the expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free—*we discourage the use of this term.* See **Invested Capital**.

Discount for Lack of Control—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights—an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate—a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method—a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method—a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

Economic Benefits—inflows such as revenues, net income, net cash flows, etc.

Economic Life—the period of time over which property may generate economic benefits.

Effective Date—see **Valuation Date**.

Enterprise—see **Business Enterprise**.

Equity—the owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method—a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of *a*) the value of the assets derived by capitalizing excess earnings and *b*) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

Fair Market Value—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term “price” should be replaced with the term “highest price”.}

Fairness Opinion—an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

Forced Liquidation Value—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow—*we discourage the use of this term*. See **Net Cash Flow**.

Going Concern—an ongoing operating business enterprise.

Going Concern Value—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

Goodwill—that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

Goodwill Value—the value attributable to goodwill.

Guideline Public Company Method—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Income (Income-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Internal Rate of Return—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value—the value that an investor considers, on the basis of an evaluation or available facts, to be the “true” or “real” value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

Invested Capital—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Invested Capital Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk—the degree of uncertainty as to the realization of expected returns.

Investment Value—the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is “*Value to the Owner*” .}

Key Person Discount—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta—the beta reflecting a capital structure that includes debt.

Limited Appraisal—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

Liquidity—the ability to quickly convert property to cash or pay a liability.

Liquidation Value—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either “orderly” or “forced.”

Majority Control—the degree of control provided by a majority position.

Majority Interest—an ownership interest greater than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity—the share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital—the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple—the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability—the ability to quickly convert property to cash at minimal cost.

Marketability Discount—see **Discount for Lack of Marketability**.

Merger and Acquisition Method—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount—a discount for lack of control applicable to a minority interest.

Minority Interest—an ownership interest less than 50% of the voting interest in a business enterprise.

Multiple—the inverse of the capitalization rate.

Net Book Value—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows—when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

Net Present Value—the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net Tangible Asset Value—the value of the business enterprise’s tangible assets (excluding excess assets and nonoperating assets) minus the value of its liabilities.

Nonoperating Assets—assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is “*Redundant Assets*”}.

Normalized Earnings—economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements—financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value—liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

Premise of Value—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

Present Value—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount—an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple—the price of a share of stock divided by its earnings per share.

Rate of Return—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Redundant Assets—see **Nonoperating Assets**.

Report Date—the date conclusions are transmitted to the client.

Replacement Cost New—the current cost of a similar new property having the nearest equivalent utility to the property being valued.

Reproduction Cost New—the current cost of an identical new property.

Required Rate of Return—the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

Residual Value—the value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity—the amount, expressed as a percentage, earned on a company's common equity for a given period.

Return on Investment—See **Return on Invested Capital** and **Return on Equity**.

Return on Invested Capital—the amount, expressed as a percentage, earned on a company's total capital for a given period.

Risk-Free Rate—the rate of return available in the market on an investment free of default risk.

Risk Premium—a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb—a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

Special Interest Purchasers—acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

Standard of Value—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

Sustaining Capital Reinvestment—the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk—the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Tangible Assets—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value—See **Residual Value**.

Transaction Method—See **Merger and Acquisition Method**.

Unlevered Beta—the beta reflecting a capital structure without debt.

Unsystematic Risk—the risk specific to an individual security that can be avoided through diversification.

Valuation—the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

Valuation Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

Valuation Date—the specific point in time as of which the valuator’s opinion of value applies (also referred to as “Effective Date” or “Appraisal Date”).

Valuation Method—within approaches, a specific way to determine value.

Valuation Procedure—the act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio—a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Value to the Owner—see **Investment Value**.

Voting Control—*de jure* control of a business enterprise.

Weighted Average Cost of Capital (WACC)—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise’s capital structure.

APPENDIX C

Glossary of Additional Terms

Assumptions and Limiting Conditions. Parameters and boundaries under which a valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

Business Ownership Interest. A designated share in the ownership of a business (business enterprise).

Calculated Value. An estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values based on those procedures.

Calculation Engagement. An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

Capital or Contributory Asset Charge. A fair return on an entity's *contributory assets*, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

Capitalization of Benefits Method. A method within the income approach whereby expected future benefits (for example, earnings or

cash flow) for a representative single period are converted to value through division by a capitalization rate.

Comparable Profits Method. A method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

Comparable Uncontrolled Transaction Method. A method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market place made between independent (uncontrolled) parties.

Conclusion of Value. An estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.

Control Adjustment. A valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners' compensation that is in excess of market compensation.

Engagement to Estimate Value. An engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.

Excess Operating Assets. Operating assets in excess of those needed for the normal operation of a business.

Fair Value. In valuation applications, there are two commonly used definitions for fair value:

- (1) For financial reporting purposes only, the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Source:* Financial Accounting Standards Board definition in Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*, as used in the context of Generally Accepted Accounting Principles (GAAP) (Effective 2008).

- (2) For state legal matters only, some states have laws that use the term *fair value* in shareholder and partner matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

Guideline Company Transactions Method. A method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

Hypothetical Condition. That which is or may be contrary to what exists, but is supposed for the purpose of analysis.

Incremental Income. Additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

Normalization. See *Normalized Earnings* in Appendix B, "International Glossary of Business Valuation Terms."

Pre-adjustment Value. The value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

Profit Split Income. With respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage) is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

Relief from Royalty Method. A valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the exemption from paying a royalty for its use. Application of this method usually involves estimating the fair market value of an intangible asset by quantifying the present value of

the stream of market-derived royalty payments that the owner of the intangible asset is exempted from or “relieved” from paying.

Residual Income. For an entity that owns or operates an intangible asset being valued, the portion of the entity’s income or cash flow remaining after subtracting a capital charge on all of the entity’s tangible and other intangible assets. *Income or cash flows* can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

Security. A certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

Subject Interest. A business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

Subsequent Event. An event that occurs subsequent to the valuation date.

Valuation Analyst. For purposes of this Statement, an AICPA member who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

Valuation Assumptions. Statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

Valuation Engagement. An engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, as outlined in the AICPA Statement on Standards for Valuation Services, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range.

Valuation Service. See **Engagement to Estimate Value.**

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

Background

1. The Statement on Standards for Valuation Services (SSVS) establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the Statement. When originally proposed on March 30, 2005, the Exposure Draft contained a list of questions and answers (Appendix A of the March 30, 2005 Exposure Draft) that were intended to assist members in determining if an engagement, particularly with regard to litigation or tax engagements, fell within the scope of the Statement. Through the Exposure Draft process, it was determined that the questions and answers were an integral part of the Statement and should be made authoritative. This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in valuation practice, and its desire to provide guidance to members when providing valuation services. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards.

General Interpretation

2. The SSVSs apply to an engagement to estimate value if, as all or as part of another engagement, a member determines the value of a business, business ownership interest, security, or intangible asset (SSVS paragraphs 1 and 2). In the process of estimating value, professional judgment is used to apply valuation approaches and valuation methods as described in the SSVSs (SSVS paragraph 4).

3. In determining whether a particular service falls within the scope of the Statement, a member should consider those services that are specifically excluded:

- Audit, review, and compilation engagements (SSVS paragraph 5)
- Use of values provided by the client or a third party (SSVS paragraph 6)
- Internal use assignments from employers to employee members not in the *practice of public accounting* (SSVS paragraph 7)
- Engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) and that do not include an engagement to estimate value (SSVS paragraph 8)
- Mechanical computations that do not rise to the level of an engagement to estimate value (SSVS paragraph 9(a))
- Engagements where it is not practical or reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods described in this Statement. (SSVS paragraph 9(b))
- Engagements meeting the jurisdictional exception (SSVS paragraph 10)

4. A member should be diligent in determining if an engagement falls within the scope of the Statement. Unless specifically excluded by the SSVS, if the engagement requires a member to apply valuation approaches and methods, and use professional judgment in applying those approaches and methods, the SSVS would apply. In determining the scope and requirements of the engagement, a member should consider the client's needs, or the requirements of a third party for which the valuation is intended, including governmental, judicial, and accounting authorities. In addition, a member should consider other professional standards that might apply.

Specific Illustrations

5. The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in general facts, or to particular facts and circumstances, may lead to different conclusions. In each illustration, there is no authority other than that indicated.

Illustrations Relating to Litigation Engagements and Certain Controversy Proceedings

6. *Illustration 1.* Do lost profits damage computations fall within the scope of the Statement?

7. *Conclusion.* No, unless the computations are undertaken as part of an engagement to estimate value (SSVS paragraphs 1, 2, and 8).

8. *Illustration 2.* Is an economic damages computation that incorporates a terminal value within the scope of the Statement?

9. *Conclusion.* The use of a terminal value exclusively for the determination of lost profits is not within the scope of this statement unless that determination will be used as part of an engagement to estimate value (Illustration 1).

10. *Illustration 3.* If a start-up business is destroyed, is the economic damages computation within the scope of the Statement?

11. *Conclusion.* There are two common measures of damages: lost profits and loss of value. If a valuation analyst performs an engagement to estimate value to determine the loss of value of a business or intangible asset, the Statement applies. Otherwise, the Statement does not apply (*Illustration 1*). In order to determine whether the Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes an engagement to estimate value with respect to the business, business interest, security, or intangible asset or whether it constitutes a lost-profits computation.

12. *Illustration 4.* Does the Statement include any exceptions relating to litigation or controversy proceedings?

13. *Conclusion.* Yes, the Statement includes a reporting exemption for certain controversy proceedings (SSVS paragraph 50); however, there is no litigation or controversy proceeding exemption from the developmental provisions of the Statement (SSVS paragraphs 21–46) in circumstances in which an engagement to estimate value is performed (*Illustration 1*).

14. *Illustration 5.* Is the Statement’s reporting exemption for litigation or controversy proceedings (see SSVS paragraph 50) the same as the “litigation exemption” in the AICPA attestation standards?

15. *Conclusion.* No, the so-called “litigation exemption” is provided for in the AICPA attestation standards and is further discussed in the attestation interpretations. The attestation standards do not apply to engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts. This is clarified in the attestation interpretation, which states, in part, that the attestation standards do not apply to litigation services engagements when (among other requirements) the practitioner “has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on the subject matter, or an assertion about the subject matter that is the responsibility of another party.” (Interpretation No. 3, “Applicability of Attestation Standards to Litigation Services,” of Chapter 1, “Attest Engagements,” of Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, as revised [AICPA, *Professional Standards*, vol. 1, AT sec. 9101.34–.42].) However, unlike the AICPA attestation standards, which do not apply in any capacity to litigation or controversy proceeding situations, as discussed above, the Statement’s exemption for litigation or certain controversy proceedings is an exemption from the reporting provisions of the Statement (SSVS paragraphs 47–78).

Illustrations Relating to Tax Engagements

16. *Illustration 6.* When does the Statement apply to members who determine values related to tax reporting and planning engagements?

17. *Conclusion.* The Statement applies when the member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (SSVS paragraph 1). The application of valuation approaches and methods and the use of professional judgment (SSVS paragraph 4) are required, unless an exception applies (SSVS paragraphs 5 through 10).

18. *Illustration 7.* If the sole purpose of an engagement is reporting a value in a tax return and the Statement applies to this engagement, are any separate reports (specifically, valuation reports) required to be issued? To whom are those reports required to be

provided? Is a report required to be attached to the tax return? Are any specific disclosures required?

19. *Conclusion.* The Statement requires the preparation of a written or oral valuation report (SSVS paragraphs 47–78) that is communicated to the client (SSVS paragraph 47) but does not require that any report be attached to the tax return or mandate any other tax-specific disclosures. In limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (SSVS paragraph 10 and *Illustration 18*). There is also a reporting exemption for certain controversy proceedings (SSVS paragraph 50 and *Illustration 4*).

20. *Illustration 8.* Are mechanical computations of value, for example, computations using actuarial tables, excluded from the Statement?

21. *Conclusion.* Mechanical computations of value are excluded from the Statement if they do not rise to the level of an engagement to estimate value, that is, if the member does not apply valuation approaches and methods, and does not use professional judgment, as described in the Statement (SSVS paragraph 9(a)).

22. Examples of services that do **not** rise to the level of an engagement to estimate value include: (a) computations of a remainder interest under a grantor retained annuity trust (GRAT) using actuarial tables; (b) determining the value of relatively small blocks (relative to the total amount of corporate stock outstanding) of publicly traded stock whose per share price is readily ascertainable; (c) preparing a tax return using the valuation of a business that was provided by a third-party appraiser, or by the client (SSVS paragraph 6); and (d) calculating cash “hold back” requirements for tax contingencies (SSVS paragraphs 1,4, and 9(a)).

23. Examples of services that rise to the level of an engagement to estimate value include: (a) valuing a block of publicly traded stock, if the analysis includes consideration of a discount for blockage, lock-up, 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 of value; (b) valuing stock that is not publicly traded; and (c) computing the fair market value of assets in a charitable

remainder trust (CRT), if the engagement requires the application of valuation approaches and methods, and the use of professional judgment to estimate the fair market value.

24. *Illustration 9.* Does the “jurisdictional exception” (SSVS paragraph 10) provide that an engagement to estimate value is not subject to the Statement if a member determines and reports values using procedures mandated or allowed by the Internal Revenue Code (IRC), Internal Revenue Service (IRS) regulations, court cases, or other published guidance and other sources of federal, state, and local law solely for purposes of tax return preparation and other tax services using these methods?

25. *Conclusion.* No, the “jurisdictional exception” would not exempt the engagement from this Statement, even if the engagement’s sole purpose was to value a subject interest (SSVS paragraph 1) for tax reporting purposes. Only the portion of the Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of the Statement applies to the engagement.

26. *Illustration 10.* Is an interest in a publicly traded partnership whose shares are frequently traded considered a “security” under the Statement? Is an interest in a family limited partnership (FLP), or in another nontraded partnership, considered a “security” under the Statement?

27. *Conclusion.* Whether interest constitutes a “security” is a legal determination. However, where the value of a security is readily ascertainable, a valuation analyst does not need to apply valuation approaches and methods and use professional judgment. Accordingly, the valuation of such an interest would not be subject to the Statement (SSVS paragraphs 1 and 9(a)). An interest in a non-publicly traded partnership, such as an FLP, whether considered a security or not, is a business ownership interest. The valuation of such nonpublicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (SSVS paragraphs 1, 4, and *Illustration 6*), unless the exception under SSVS paragraph 9(b) applies (*Illustration 13e*). If the engagement requires the valuation analyst to consider and apply adjustments, for example, valuation discounts or premiums, then the engagement would be subject to the Statement.

28. *Illustration 11.* A client engages a member to provide advice for planning purposes (such as estate planning, personal financial planning, or merger and acquisitions planning). The client holds an ownership interest in a family business being operated as a limited liability company, an interest in a private real estate limited partnership, publicly traded stock, a personal residence, and a retirement account (not an IRA). Is this a valuation engagement subject to the Statement?

29. *Conclusion.* It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates a value to illustrate various planning options, he or she may fall under the Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the plan illustrations is a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the values for these assets, or the member does not use assumed or hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to the Statement with regard to these assets (SSVS paragraph 1 and *Illustration 6*). In this example, if the member applies valuation approaches and methods and uses professional judgment to determine the value of the ownership interest in the family business or the interest in the private real estate limited partnership in order to provide planning advice, the Statement would apply. In contrast, if the client or a third party provides the values for these assets, or the member uses assumed or hypothetical values, the Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. In addition, the exception under SSVS paragraph 9(b), where it is not practical or reasonable to obtain or use relevant information, could apply (see *Illustration 13e*). The computation of the “estimated estate tax” or other taxes once the values have been determined, assumed, or provided is not subject to the Statement, as the computation is a tax computation but would be subject to the Statement on Standards for Tax Services (*Illustration 10* at paragraph 27 of this Interpretation).

30. *Illustration 12.* There are many instances where a tax engagement involves the need for a member to estimate value. The estimation of value may not be the primary purpose of the engagement, but rather a necessary task to perform or item to consider, when making

a tax determination concerning the reporting of a transaction on a tax return. Consider the following practice situations:

31. *Illustration 12a.* A member has been engaged to determine the deductibility of interest on a nonrecourse loan. Under applicable regulations, interest on a nonrecourse loan cannot be deducted if it is clear that the company will be unable to service the debt. For purposes of tax reporting, a conclusion must be reached concerning the ability of the company to service the debt. Is this considered a valuation engagement subject to the Statement?

32. *Conclusion.* This is not a valuation engagement covered by the Statement because it is not the valuation of a subject interest (SSVS paragraph 1). This example is a debt-service analysis.

33. *Illustration 12b.* There are compliance filings that require an estimate of the value of a company. For example, the “market value” of “intangible personal property,” as defined by a state’s taxing authority may need to be reported annually on an intangible personal property tax return. A client has a subject interest that is considered intangible personal property for purposes of the return. The member has been engaged to prepare the tax return. Is this a valuation engagement subject to the Statement?

34. *Conclusion.* It depends. If the state requires an estimation of the value of a subject interest, and the estimation of value requires the application of valuation approaches and methods and the use of professional judgment (SSVS paragraphs 1 and 4), the Statement applies. If, however, the client or a third-party appraiser provides the value of the subject interest to the member, the Statement does not apply (SSVS paragraphs 1 and 6). In addition, the exception under SSVS paragraph 9(b), where it is not practical or reasonable to obtain or use relevant information, could apply (*Illustration 13e*). Alternatively, if the state follows more informal rules where the application of valuation approaches or valuation methods are not necessary, the Statement does not apply (SSVS paragraph 4).

35. *Illustration 12c.* There are times when a member must allocate value among various assets. For example, IRC sections 1060 and 338 require the allocation to assets, based on relative values, of consideration paid. In partnership taxation, there may be allocations under IRC sections 754, 743, and 734 and special tax basis

adjustments for partnerships (sales or exchanges and transfers at or upon death) may require an allocation of value among various partnership assets. Are these types of allocations engagements to estimate value subject to the Statement?

36. *Conclusion.* It depends. If one or more of the assets to which value is to be allocated is a subject interest (that is, a business, business ownership interest, security, or intangible asset), and the client or a third party did not provide the member with a value for those assets, then the member performing the allocation would be subject to the Statement, and the member is required to apply valuation approaches and methods, and use professional judgment to value those assets (SSVS paragraphs 1, 4, and *Illustration 6*), unless an exception applies (SSVS paragraphs 5–10). For example, in an IRC section 1060 allocation, after the allocation of purchase price to cash, receivables, inventory, and depreciable tangible assets, there is a residual amount of value allocable to goodwill or going concern. The mechanical assignment of the residual amount to goodwill or going concern is not subject to the Statement. However, if the member allocates this residual amount to specific intangible assets (such as to various customer-based and supplier-based intangibles), such allocation is based on the assets' relative values. Because the member applies valuation approaches and methods and uses professional judgment to value those specific intangible assets, the Statement applies.

37. *Illustration 12d.* If the member does not apply any discount and simply computes the fair market value of an interest in a family limited partnership (FLP) for tax purposes, is this a valuation engagement subject to the Statement?

38. *Conclusion.* Yes, the Statement applies if the member determines the value of the FLP or an interest in an FLP. The application of valuation approaches and methods, and the use of professional judgment are required, unless an exception applies (SSVS paragraphs 5–10). The fact that the member does not apply a discount does not exempt the engagement from the Statement (SSVS paragraphs 1–4 and 9(a)).

39. *Illustration 12e.* Would the Statement apply to the computation of the fair market value of assets in, or the computation of the required distribution of, a charitable remainder trust (CRT)?

40. *Conclusion.* It depends on the underlying assets held by the CRT. The Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS paragraph 1). To the extent that the CRT holds assets that, to be valued, require the application of valuation approaches and methods, and the use of professional judgment, such as an interest in a limited liability corporation (LLC), the Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, the Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (SSVS paragraphs 1 and 4, and *Illustration 6*).

41. *Illustration 12f.* In circumstances in which the value of assets contributed by partners to a partnership differ from their cost basis, each difference must be tracked for tax purposes under IRC section 704(c) so that amounts of gain or loss can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to the Statement?

42. *Conclusion.* It depends. If one or more of the assets for which value is relevant under IRC section 704(c) is a subject interest that is, a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the valuation, and the member applies valuation approaches and methods and uses professional judgment to value these assets for IRC section 704(c) tax purposes, then the Statement applies (SSVS paragraphs 1 and 6, and *Illustration 6*).

43. *Illustration 12g.* A member has been engaged to perform a cost segregation study. The study involves an analysis of the costs of building a structure and the allocation of such costs to the real and personal property components of the structure so that depreciation of those components may be properly computed. Is this a valuation engagement subject to the Statement?

44. *Conclusion.* No, none of the assets constitutes a subject interest (SSVS paragraph 1).

45. *Illustration 12h.* A member has been engaged to provide advice to a company regarding the tax planning for income from discharge of indebtedness under IRC section 108. The company has advised the member that the company will be able to negotiate a set-

tlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to the Statement?

46. *Conclusion.* It depends. Under IRC section 108(a), gross income of the company excludes income from discharge of indebtedness only under certain circumstances. One of those circumstances is the insolvency of the company. Under IRC section 108(d) (3), insolvency results from an excess of liabilities over the fair market value of assets. If (a) the company must rely on the insolvency provisions of IRC section 108; (b) one or more of the assets for which value is relevant under IRC section 108 is a subject interest (that is, a business, business ownership interest, security, or intangible asset); (c) the company or a third party does not provide the valuation; and (d) the member applies valuation approaches and methods, and uses professional judgment to value the subject interest(s) for purposes of the IRC section 108(d)(3) insolvency determination, the Statement applies.

47. *Illustration 13.* An executor has engaged a member to prepare an estate tax return, which requires determining values for the following estate assets: (a) shares in a publicly traded company, “TI Corporation,” whose shares are infrequently traded; (b) a large block of stock in “LB Corporation,” a publicly traded company; (c) a brokerage account consisting of shares in various publicly traded companies; (d) “CHB Corporation,” a closely held business owned by the decedent and the decedent’s family; and (e) a 5 percent interest in “RP,” a privately held rental real estate partnership. Does the Statement apply to any of the following assets owned by the estate? (See *Illustration 10* at paragraph 27 of this Interpretation regarding the valuation of a security.)

48. *Illustration 13a.* Does the Statement apply to shares in a publicly traded company, “TI Corporation,” whose shares are traded infrequently?

49. *Conclusion.* It depends; although the price of a share of publicly traded stock is ascertainable from published sources, there are no definitive criteria that would indicate when the Statement applies to shares that are infrequently traded. A key consideration is the average daily trading volume of TI Corporation stock on or around the valuation date. The concept of fair market value incorporates the notions that (1) cash could have been received for the stock at the valuation date, and (2) the share price of an infrequently traded stock

could decrease if a relatively large block of the stock were to be put on the market on that date. If the subject shares held by the estate do not represent a significant percentage of the daily trading volume of TI stock on or around the valuation date, and the price of a share of the stock is readily ascertainable on the valuation date, then the resulting value (the quoted share price times the number of shares owned) represents a cash price that could have been received at the valuation date for the block, and the Statement does not apply because the calculation of value is mechanical (SSVS paragraph 9(a)). If, however, the subject shares held by the estate represent a large percentage of the average daily trading volume of the stock, the quoted market price for a share may not be adequate for purposes of determining the fair market value of the block of shares on the valuation date. In that case, the Statement applies because valuation approaches and methods need to be applied, and professional judgment needs to be used in determining the value of the block (SSVS paragraphs 1 and 4) (See *Illustration 10* at paragraph 27 of this Interpretation regarding the valuation of a security.)

50. *Illustration 13b*. Does the Statement apply to a large block of stock in “LB Corporation,” a publicly traded company?

51. *Conclusion*. The answer depends on the amount of shares to be valued in relation to the average daily trading volume in LB Corporation on or around the valuation date. There are no definitive criteria that would indicate when the Statement applies to the valuation of a large block of publicly traded stock. The concept of fair market value incorporates the notion that cash could have been received from a sale of the block on the valuation date. A large block could decrease the share price if sold on the valuation date. The Statement would typically not apply to the valuation of a large block (for example, 200,000 shares) of a large and actively-traded public company. Even though the value of the estate’s stock may be large in absolute terms, the daily trading volume in such stock on the valuation date may be sufficiently high that a sale of the block on the valuation date would not affect the market price of a company’s shares. In such a case, the quoted market price of a share times the number of shares held by the estate may be considered to reflect the fair market value of the subject block of stock, and because it would not be the case that valuation approaches and methods would need to be applied and professional judgment used, the Statement would not apply. If, however, the large block of publicly traded shares repre-

sents a significant percentage of the daily trading volume, the Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (SSVS paragraphs 1 and 4).

52. *Illustration 13c.* Does the Statement apply to a brokerage account consisting of shares in various publicly traded companies?

53. *Conclusion.* The Statement would not apply to the determination of the value of a brokerage account consisting of publicly traded securities, except as discussed in paragraphs 49 and 51 of this interpretation. Absent certain scenarios involving infrequently traded securities or large blocks of stock, the application of valuation approaches and methods and the use of professional judgment are not necessary in that determination (SSVS paragraphs 1 and 4).

54. *Illustration 13d.* Does the Statement apply to “CHB Corporation,” a closely held business owned by the decedent and the decedent’s family?

55. *Conclusion.* The Statement would apply to the determination of value of CHB Corporation because valuation approaches and methods need to be applied, and professional judgment needs to be used to determine the fair market value of the ownership interest in CHB (SSVS paragraphs 1 and 4).

56. *Illustration 13e.* Does the Statement apply to a 5 percent interest in a privately held rental real estate partnership (RP)?

57. *Conclusion.* The Statement would apply to the determination of value of the 5 percent interest in rental real estate partnership (RP) because valuation approaches and methods need to be applied and professional judgment needs to be used to determine the fair market value of the ownership of a fractional interest in a privately held partnership (SSVS paragraphs 1 and 4). However, where it is not practical or not reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods, the Statement would not apply. For example, the member has requested from RP’s general partner financial information the member needs in order to apply valuation approaches and methods. The general partner is not responsive to the member’s requests, and the due date for filing the estate tax return is near. Given the small ownership interest, and given that RP is likely a relatively small percent of the total estate, unless prohibited by statute or

by rule, the member may then use the taxpayer's estimates if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member) (SSVS paragraph 9(b)).

58. *Illustration 14.* Would the answers to *Illustration 13* change if the values were provided by the client or a client-engaged third party?

59. *Conclusion.* The Statement would not apply if the values were provided by the client or by a client-engaged third party because the member is not applying valuation approaches and methods and using professional judgment to determine value (SSVS paragraphs 1 and 4). However, the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns*, in providing appropriate due diligence with respect to the values provided to the member (see AICPA, *Professional Standards*, vol. 2, TS sec. 300). It is also recommended that the understanding between member and client in these circumstances include documentation of the fact that the member is not determining but rather is being provided with the value of the subject interest.

60. *Illustration 15.* Would the answers to *Illustration 13* change if the values were provided by an outside third-party specialist hired by the member?

61. *Conclusion.* If the member engages an outside third-party specialist to assist with the member's work, and it is the member expressing a conclusion or calculated value, the member will be applying valuation approaches and methods and using professional judgment; thus, the Statement would apply (SSVS paragraphs 1 and 4; SSVS paragraphs 20, "Using the Work of Specialists in the Valuation Engagement"). If, however, the third-party specialist is determining the value in his or her own name and providing that value to the client, and the member will not be applying valuation approaches and methods or using professional judgment (SSVS paragraphs 1 and 4, and *Illustration 6*), the Statement would not apply, but the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns*, in providing appropriate due diligence with respect to the values provided (AICPA, *Professional Standards*, vol. 2, TS sec. 300).

62. *Illustration 16.* The client and the member agree that the member will value a partnership interest and then apply an “average” discount that the member is to determine (based on the results of various studies and case law). Does the Statement apply? If so, is this a valuation engagement or a calculation engagement?

63. *Conclusion.* Yes, the Statement applies because the member determined the value of the partnership interest by applying valuation approaches and valuation methods and using professional judgment. This would be considered a calculation engagement because the member and the client have agreed on the specific valuation approaches or valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform (SSVS paragraph 21(b) and *Illustration 6*).

64. *Illustration 17.* Would the Statement apply if a member has an informal conversation or communicates in writing with a client regarding the alternative tax consequences of gifting versus selling a business using a presumption of a specific value of the business?

65. *Conclusion.* No, the Statement would not apply. The member is providing tax advice using an assumed or hypothetical value of a business and is not determining value, applying valuation approaches and methods, and using professional judgment to value a business (SSVS paragraphs 1 and 4, and *Illustration 6*).

66. *Illustration 18.* Would the Statement apply to a transfer pricing study (IRC section 482) that involves the use of specific methodologies, data, terminology, and documentation requirements that are provided in the IRS regulations and procedures, and whose methodologies and documentation requirements differ from those contained in the Statement?

67. *Conclusion.* No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, the Statement would not apply (see SSVS paragraph 1 and *Illustration 6*). To the extent that the transfer pricing study applies to the valuation of intangible assets, the Statement would normally apply. However, because the IRS regulations require that the taxpayer reasonably calculate an arm’s-length price according to the best method that is determined using third-party comparable data under explicit IRS rules and documentation procedures, and to the extent these IRS rules and procedures differ from the Statement,

the jurisdictional exception (SSVS paragraph 10) would exempt the valuation of the intangible assets from the developmental provisions of the Statement (SSVS paragraphs 25–48). In addition, to the extent that the IRS regulations (such as IRS regulation section 1.6662-6(d) (2) (iii)) and procedures provide specific documentation requirements for avoiding potential penalties, and if a transfer pricing report is provided to a client according to such IRS documentation requirements, the jurisdictional exception would apply to the reporting provisions of the Statement (SSVS paragraphs 50–78) and thus a valuation report would not be necessary.

68. *Illustration 19.* In a situation where the Statement applies to members who determine value as part of tax engagements, would the member also be required to be in compliance with the Statements on Standards for Tax Services (SSTs)?²

69. *Conclusion.* Yes, the Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTs would apply to all aspects of the engagement. For example, even though the Statement would govern the determination of value of an applicable asset reported on a tax return, the member would also have to be in compliance with SST No. 1, *Tax Return Positions*, for that valuation.

70. *Illustration 21.* Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under the Statement?

71. *Conclusion.* No, settlements or negotiations of value in offers-in-compromise or tax disputes are part of a tax process. However, if a member prepares a valuation in preparation for a settlement or negotiation of value, and the valuation involves the application of valuation approaches and methods and the use of professional judgment, the valuation would fall under the developmental aspects of the Statement. The settlement or negotiation process itself is not a valuation and would not fall under the Statement. In addition, the Statement's reporting exemption for certain controversy proceedings would apply as the valuation was performed specifically for the administrative matter (SSVS paragraph 50).

Illustrations Relating to Other Engagements

72. *Illustration 20.* Does determining the value of accounts receivable fall under the Statement?

73. *Conclusion.* No, accounts receivable constitute **tangible assets** under the Statement (SSVS Appendix B), and do not constitute a subject interest (SSVS paragraph 1).

74. *Illustration 22.* In the course of performing a valuation under the Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs)?

75. *Conclusion.* No, Chapter 1, “Attest Engagements,” of SSAE No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1, AT sec. 101), as amended (AT sec. 101.01) states that the attestation standards apply when a practitioner is “engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter..., that is the responsibility of another party.” If the valuation analyst has not been engaged to examine, compile, assemble, review, or apply agreed-upon procedures to prospective financial information, and does not issue an examination, compilation, assembly, or agreed-upon report on prospective financial information, the SSAEs do not apply (SSARS 14).

76. *Illustration 23.* Under a valuation engagement, a valuation analyst is free to select any and all valuation approaches and methods the valuation analyst deems appropriate in the circumstances. Under a calculation engagement, the valuation analyst and the client agree to the specific approaches or methods the valuation analyst will use or the extent of calculation procedures the valuation analyst will perform. (SSVS paragraph 21.) Under SSVS paragraph 18, a restriction or limitation on the scope of the valuation analyst’s work, or the data available for analysis may be present and known to the valuation analyst at the outset of the engagement, or may arise during the course of an engagement (and such restriction or limitation should be disclosed in the report). Is it possible to have a restriction or limitation

that is of such a degree that a valuation analyst engaged to perform a valuation engagement should propose altering the engagement to be a calculation engagement?

77. *Conclusion.* Although the two engagements represent two different types of service performed by valuation analysts, the possibility exists. If, in the course of a valuation engagement, restrictions, or limitations on the scope of the valuation analyst's work or the data available for analysis are so significant that the valuation analyst believes that he or she cannot, even with disclosure in the valuation report of the restrictions or limitations, adequately perform a valuation engagement leading to a conclusion of value, the valuation analyst should determine whether he or she has the ability to adequately complete the engagement as a calculation engagement or should consider resigning from the engagement.

78. *Illustration 24.* If a member employed in industry, government, or education "moonlights" doing engagements to estimate value, do the Standards apply?

79. *Conclusion.* Yes, the Standard applies. By moonlighting, the member is holding him or herself out as a certified public accountant and as being in public practice. The Standard would apply just as it would to any other member in public practice unless one of the exceptions applies.

80. *Illustration 25.* Does the Statement apply to an assignment from an employer to an employee member not in public practice to prepare a valuation for internal financial reporting purposes?

81. *Conclusion.* No, paragraph 7 exempts internal use assignments from an employer to an employee member not in the practice of public accounting. However, if the valuation is to be used for financial reporting purposes, the employer and the employee may wish to consider whether the work will be accepted by the employer's outside auditors if the statement is not followed.

Illustrations for PFP-Specific Engagements

These illustrations assume the member has not been engaged to perform a business valuation.

82. *Illustration 26.* When does the Statement apply to members who determine values related to personal financial planning engagements?

83. *Conclusion.* The Statement applies to personal financial planning engagements when the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS paragraph 1) and in the process of determining the value applies valuation approaches and methods and uses professional judgment (SSVS paragraph 4) unless an exception applies (SSVS paragraphs 5–10).

84. *Illustration 27.* If a member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest, does the Statement apply?

85. *Conclusion.* No. The Statement does not apply because estimate of future sales proceeds does not in itself constitute a valuation engagement (SSVS paragraphs 1 and 4).

86. *Illustration 28.* A member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest. As part of that engagement, the member shares general industry knowledge to assist the client in estimating the current value of the business interest. Does the Statement apply?

87. *Conclusion:*

- (a) If, in the process of determining the current value from which the member estimates future sales proceeds, the member applies valuation approaches and methods and uses professional judgment, the Statement applies to the determination of the current value (SSVS paragraph 4). However, the Statement does not apply when the member shares general industry knowledge with the client instead of applying professional judgment.

- (b) If the client or another party provides the current value, and the member does not apply valuation approaches and methods, the Statement does not apply (SSVS paragraphs 4 and 6).
- (c) If the member uses a hypothetical or assumed value as the starting point for the calculation of future sales proceeds and does not apply valuation approaches and methods, the Statement does not apply (SSVS paragraphs 1 and 4). The Statement does not apply to a general discussion with the client of valuation concepts or industry price multiples based on the member's industry knowledge, which assists the client in determining a hypothetical or assumed value (SSVS paragraphs 4 and 6).

88. *Illustration 29.* The client has asked the member to prepare a personal financial plan that includes an estimate of future proceeds from a sale of the business interest at retirement. The member estimates the future proceeds based on an estimate of the business' current value by applying a rule of thumb for the business' industry, but the member does not consider the risk factors of the subject interest or exercise other professional judgment in applying the multiple. Does the Statement apply?

89. *Conclusion.* No, the Statement does not apply because the member did not use professional judgment (SSVS paragraph 4). If the member considers specific risk factors of the business interest in applying the price multiple, the Statement applies.

This Statement titled Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset was unanimously adopted by the assenting votes of the AICPA Consulting Services Executive Committee.

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