EXPOSURE DRAFT

Proposed Statement on Standards for Valuation Services

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

March 30, 2005

Prepared by the AICPA Consulting Services Executive Committee for comment

Comments should be received by June 15, 2005 and sent by electronic mail to bvstds@aicpa.org, or addressed to
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Jersey City, NJ 07311-3881

March 30, 2005

Accompanying this letter is an exposure draft, approved by the AICPA Consulting Services Executive Committee, of a proposed Statement on Standards for Valuation Services (SSVS), *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*. This proposed Statement establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the proposed Statement.

Areas Requiring Particular Attention by Respondents

Comments are specifically requested on the following issues addressed by this exposure draft:

Interaction with other standards

Issue 1 – There currently exist business valuation standards promulgated by other recognized valuation or appraisal organizations. Those standards do not agree with each other in all respects. The Consulting Services Executive Committee has compared this proposed business valuation standard (the proposed Statement) with the standards of those organizations and believes the proposed Statement, while improving practice, will not result in conflicts with those standards. Do you agree? If not, please describe specific areas where you believe that following the proposed Statement could result in a conflict with other standards, or areas where you believe that following other standards could result in a conflict with the proposed Statement.

Documentation of understanding with the client

Issue 2 – Under paragraph 17 of this exposure draft, a valuation analyst should establish an understanding with the client, preferably in writing, regarding the valuation engagement to be performed. The understanding is required to be documented in writing—if not in a written understanding with the client then by appropriate memoranda or notations in the workpapers. Do you believe the final Statement should permit oral understandings and be silent as to the preferability of oral versus written understandings with the client, permit oral understandings and recommend written understandings with the client as a best practice, or require that all understandings with the client be in writing?

Use of specialists

Issue 3 – Paragraphs 22 and 23 of this exposure draft prescribe “procedures” for the valuation analyst to perform when using the work of a specialist, such as an outside real estate or equipment appraiser. The procedures differ based on who engages the specialist. When using an outside specialist engaged by the valuation analyst or the valuation analyst’s firm, the valuation analyst is required to evaluate the specialist’s qualifications and describe in the valuation report how the specialist’s work was used in the valuation. However, when using an outside specialist engaged by a party other than the valuation analyst or the valuation analyst’s firm, the valuation analyst is required only to describe in the valuation report how the specialist’s work was used in the valuation. In practice it is typically more often the case that the specialist is engaged by a party other than the valuation analyst or the valuation analyst’s firm. Many believe that it would not be practicable for the valuation analyst to evaluate the qualifications of outside specialists not hired by the valuation analyst or the valuation analyst's firm, whereas a valuation analyst hiring a specialist may be held responsible to at least hire someone competent and with experience in the particular area. However, as pointed out in paragraph 69(h), irrespective of who hires a specialist, the valuation analyst should include in his or her representation a statement that the valuation analyst has performed no corroborating procedures to confirm the validity of an outside specialist's work.

Do you agree with the different procedural requirements for the valuation specialist based on who hires the specialist, or do you believe the requirements should be the same irrespective of who hires the valuation specialist, and why? If you believe the requirements should be the same, explain what you believe the specific requirements should be and address their practicality. Additionally, do you believe the requirements should include procedures related to the objectivity of the specialist?

Post-valuation events

Issue 4 – A "post-valuation event" is defined as an event that could affect the valuation and that occurs subsequent to the valuation date but prior to the issuance of a valuation report. Under paragraph 45(b) of this exposure draft:

- A valuation is not updated to reflect post-valuation events that are indicative of conditions that were not known or knowable to market participants at the valuation date, including conditions that arose subsequent to the valuation date.
- The valuation report would typically not include a discussion of those events because a valuation is performed as of a point in time—the valuation date—and events occurring subsequent to that date are not relevant to the value determined as of that date. However, in situations in which a valuation is performed in conjunction with a purchase or sale of a subject interest and the value of the subject interest is meaningful to the purchaser beyond the valuation date, the events may be of such nature and significance as to warrant disclosure in a separate section of the report in order to keep users from being misled. Such disclosure should clearly indicate that the events are provided for informational purposes only and do not affect the determination of value.

Do you agree that the above disclosure is appropriate in the purchase or sale situations described above? Alternatively, do you believe: (*a*) the above-described disclosure is appropriate in additional situations—for example, for *all* post-valuation events that are indicative of conditions that were not known or knowable to market participants at the valuation date, including conditions that arose subsequent to the valuation date, or (*b*) the above-described disclosure is appropriate in fewer or no situations?

Oral valuation reports

Issue 5 – Paragraph 50 of this exposure draft requires that, with an exception for reporting in litigation, valuation reports be in writing. It was thought that the proposed Statement could not adequately establish standards of quality and due professional care with respect to oral reports, and therefore the risks associated with oral reports could not be kept to an acceptable level under the proposed Statement. Do you believe the final Statement should permit oral reports and be silent as to the preferability of oral versus written reports, permit oral reports and recommend written reports as a best practice, or require that all reports be in writing? If you believe oral reports should be permitted, please include in your reasoning a discussion of how such reports would be in the public interest as well as how they would provide sufficient risk management for the valuation analyst.

Guideline language for conclusion or indication of value

Issue 6 – Paragraphs 70, 71, 78, and 79 of the proposed Statement provide elements and guideline language for purposes of summarizing the conclusion or indication of value for the two types of valuation engagements described in paragraph 24. Do you believe that such guideline language will improve the reporting and facilitate the understanding of the results of a valuation engagement, or do you believe that such guideline language is unnecessary, or that it should be recommended but not required?

Glossary

Issue 7 – The International Glossary of Business Valuation Terms is included verbatim as Appendix C of this exposure draft. A second, separate glossary of additional terms used in this exposure draft and related to business valuation is included as Appendix D. The International Glossary of Business Valuation Terms includes a number of terms not used in this Statement and points out, where applicable, differences between the United States and Canada in the use of certain terms. Do you prefer that the Statement include two separate glossaries in this fashion, or would you prefer a single glossary (for example, a combined glossary of some or all terms from the International Glossary of Business Valuation Terms and other terms)? Do you believe the final glossary(ies) should include only terms used in the Statement, or should it (they) include, as is the case in the exposure draft, other terms?

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate the Consulting Services Executive Committee's consideration of responses, responses should refer to specific paragraph numbers, include supporting reasons for each comment or suggestion, and provide alternative wording if appropriate.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after June 15, 2005, for one year. Responses should be sent by electronic mail to bvstds@aicpa.org in time to be received by June 15, 2005. Alternatively, responses may be sent to Janice Fredericks, Financial Planning Project Manager, AICPA, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

We recognize that this may be a busy time of year for some of our members, but in order to maximize the pre-adoption and preparation period in conjunction with the January 1, 2006, effective date proposed in the exposure draft, we are exposing the document now.

Sincerely,

Dominic A. Cingoranelli
Chair
Consulting Services Executive Committee

Paul Herring
Director
Business Reporting, Assurance and Advisory Services

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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 in connection with one or more of the following:

a. Transactions (or potential transactions), such as acquisitions, mergers, leveraged buy-outs, initial public offerings, employee stock ownership plans, partner and shareholder buy-ins or buyouts, and stock redemptions.

b. 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.

c. Compliance-oriented engagements, including (1) financial reporting and (2) tax matters such as corporate reorganizations; S corporation conversions; income, estate, and gift tax planning and compliance; purchase price allocations; and charitable contributions.

The need for business valuations has increased significantly since the early 1980s. Unlike other types of valuations, such as valuations of real estate and personal property, business valuations involve matters that are particularly within a CPA's expertise.

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 whenever they undertake to perform a business valuation engagement that culminates in the expression of a conclusion of value or an indication of value.

The Consulting Services Executive Committee is a body designated by AICPA Council to promulgate technical standards under rules 201 and 202 of the AICPA *Code of Professional Conduct*.

Statement on Standards for Valuation Services

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, determine 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, a "business" includes a not-for-profit entity or activity.

2. As used in this Statement, the term ***valuation engagement*** refers to an engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a subject interest. A valuation engagement culminates in the expression of either a ***conclusion of value*** or an ***indication of value*** (see paragraph 24). A member who performs a valuation engagement is referred to in this Statement as a ***valuation analyst***.

3. In the process of determining value as part of a valuation 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 determining value because value determinations are, by their nature, estimates of value.

4. 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 valuation analyst does not apply valuation approaches and methods as described in this Statement.

5. This Statement is not applicable to 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*

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[1] This Statement includes two glossaries. The first glossary, Appendix C, is the International Glossary of Business Valuation Terms (IGBVT), which was developed jointly by the AICPA, the American Society of Appraisers, the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and the Institute of Business Appraisers. The IGBVT is reproduced verbatim in Appendix C and is publicly available at: http://bvfls.aicpa.org/Resources/Business+Valuation/Tools+and+Aids/Definitions+and+Terms/International+Glossary+of+Business+Valuation+Terms.htm. The second glossary, Appendix D, provides definitions for terms included in this Statement but not defined in the IGBVT. The terms defined in Appendix C are in non-italicized boldface type the first time they appear in this Statement. The terms defined in Appendix D are in italicized boldface type the first time they appear in this Statement.

Standards, vol. 2, ET sec. 92.25). For purposes of this Statement, such members are presumed not to be objective with respect to such assignments (see paragraph 14).

6. This Statement is not applicable to engagements that are exclusively for the purpose of determination of economic damages or lost profits, even if the analyses used in such determination include the use of valuation approaches and methods that are also used in a valuation engagement, unless those analyses will be used as part of a valuation engagement that is intended to reach a conclusion of value or an indication of value.

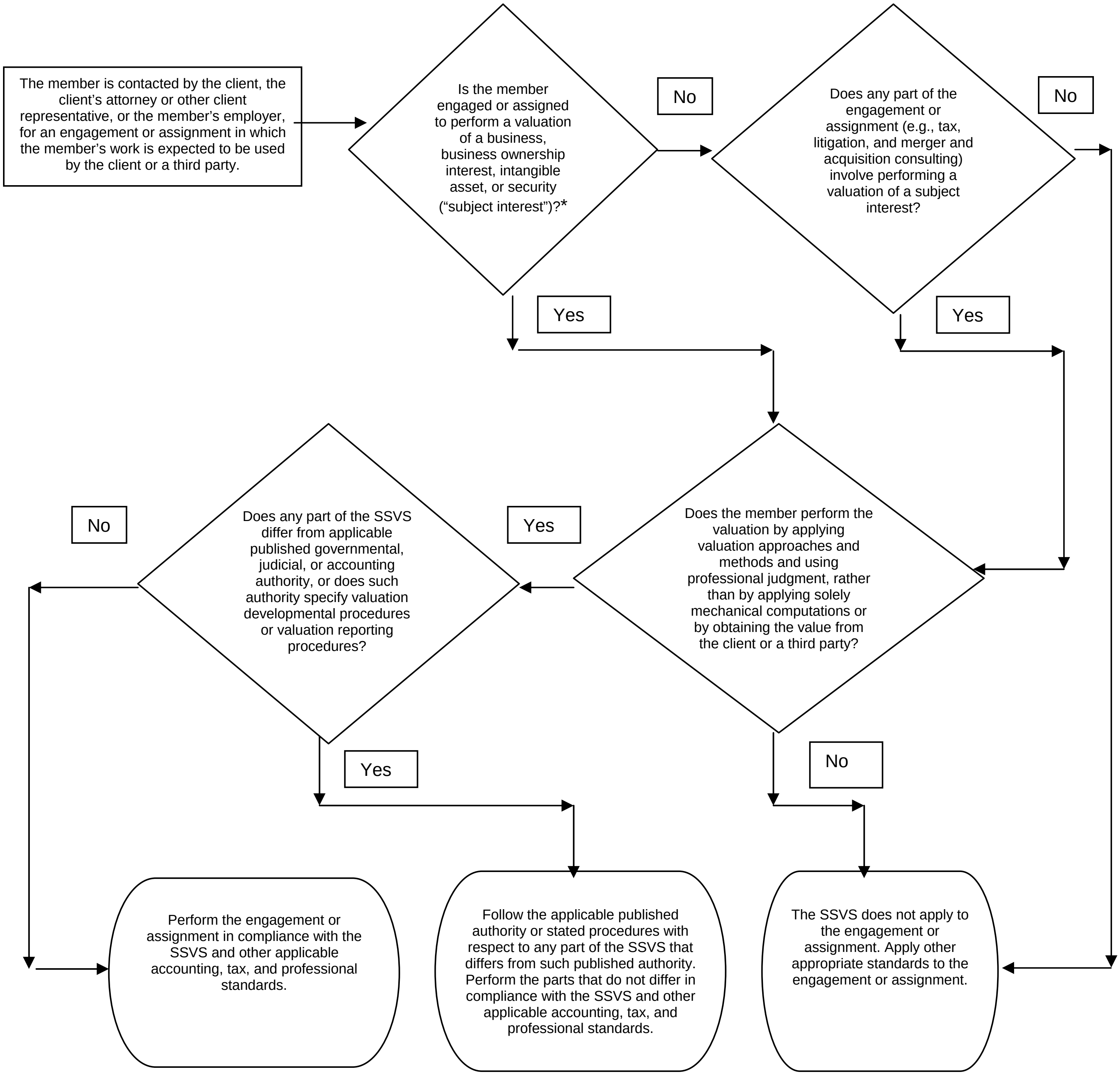
7. This Statement is not applicable to mechanical computations for tax reporting purposes where such computations do not rise to the level of a valuation engagement, that is, where the member does not apply valuation approaches and methods as described in this Statement. See also Appendix A, "Questions and Answers."

8. Valuation analysts should be aware of any laws, governmental regulations, and other professional standards applicable to the engagement, including the AICPA *Code of Professional Conduct*; Statement on Standards for Consulting Services No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards,* vol. 2, CS sec. 100); and *Statements on Standards for Tax Services*. Compliance with the requirements of this Statement and any applicable laws, governmental regulations, or other professional standards applicable to the valuation engagement is the responsibility of the valuation analyst.

9. *Jurisdictional exception*. If any part of this Statement differs from published governmental, judicial, or accounting authority, or such authority specifies valuation developmental procedures or valuation reporting procedures, then the valuation analyst should follow the applicable published authority or stated procedures with respect to that part. The other parts of this Statement continue in full force and effect. See also Appendix A, "Questions and Answers."

10. The following flowchart illustrates the applicability or scope of this Statement to engagements (for example, litigation or tax engagements) in which a member makes a determination of value for a client. As discussed in paragraph 2, that determination may constitute an entire engagement or may constitute only a part of an engagement.

DECISION TREE TO DETERMINE THE APPLICATION OF THE STATEMENT ON STANDARDS FOR VALUATION SERVICES (SSVS)



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

Business (business enterprise) – a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity. (For purposes of this Statement, a "business" includes a not-for-profit entity or activity.)

Business Ownership Interest – a legal share in the ownership of a business (business enterprise).

Intangible Assets – non-physical 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.

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.

OVERALL ENGAGEMENT CONSIDERATIONS

Professional Competence

11. Rule 201A 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 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 the necessary data, consider and apply the appropriate valuation approaches and methods, and use professional judgment in developing the estimate (whether a single amount or a range) of value. 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 (see paragraphs 20 and 21)
  - *iii.* Applicable **standard of value** (for example, ***fair value*** or **fair market value**)
  - *iv.* Type of valuation report to be issued (see paragraph 51), intended use and users of the report, and restrictions on the use of the report
- *e.* Laws, 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.* Expected terms of the valuation engagement
- *b.* Identity of the client
- *c.* The nature of the interest and ownership rights in the business, security, or intangible asset being valued, including **control** characteristics and 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

Objectivity and Conflict of Interest

14. The AICPA *Code of Professional Conduct* requires objectivity in the performance of all professional services, which include valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free of 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). Interpretation No. 102-2 states in part:

> A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301, *Confidential Client Information* [ET section 301.01].

Independence and Valuation

15. Additionally, if valuation services are performed for a client for which the valuation analyst or valuation analyst's firm also performs an audit, review, compilation, or attest engagement performed under the AICPA Statements on Standards for Attestation Engagements (SSAEs) (hereinafter referred to as an "attest client," which term incorporates all four types of engagements), 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). Interpretation No. 101-3 states in part:

> Independence would be impaired if a member performs an **appraisal**, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.
>
> Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce

results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.* However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

* Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings.

16. Interpretation No. 101-3 also requires that certain "general requirements" be met when performing valuation services for an attest client, so as not to impair the member's independence with respect to the client, including:

- The member should not perform management functions or make management decisions for the attest client.

- The attest client must agree to perform the following functions in connection with the nonattest (for example, valuation) engagement:
  - — Make all management decisions and perform all management functions;
  - — Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the nonattest services;
  - — Evaluate the adequacy and results of the services performed;
  - — Accept responsibility for the results of the services; and
  - — Establish and maintain internal controls, including monitoring ongoing activities.

- Prior to performing nonattest (for example, valuation) services, the member should establish and document in writing his or her understanding with the attest client regarding the:
  - — Objectives of the engagement;
  - — Services to be performed;
  - — Client's acceptance of its responsibilities;
  - — Member's responsibilities; and
  - — Any limitations of the engagement.

Establishing an Understanding with the Client

17. The valuation analyst should establish an understanding with the client, preferably in writing, regarding the valuation engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the workpapers. (This is consistent with the requirements of Interpretation No. 101-3 where, as noted in paragraph 16 above, if the valuation engagement is being performed for an attest client, the documentation is required 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 valuation engagement that make it appropriate to modify that understanding.

18. 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 and objective of the valuation engagement, client's responsibilities, valuation analyst's responsibilities, assumptions and limiting conditions, type of report to be issued, and standard of value to be used.

Representations Regarding Information Provided to the Valuation Analyst

19. In certain circumstances, 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.

Assumptions and Limiting Conditions

20. Assumptions and limiting conditions are common to valuation engagements and should be included in the valuation report (see paragraphs 55(m), 69(a), 70(g), 73(n), and 76). Examples of typical assumptions and limiting conditions for a business valuation are provided in Appendix B, "Illustrative List of Assumptions and Limiting Conditions for a Business Valuation." The objective of including assumptions and limiting conditions in a valuation report is to establish reasonable, agreed-upon boundaries on the scope of work to be performed, in order that a valuation analyst may estimate value in an effective and efficient manner. For example, assumptions and limiting conditions typically include a statement that the valuation analyst accepts financial information provided by management and does not perform procedures to corroborate that information.

21. Assumptions and limiting conditions are not, however, intended to restrict or limit the scope of the valuation analyst's work or the data available for analysis. 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 (see paragraphs 55(n), 70(e), and 73(o)). An example would be, for a business valuation related to litigation, denying the valuation analyst access to the detailed depreciation schedules outlining the equipment owned by the subject entity. The denial of access represents a scope limitation that should be disclosed in the valuation report.

PLANNING CONSIDERATIONS

Use of Work of Specialists in the Valuation Engagement

22. In the course of the valuation engagement, a valuation analyst may use the work of a specialist (for example, a real estate or equipment appraiser) to assist in the valuation engagement. A specialist may be engaged or employed by the valuation analyst or the valuation analyst's firm or engaged by a party other than the valuation analyst (for example, the client). When the valuation analyst uses the work of a specialist, the valuation analyst should describe in the valuation report how the work of the specialist was used in the valuation. See paragraphs 55(p), 73(q), and 76.

23. If a specialist is engaged by the valuation analyst or the valuation analyst's firm or is an employee of the valuation analyst's firm, the valuation analyst should evaluate the specialist's qualifications to determine that the specialist possesses the necessary skill or knowledge in the particular field. In evaluating that specialist's qualifications, the valuation analyst should consider, as applicable, the following:

- *a.* Education and, as appropriate, professional certification, license, or other recognition of the competence of the specialist in his or her field
- *b.* Reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance
- *c.* Specialist's knowledge and understanding of valuation concepts, the requirements applicable to the subject matter of the specialist's engagement, and the relevant laws, governmental regulations, and standards
- *d.* Specialist's experience in the type of assignment
- *e.* Specialist's level of knowledge and experience in the subject entity's industry

If that specialist is deemed to be qualified, the valuation analyst is in a position to use his or her work. The valuation analyst should not use the work of that specialist if the specialist is deemed not qualified.

DEVELOPMENT OF A VALUATION ENGAGEMENT

Types of Engagement

24. There are two types of valuation engagements a valuation analyst may perform—a ***valuation analysis*** or a ***calculation analysis***. The scope of the valuation engagement, as established in the understanding with the client (paragraphs 17 and 18), determines which type of valuation engagement the valuation analyst is engaged to perform:

a. *Valuation analysis*—A valuation analyst performs a valuation analysis when (1) the valuation engagement calls for the valuation analyst to determine an estimate of value of a subject interest and (2) the valuation analyst estimates the value as outlined in paragraphs 26 through 48 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 analysis as a conclusion of value. The conclusion of value, expressed in terms of cash equivalents, may be either a single amount or a range.

b. *Calculation analysis*—A valuation analyst performs a calculation analysis when (1) the valuation analyst and the client agree on the specific valuation approaches or valuation methods the valuation analyst will use or the extent of **valuation procedures** the valuation analyst will perform to determine an estimate of value of a subject interest and (2) the valuation analyst estimates the value in compliance with the agreement. The valuation analyst expresses the results of the calculation analysis as an indication of value. The indication of value, expressed in terms of cash equivalents, generally is expressed as a range but may also be expressed as a single amount. A calculation analysis does not include all of the procedures required for a valuation analysis. See paragraph 49.

Hypothetical Conditions

25. ***Hypothetical conditions*** may be required for legal purposes or for comparison purposes in the above two analyses. When a valuation analyst uses hypothetical conditions during a valuation engagement, he or she should indicate the basis for their use and disclose their use in the valuation report (see paragraphs 55(o), 73(p), and 76).

Valuation Analysis

26. In performing a valuation analysis, the valuation analyst should:

- Analyze the subject interest
- Consider and apply valuation approaches and methods
- Prepare and maintain appropriate documentation

27. Even though the list in paragraph 26 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 in different valuation engagements.

Analysis of the Subject Interest

28. 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 and available to perform the analysis will depend on, at a minimum, the following:

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

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

30. *Nonfinancial information.* The valuation analyst should, as 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)
- Products and/or services
- Economic environment
- Geographic markets
- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**

The valuation analyst also should obtain sufficient ownership information regarding the subject interest to enable him or her to:

- Determine the type of ownership interest, for example, whether an interest being valued is a controlling ownership interest
- 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 legal rights included in or excluded from an intangible asset
- Understand any other matter 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, restrictions, and other contractual obligations affecting the owners and the subject interest
  — *For an intangible asset*: Licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations

31*.* *Financial information.* The valuation analyst should obtain and analyze applicable and available financial information on the subject entity, including:

- Historical financial information (including annual and interim financial statements,[2] 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
- **Common size statements** entity information (compared with applicable industry information)
- Tax returns for an appropriate number of years

32. When using prospective financial information in a valuation engagement, the valuation analyst should read the information to determine that it is not unreasonable for purposes of the valuation analysis.

[2] The valuation analyst may have to compile historical financial statements from the subject entity's general ledger or other source documents. See paragraph 60 for a discussion of applicable guidance when the valuation analyst compiles financial statements and includes them in the valuation report.

Valuation Approaches and Methods

33. In developing the valuation analysis, there are three valuation approaches that the valuation analyst should consider:

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

34. The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on use of approaches and methods appears in paragraphs 35 through 43, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this Statement.

35. *Income Approach*. The commonly used methods under the income approach include the **capitalization of earnings method**/***capitalization of cash flow method*** and the **discounted future earnings method**/**discounted cash flow method**. When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to the following:

a. Capitalization of earnings method/capitalization of cash flow method—The valuation analyst should consider the following:

- ***Normalization*** adjustments
- Nonrecurring revenue and expense items
- Taxes
- **Capital structure** and financing costs
- **Sustaining capital reinvestments**
- Noncash items
- Qualitative judgments for risks used to compute discount and **capitalization rates**
- Expected changes (growth or decline) in future earnings/**cash flow**

b. Discounted future earnings method/discounted cash flow method—In addition to the items in *a* above, the valuation analyst should consider the following:

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

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

- Remaining useful life

- Position of intangible asset in its life cycle
- Appropriate ***capital charge***, if any
- 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

36. *Asset-Based Approach and Cost Approach*. When using methods of the asset-based approach in valuing a business entity, the valuation analyst should consider, as appropriate, the following information:

- Value of assets and liabilities
- Liquidation costs (if applicable)

37. When using methods of 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), the appropriate forms of depreciation and obsolescence, and the remaining useful life of the intangible asset.

38. *Market Approach.* The three most common valuation methods under this approach for valuing a business, business ownership interest, or security are the following:

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

The three most common market approach valuation methods for intangible assets are the following:

- 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, typically 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.

39. In applying the methods listed in paragraph 38 to determine valuation pricing multiples, the valuation analyst should consider:

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

40. When the valuation analyst uses valuation methods other than those discussed in paragraphs 35 through 38, he or she should set forth the rationale and support for using such other methods (see paragraph 47). An example of such other method is the **excess earnings method**.

41. 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 determine the value of the subject interest. A valuation analyst using a rule of thumb during a valuation engagement should use other valuation methods in arriving at a conclusion of value. When a rule of thumb is used in combination with other methods, the valuation analyst should document in the workpapers and disclose in the valuation report the source(s) of data used and how the rule of thumb was applied (see paragraphs 47 and 66).

42. *Valuation Adjustments.* During the course of a valuation analysis, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a value determined using one of the three valuation approaches. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability** and a **discount for lack of control**. Examples of valuation adjustments for valuation of an intangible asset include a discount for less than fee simple ownership rights and a discount for less than perpetuity ownership term.

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

Conclusion of Value

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

a. Compare, 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 *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 one or more approaches or methods.

Post-Valuation Events

45. The valuation date is the specific date as of which the valuation analyst estimates the value of the subject interest. 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 valuation may occur subsequent to the valuation date but prior to the issuance of a valuation report. Such an occurrence is referred to as a ***post-valuation event***. The valuation analyst should consider two types of post-valuation events:

a. Events indicative of conditions that were known or knowable to market participants at the valuation date. The valuation should take those events and conditions into account.
b. Events indicative of conditions that were not known or knowable to market participants 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. However, in situations in which a valuation is performed in conjunction with a purchase or sale of a subject interest and the value of the subject interest is meaningful to the purchaser beyond the valuation date, the events may be of such nature and significance as to warrant disclosure in a separate section of the report in order to keep users from being misled. (See paragraphs 55(q), 73(s), and 76.) Such disclosure should clearly indicate that the events are provided for informational purposes only and do not affect the determination of value.

Documentation

46. The valuation analyst should prepare and maintain documentation, the form and content of which should be designed to meet the circumstances of the particular valuation engagement. That documentation is the principal record of

information obtained and analyzed, the procedures performed, valuation approaches and methods considered and used, and the conclusion of value.

47. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. However, he or she should, at a minimum, document the following:

- Work performed to comply with the requirements of paragraphs 22 and 23 regarding the use of specialists
- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (see paragraphs 28 through 32)
- Assumptions and limiting conditions (see paragraph 20)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (see paragraph 21)
- Basis for any ***valuation assumptions*** made by the valuation analyst in developing the valuation analysis (this is particularly applicable to paragraphs 33 through 43)
- Valuation approaches and methods considered and, for those approaches not used, the reasons they were not used
- Valuation approaches and methods used, including the rationale and support for use of valuation methods other than those described in paragraphs 35 through 38 (see paragraph 40)
- Valuation analyst's consideration in certain circumstances of events, if any, occurring after the valuation date and prior to issuance of the valuation report (see paragraph 45(b))
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (see paragraph 41)

48. The valuation analyst should adopt procedures to retain the documentation for a period of time sufficient to meet the needs of his or her practice and to satisfy any applicable legal, regulatory, or other professional standard engagement requirements for records retention. The procedures should enable the valuation analyst to access throughout the retention period any retained electronic or nonelectronic documentation relevant to the valuation engagement.

Calculation Analysis

49. In performing a calculation analysis, the valuation analyst should consider, at a minimum, the following:

a. Terms of the valuation engagement
b. Identity of the client
c. Identity of the subject interest
d. For a business interest, whether or not the interest has ownership control characteristics and its degree of marketability

e. Purpose and intended use of the valuation
f. Intended users of the report and the limitations on its use
g. Valuation date
h. Applicable premise of value
i. Applicable standard of value
j. Sources of information used in the valuation engagement
k. Valuation approaches or valuation methods agreed upon with the client
l. Post-valuation events (see paragraph 45)

In addition, the valuation analyst should comply with the documentation requirements in paragraphs 46 and 48. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

THE VALUATION REPORT

50. A valuation report is a communication to the client containing the conclusion of value or the indication of value of the subject interest. A report communicating a conclusion of value or an indication of value must be in writing unless it is issued for use only in litigation (see paragraph 53).

51. The three types of written reports that a valuation analyst should use to communicate the results of the valuation engagement are:

a. *Detailed Report*: This report may be used only to report the results of a valuation analysis (conclusion of value). It should not be used to communicate the results of a calculation analysis (indication of value). See paragraph 54.

b. *Summary Report*: This report may be used only to report the results of a valuation analysis (conclusion of value). It should not be used to communicate the results of a calculation analysis (indication of value). See paragraph 73.

For a valuation analysis, the determination of whether to prepare a Detailed Report or a Summary Report is based on the level of reporting detail decided upon by the client, the valuation analyst, or both.

c. *Calculation Report*: This type of report should be used only to communicate the results of a calculation analysis (indication of value). It should not be used to communicate the results of a valuation analysis (conclusion of value). See paragraph 75.

52. 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). However, the

valuation analyst is not responsible for controlling a client's distribution of a valuation report that has been restricted as to use. See paragraph 69(f).

53. *Reporting Exemption for Litigation*. A valuation performed only for use in a litigation case to be decided by a trier of fact is exempt from the reporting provisions of this Statement. The form and content of a report for use only in such litigation case may be specified by legal counsel, by the Federal Rules of Civil Procedure, or by some other requirement particular to the case. The exemption applies only to the reporting provisions of this Statement (paragraphs 50 through 52 and 54 through 79). The developmental provisions of the Statement (paragraphs 24 through 49) still apply whenever the valuation analyst expresses a conclusion of value or an indication of value. See also Appendix A, "Questions and Answers."

Detailed Report

54. The Detailed Report is structured to provide sufficient information to permit knowledgeable individuals to adequately understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A Detailed Report should include, as applicable, the following sections**:**

- 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
- Non-operating Assets and Excess Operating Assets (if any)
- Representation of the Valuation Analyst
- Conclusion of Value
- Appendices/Exhibits

Introduction

55. This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the 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. Terms of the valuation engagement
b. Identity of the client
c. Purpose and intended use of the valuation
d. Intended users of the valuation
e. Identity of the subject entity

f. Description of the subject interest
g. If a business interest is being valued, a comment as to whether or not the interest has ownership control characteristics and its degree of marketability
h. Valuation date
i. **Report date**
j. Type of report issued (namely, a Detailed Report; see paragraph 51)
k. Applicable premise of value
l. Applicable standard of value
m. Assumptions and limiting conditions (alternatively, these often appear in an appendix; see paragraph 20)
n. Any restrictions or limitations in the scope of work or data available for analysis (see paragraph 21)
o. Any hypothetical conditions used in the valuation engagement, including the basis for their use (see paragraph 25)
p. If the work of a specialist was used in the valuation (see paragraph 22), a description of how the specialist's work was used
q. Disclosure of post-valuation events in certain circumstances [see paragraph 45(b)]
r. Any application of the jurisdictional exception (see paragraph 9)
s. 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

56. This section of the report should identify the relevant sources of the information analyzed or otherwise used during 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 all persons interviewed and their relationships to the subject interest
d. Financial information (see paragraphs 57 and 58)
e. Tax information (see paragraph 58)
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

57. If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the SSAEs) by a CPA or CPA firm, the valuation report should identify the CPA or CPA firm and the type of report issued and describe the relationship of the CPA or CPA firm to the valuation analyst. 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 state also that the valuation analyst assumes no responsibility for the financial information.

58. 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 56(e)), the valuation analyst should identify the tax returns used, the preparer of the tax returns, and any existing relationship between the valuation analyst and that 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 state also that the valuation analyst assumes no responsibility for that derived information.

59. 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

60. During the course of a valuation engagement, a valuation analyst may draft financial statements from the subject entity's general ledger or other source documents. If the valuation analyst includes those financial statements in the valuation report, he or she is considered to have submitted the financial statements and must comply with the applicable provisions of AICPA Statements on Standards for Accounting and Review Services (SSARS). See SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.06-.10). See also Interpretation No. 23, "Applicability of Statements on Standards for Accounting and Review Services When an Accountant Engaged to Perform a Business Valuation Derives Information From an Entity's Tax Return," of SSARS No. 1 (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.89-.92).

Analysis of the Subject Entity and Related Nonfinancial Information

61. The valuation analyst should include an analysis of the information listed and discussed in paragraph 30.

Financial Statement / Information Analysis

62. This section should include an analysis of the information provided in the items listed in paragraph 31. Such analysis may include:

a. The rationale underlying any normalization or ***control adjustments*** to the financial information
b. Discussion of any unusual characteristics of the financial information

Valuation Approaches and Methods Considered

63. This section should:

- State that the valuation analyst has considered the three valuation approaches (as discussed in paragraph 33)
- For any of the three approaches not used, describe why not used
- Describe the methods considered and, when applicable, the reason(s) for not using the methods considered

Valuation Approaches and Methods Used

64. The valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

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

a. Income approach:

- Composition of the representative benefit stream (either income or cash flow)
- Method(s) used and the risk factors considered in selecting the appropriate **discount rate**, the capitalization rate, or both
- Other factors as discussed in paragraph 35

b. Asset-based approach or cost approach:

- *Asset-based approach:* Any adjustments made by the valuation analyst to the 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 guideline public company method:
  - — The selected guideline companies and the process used in their selection
  - — 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 guideline 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 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

66. 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 (see paragraph 41).

Valuation Adjustments

67. This section should (*a*) identify each valuation adjustment considered and determined to be applicable, (*b*) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (*c*) describe the base value(s) to which the adjustment was applied. See paragraph 42.

Non-operating Assets and Excess Operating Assets

68. When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related non-operating assets or excess operating assets and their effect on the valuation (see paragraph 43).

Representation of the Valuation Analyst

69. The representation of the valuation analyst should include the following:

a. A statement that the analyses, opinions, and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph 20), and that they are the personal analyses, opinions, and conclusion of value of the valuation analyst
b. A statement that for data included in the valuation report that have been obtained from various printed or electronic reference sources, the valuation analyst believes those sources to be reputable (any exceptions should be

noted) but has not performed corroborating procedures to substantiate that data

c. A statement that the valuation analyst performed the valuation engagement with objectivity. When the valuation analyst identifies a potential conflict of interest and makes the disclosure required under Interpretation No. 102-2 of the AICPA *Code of Professional Conduct*, the valuation analyst should disclose the relationship and, after obtaining the consent from the client required under that Interpretation, state that he or she obtained such consent.

d. A statement that neither the valuation analyst's firm nor any of its employees have a present or intended material financial interest in the subject interest

e. A statement that the valuation engagement was performed in accordance with the AICPA Statement on Standards for Valuation Services

f. A statement identifying the parties for which the information and use of the valuation report is restricted, and a statement that the valuation report is not intended to be and should not be used by anyone other than such parties (see paragraph 52)

g. A statement as to whether the analyst's compensation is fee-based or is contingent on the outcome of the valuation

h. A statement as to whether the valuation analyst used the work of one or more outside specialists (specialists other than those employed by the valuation analyst or the valuation analyst's firm) to assist during the valuation engagement. If the work of such a specialist was used, the specialist should be identified and an indication provided as to whether the specialist was hired by the valuation analyst or the valuation analyst's firm to assist in the valuation engagement or was engaged by a party other than the valuation analyst (for example, the client). If the specialist was engaged by a party other than the valuation analyst, that party should be identified. The valuation report should include a statement that the valuation analyst has performed no corroborating procedures to confirm the validity of the specialist's work. (See paragraph 22.)

i. Signature of the valuation analyst. The person or persons assuming responsibility for the valuation should sign the representation in their own name(s).

Conclusion of Value

70. This section should present the valuation analyst's estimate of the value of the subject interest. In addition to a discussion of the rationale underlying the determination of the estimate, this section should include the following:

a. A statement that a valuation analysis was performed, including the subject interest and the valuation date

b. A description of the purpose of the valuation, and a statement that the analysis was performed solely to assist in achieving that purpose

c. A statement that the estimate of value resulting from a valuation analysis is expressed as a conclusion of value

d. A statement that the valuation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants
e. A statement describing any restrictions or limitations in the scope of work or data available for analysis (see paragraph 21)
f. A statement of the conclusion of value, either a single amount or a range
g. A statement that the conclusion of value is subject to the assumptions and limiting conditions (see paragraph 20) and to the valuation analyst's representation (see paragraph 69)
h. The signature of the valuation analyst or the valuation analyst's firm
i. The date of the valuation report

71. The section should include language similar to the following:

> We have performed a *valuation analysis*, 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 analysis was performed solely to assist in the matter of [*purpose of the valuation*] and the resulting estimate of value should not be used for any other purpose. This valuation analysis was conducted in accordance with the SSVS. The estimate of value that results from a valuation analysis 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*].
>
> In our opinion, based on our analysis as contained in this valuation report, the 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 of 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*].
>
> [*Signature*]
>
> [*Date*]

Appendices/Exhibits

72. 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

73. A Summary Report is structured to provide a summary 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. Terms of the valuation engagement
b. Identity of the client
c. Purpose and intended use of the valuation
d. Intended users of the valuation
e. Identity of the subject entity
f. Description of the subject interest
g. If a business interest is being valued, a comment as to whether or not the interest has ownership control characteristics and its degree of marketability
h. Valuation date
i. Valuation report date
j. Type of report issued (namely, a Summary Report; see paragraph 51)
k. Applicable premise of value
l. Applicable standard of value
m. Sources of information used in the valuation engagement
n. Assumptions and limiting conditions of the valuation engagement (see paragraph 20)
o. Any restrictions or limitations in the scope of work or data available for analysis (see paragraph 21)
p. Any hypothetical conditions used in the valuation engagement, including the basis for their use (see paragraph 25)
q. If the work of a specialist was used in the valuation (see paragraph 22), a description of how the specialist's work was used
r. Description of the valuation approaches and methods used
s. Disclosure of post-valuation events in certain circumstances (see paragraph 45(b))
t. Any application of the jurisdictional exception (see paragraph 9)
u. Representation of the valuation analyst (see paragraph 69)
v. Section as discussed in paragraphs 70 and 71, summarizing the conclusion of value

74. Appendices or exhibits may be used for required information (paragraph 73) or information that supplements the Summary Report. Often the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the Summary Report.

Calculation Report

75. As indicated in paragraph 51, a Calculation Report is the only report that should be used to report the results of a calculation analysis. The report should

state that it is a Calculation Report. The Calculation Report should include the representation of the valuation analyst [see paragraph 69, replacing “conclusion of value” with “indication of value” in paragraph 69(a)].

76. The Calculation Report should identify any hypothetical conditions used in the valuation engagement, including the basis for their use (see paragraph 25), any application of the jurisdictional exception (see paragraph 9), and any assumptions and limiting conditions applicable to the engagement (see paragraph 20). If the valuation analyst used the work of a specialist (see paragraph 22), the valuation analyst should describe in the Calculation Report how the specialist’s work was used. The Calculation Report should also include a disclosure of post-valuation events in certain circumstances (see paragraph 45(b)).

77. Appendices or exhibits may be used for required information (paragraph 78) 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.

78. For an indication of value based on a calculation analysis, the Calculation Report should include a section summarizing the indication of value. This section should include the following:

a. A statement, identifying the subject interest and providing the valuation date, that certain valuation procedures were performed
b. A description of those valuation procedures, or a reference to the section(s) of the valuation report in which the valuation procedures are described
c. A description of the purpose of the valuation procedures, and a statement that the valuation procedures were performed solely to assist in achieving that purpose
d. A statement that the valuation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants
e. A statement that the estimate of value resulting from a calculation analysis is expressed as an indication of value
f. A general description of a calculation analysis, including statements that (1) a calculation analysis does not include all of the procedures required for a valuation analysis and (2) had a valuation analysis been performed, the results may have been different and the difference may have been significant
g. A statement of the indication of value, either a single amount or a range
h. The signature of the valuation analyst or the valuation analyst’s firm
i. The date of the valuation report

79. The section should include language similar to the following:

> We have performed a *calculation analysis*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American

Institute of Certified Public Accountants. Under that calculation analysis, we performed certain valuation 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 [*valuation date*]. The specific valuation procedures are detailed in paragraphs [*reference to paragraph numbers*] of our Calculation Report. The valuation procedures were performed solely to assist in the matter of [*purpose of valuation procedures*] and the resulting estimate of value should not be used for any other purpose. This calculation analysis was conducted in accordance with the SSVS. The estimate of value that results from a calculation analysis is expressed as an indication of value.

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

In our opinion, based on our calculations as contained in this report, which are based solely upon the valuation procedures agreed upon as referred to above, the resulting indication of the 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 indication of 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*].

[*Signature*]

[*Date*]

EFFECTIVE DATE

80. This Statement applies to valuation engagements accepted after December 31, 2005.

APPENDIX A
QUESTIONS AND ANSWERS[1]

Questions and answers relating to litigation engagements

Q1: Do lost-profits damage computations fall under this Statement?

A1: No. This Statement applies to a *valuation engagement*, which is defined as an engagement, or any part of an engagement, that involves determining the value of a business, business ownership interest, security, or intangible asset (collectively, a *subject interest*). See paragraphs 1, 2, and 6.

Q2: Is an economic damages computation that incorporates a terminal value within the scope of this Statement?

A2: The use of a terminal value in and of itself does not determine whether the engagement is within the scope of this Statement. Terminal value is a common concept in finance literature. A damages computation that takes into account a terminal value is within the scope of this Statement only in circumstances in which the valuation analyst performs a valuation engagement (see paragraph A1).

Q3: If a start-up business is destroyed, is the economic damages computation within the scope of this Statement?

A3: There are two common measures of damages: lost profits and loss of value.

If a valuation analyst performs a valuation engagement to determine the lost value of a business or intangible asset, this Statement applies. Otherwise, this Statement does not apply. See paragraph A1.

In order to determine whether this Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes a valuation engagement with respect to the business or intangible asset or whether it is a lost-profits computation.

Q4: Does this Statement include any exceptions relating to litigation?

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[1] These Questions and Answers are part of this Statement for exposure purposes only and are intended to be published separately from the final Statement. Additional Questions and Answers may then be added as additional questions arise.

A4: Yes. This Statement includes a reporting exemption for litigation matters (see paragraph 53). However, there is no litigation exemption from the developmental provisions of this Statement (see paragraphs 24 through 49) in circumstances in which a valuation engagement is performed (see paragraph A1).

Q5: Is this Statement's reporting exemption for litigation (see paragraph 53) the same as the "litigation exemption" in the AICPA attestation standards?

A5: No. The so-called "litigation exemption" is provided for in the AICPA attestation standards and is further clarified 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." (See 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 situations as discussed above, this Statement's exemption for litigation is an exemption only from the reporting provisions (paragraphs 50 through 79) of this Statement.

Q6: Do the standards of the primary outside business valuation organizations include any litigation exception?

A6: Yes. The standards of the primary outside business valuation organizations provide a litigation exemption for reporting that is similar to that in this Statement.

Questions and answers relating to tax engagements

Q7: When does this Statement apply to members who determine values related to tax engagements?

A7: This Statement applies when the member determines the value of a business, business ownership interest, security, or intangible asset (see paragraph 1). The application of valuation approaches and methods and the use of professional judgment (see paragraphs 3 and 10,) is required unless an exception applies (see paragraphs 4 through 7).

Q8: If the sole purpose of an engagement is reporting a value in a tax return and this 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?

A8: This Statement requires the preparation of a valuation report (see paragraphs 50 through 79) that is given to the client (see paragraph 50) but does not require that the report be attached to the tax return or mandate any other tax-specific disclosures. However, in limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (see paragraphs 9 and A19). There is also a reporting exemption for litigation (see paragraph 53).

Q9: Are mechanical computations of value—for example, computations using actuarial tables—excluded from this Statement?

A9: Mechanical computations of value are excluded from this Statement if they do not rise to the level of a valuation engagement, that is, if the member does not apply valuation approaches and methods as described in this Statement (see paragraph 7).

Examples of services that do not rise to the level of a valuation engagement 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; and (*c*) preparing a tax return using a valuation of a business that was provided by a third-party appraiser or by the client (see paragraph 4).

Examples of services that rise to the level of a valuation engagement 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 market 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 determine the fair market value.

Q10: Does the “jurisdictional exception” (see paragraph 9) provide that a valuation engagement is not subject to this 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?

A10: No, the “jurisdictional exception” would not exempt the engagement even if the engagement’s sole purpose was to value a subject interest (see paragraph A1) for purposes of tax return reporting. Only the portion of this Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of this Statement applies to the engagement.

Q11: Is an interest in a publicly traded partnership whose shares are traded frequently considered a “security” under this Statement? Is an interest in a family limited partnership (FLP) or in another nontraded partnership considered a “security” under this Statement?

A11: Whether something is 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 this Statement (see paragraphs 1 and 7).

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 non-publicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (see paragraphs 1, 3, and A7).

Q12: A client engages a member to provide advice regarding the client’s estate 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 this Statement?

A12: It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates an “estimated estate tax” to illustrate various planning options, he or she may fall under this Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the estate 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 hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to this Statement with regard to these assets (see paragraphs 1, 10, and A7). 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 estate planning advice, this Statement would apply. However, if the client or a third party provides the values for these assets or the member uses assumed hypothetical values, this Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. The computation of the "estimated estate tax" once the values have been determined or provided is not subject to this Statement, as the computation is a mechanical computation (see paragraph 7).

Q13: There are many instances where a tax engagement involves the need for a member to determine value. The determination 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:

Q13A: A member has been engaged to determine the deductibility of interest on a non-recourse loan. Under applicable regulations, interest on a non-recourse 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 this Statement?

A13A: This is not a valuation engagement covered by this Statement because it is not the valuation of a subject interest (see paragraph 1). This example is a debt-service analysis.

Q13B: There are annual compliance filings that require an estimate of the value of a company. For example, in one state, the "market value" of "intangible personal property," as defined by the state's taxing authority,authority needs 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 this Statement?

A13B: If the member determines the value of a subject interest (see paragraphs 1 and 3), this Statement applies. In this instance, a calculation analysis could be performed (see paragraphs 24, 49, 75 through 79, and A7). If, however, the client or a third-party appraiser provides the value of the subject interest to the member, this Statement does not apply (see paragraphs 1 and 4).

Q13C: 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 valuation engagements subject to this Statement?

A13C: 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 this Statement and the member is required to apply valuation approaches and methods and use professional judgment to value those assets (see paragraphs 1, 3, and A7) unless an exception applies (see paragraphs 4 through 7).

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 this 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, this Statement applies.

Q13D: 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 this Statement?

A13D: Yes, this 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 is required unless an exception applies (see paragraphs 4 through 7). The fact that the member does not apply a discount does not exempt the engagement from this Statement (see paragraphs 1 through 3 and 7).

Q13E: Would this 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)?

A13E: It depends on the underlying assets held by the CRT. This Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset. 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), this Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, this Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (see paragraphs 1, 3, 10, and A7).

Q13F: 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, loss, and so on can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to this Statement?

A13F: 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 this Statement applies (see paragraphs 1 and A7).

Q13G: 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 is properly computed. Is this a valuation engagement subject to this Statement?

A13G: No. None of the assets constitutes a subject interest (see paragraph 1).

Q13H: 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 settlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to this Statement?

A13H: 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, this Statement applies.

Q14: An executor has engaged a member to prepare an estate tax return, which requires determining values for the estate's assets. Does the proposed Statement apply to any of the following assets owned by the estate? (A) Shares in a publicly traded company, "TI Corporation," whose shares are traded infrequently; (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 25-percent interest in "RP," a privately held rental real estate partnership.

A14A: 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 this Statement applies to shares that are traded infrequently. 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 this Statement does not apply because the calculation of value is mechanical (see paragraph 7). 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, this Statement applies because valuation approaches and methods need to be applied and professional judgment used in determining the value of the block (see paragraphs 1 and 3).

A14B. 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 this 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, this Statement would not apply. If, however, the large block of publicly traded shares represents a significant percentage of the daily trading volume, this Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (see paragraphs 1 and 3).

A14C: 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 A14A and A14B because, 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 (see paragraphs 1 and 3).

A14D: 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 (see paragraphs 1 and 3).

A14E: The Statement would apply to the determination of value of the 25-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 (see paragraphs 1 and 3).

Q15: Would the answers to Q14 change if the values were provided by the client or a client-engaged third party?

A15: 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 (see paragraphs 1, 3, 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. 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.

Q16: Would the answers to Q14 change if the values were provided by an outside third-party specialist hired by the member?

A16: If the member employed an outside third-party specialist to assist with the member's work and it is the member expressing a conclusion or indication of value, the member will be applying valuation approaches and methods and using professional judgment and thus this Statement would apply (see paragraphs 1 and 3). In addition, see paragraphs 22 and 23, "Use of Work of Specialists in the Valuation Engagement." If, however, the third-party specialist will be 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 and using professional judgment (see paragraphs 1, 3, 10, and A7), this 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.

Q17: The client has asked the member to value a partnership interest using an "average" discount that the member is to determine based on the results of various studies and case law. Does this Statement apply? If so, is this a valuation analysis or a calculation analysis?

A17: Yes, this 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 analysis 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 (see paragraphs 24(b) and A7).

Q18: Would this 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?

A18: No, this Statement would not apply. The member is providing tax advice using an assumed value of a business and is not determining value, applying valuation approaches and methods, or computing the value of the business (see paragraphs 1, 3, and A7).

Q19: Would this 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 this Statement?

A19: No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, this Statement would not apply (see paragraphs 1, 10, and A7). To the extent that the transfer pricing study applies to the valuation of intangible assets, this Statement would 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 this Statement, the jurisdictional exception (see paragraph 9) would exempt the valuation of the intangible assets from the developmental provisions of this Statement (paragraphs 24 through 49). In addition, to the extent that the IRS regulations (such as 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 this Statement (paragraphs 50 through 79) and thus a valuation report would not be necessary.

Q20: In a situation where this 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 (SSTSs)?

A20: Yes. The Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTSs would apply to all aspects of the engagement. For example, even though this 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 SSTS No. 1, *Tax Return Positions*, for that valuation.

Q21: Does determining the value of accounts receivable fall under this Statement?

A21: No. Accounts receivable constitute **tangible assets** under this Statement (see Appendix C) and do not constitute a subject interest (see paragraph 1).

Q22: Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under this Statement?

A22: 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 this Statement. But the settlement or negotiation process itself is not a valuation and would not fall under this Statement.

Questions and answers – other

Q23: In the course of performing a valuation under this 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)?

A23: 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." [footnote omitted] 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.

Q24: Under a valuation analysis, 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 analysis, the valuation analyst and the client agree on the specific valuation approaches or valuation methods the valuation analyst will use or the extent of valuation procedures the valuation analyst will perform. (See paragraph 24.) Under paragraph 21, 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 (and such restriction or limitation should be disclosed in the valuation report). Is it possible to have a restriction or limitation that is of such degree that a valuation analyst engaged to perform a valuation analysis should propose altering the engagement to be a calculation analysis?

A24: Although the two analyses represent two different types of service performed by valuation analysts, that possibility exists. If, in the course of a valuation analysis, 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 analysis 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 valuation analysis and should consider resigning from the engagement.

APPENDIX B
ILLUSTRATIVE LIST OF ASSUMPTIONS AND LIMITING CONDITIONS FOR A BUSINESS VALUATION

The valuation report should include a list of assumptions and limiting conditions under which the valuation was performed. This appendix includes an illustrative list for a business valuation. It is important for a reader to understand the limits of a valuation report. Although a valuation analyst would be expected to question information received from management if it appeared to be unreasonable or inconsistent, valuation analysts do not audit the information received from management.

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 investigation 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.
3. Public information and industry and statistical information have been obtained from sources we deem to be reputable; however, we make no representation as to the accuracy or completeness of such information, and have accepted the information without any verification.
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. 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 their scope, and the 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 Compan*y] 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 expressly 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 Americans with Disabilities Act of 1990 (ADA) and this valuation does not consider the effect, if any, of noncompliance.

APPENDIX C
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 from the Glossary.

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 non-controlling 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 – non-physical 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 non-operating assets) minus the value of its liabilities.

Non-Operating 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, non-economic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements – financial statements adjusted for non-operating assets and liabilities and/or for nonrecurring, non-economic, 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 **Non-Operating 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 D
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 legal share in the ownership of a business (business enterprise).

Calculation Analysis – a valuation engagement wherein the valuation analyst and the client agree on the specific valuation approaches or valuation methods the valuation analyst will use, the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest, or both. A calculation analysis generally would not include all of the valuation procedures required for a valuation analysis. The valuation analyst expresses the results of the calculation analysis as an indication of value, which may be either a single amount or a range.

Capital 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 Cash Flow Method – a method within the income approach whereby future expected net cash flows for a representative single period are converted to value through division by a capitalization rate.

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 analysis and using professional judgment as to the value or range of values based on those procedures.

Control Adjustment – an 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.

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

Fair Value – the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties. [Source: Financial Accounting Standards Board definition in exposure draft of proposed Statement of Financial Accounting Standards, *Fair Value Measurements*, as used in the context of generally accepted accounting principles]

Guideline Transactions Method – a method within the market approach whereby market multiples are derived from sales of entire privately-held companies that are 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.

Indication of Value – an estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures specified in a calculation analysis and using professional judgment as to the value or range of values based on those procedures.

Normalization – see **Normalized Earnings** in the International Glossary of Business Valuation Terms in Appendix C.

Post-valuation Event – an event that could affect a valuation and that occurs subsequent to the valuation date but prior to the issuance of a valuation report.

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 exempt 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. 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.

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.

Valuation Analysis – a valuation engagement in which a valuation analyst determines an estimate of 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 analysis as a conclusion of value, which may be either a single amount or a range.

Valuation Analyst – an AICPA member who performs a valuation engagement that culminates in the expression of a conclusion of value or an indication of value.

Valuation Assumptions – statements related to a valuation engagement that are taken as true or for granted without verification in the performance of that engagement.

Valuation Engagement – 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*.

Valuation Service – See *valuation engagement*.