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ENGAGEMENT ACCEPTANCE

Before accepting a business valuation assignment, the CPA appraiser should ask these questions:

A Do I have the knowledge and experience to complete the assignment competently?

A Will I be objective, impartial, intellectually honest, and free of conflicts of interest?

The CPA valuer needs to answer "yes" to these two questions before accepting any business valuation engagement because the clients, and perhaps other potential users, may rely on the valuation conclusion. The CPA should therefore be mindful of his or her professional standing when providing valuation services.

The USPAP contain a competency provision, and the SSCS cites professional-competence, due professional care, and planning and supervision as general standards contained in rule 201 of the AICPA Code of Professional Conduct. In addition, the SSCS cites communication with client as one of the additional general standards for all consulting services. At this first phase of an engagement, the CPA valuer is obliged to inform the client of any conflicts of interest and of any significant reservations he or she may have concerning the scope or benefits of the engagement. (Exhibit 1 lists the activities that occur during each of the four phases along with the relevant standards from the USPAP and the SSCS.)

ENGAGEMENT ARRANGEMENTS

The engagement-arrangements phase can best be described as the "meeting of the minds" regarding the who, why, what, and when of the engagement. What is defined

and agreed upon between the business valuer and the client should be carried out and documented consistently throughout the engagement.

Business valuation engagements are commonly done for four broad purposes: taxation, transactions, disputes, and planning. The purpose, function, and end user of a business valuation will largely dictate the most appropriate scope for a specific business valuation engagement. Some examples of specific purposes and typical end users are listed in exhibit 2.

The SSCS requires an understanding with the client, which may be written or oral. A written engagement letter helps to eliminate misunderstandings by defining the key aspects of the engagement, disclosing any limitations or reductions in the engagement scope, and obtaining the written approval from the client to proceed under the terms of agreement. Should previous agreed-upon terms change during the course of the engagement, a revised engagement letter is recommended.

BUSINESS VALUATION PROCESS

The essence of business valuation is to arrive at a conclusion of value that is both reasonable and supportable. It is therefore crucial that the approach and logic of the valuation can be justified should the CPA be called later to defend the conclusion of value. Exhibit 3 graphically depicts the process by which the valuer reaches a valuation conclusion. A scope reduction can occur in the process leading to a valuation conclusion. The client may ask the valuer how much work is needed to complete the engagement at hand. It is important for the business valuer

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to discuss with the client the appropriate scope for a particular engagement, which will depend on the purpose and end users. The decision on scope is also affected by the prospect of litigation, and many times by the client's financial capability of paying the appraisal fee.

Under USPAP, the appraiser may provide either a *complete appraisal* or a *limited appraisal*, depending on the circumstances of the engagement. A complete appraisal is "the act or process of estimating value or an estimate of value performed without invoking the Departure Provision" of USPAP. Generally, a complete appraisal is warranted when the user is a third party such as the IRS, the Department of Labor (DOL), or lenders. Exhibit 4 depicts the scope of a complete appraisal in relation to the business valuation process.

If the end users of the valuation are identified and agree to a reduced scope for the engagement, a *limited appraisal* may be appropriate (for example, for shareholder buy-outs or employee buy-ins or for a single client user). A limited appraisal is "the act or process of estimating value or an estimate of value performed under and resulting from invoking the Departure Provision." The Departure Provision permits certain departures from *specific guidelines* within a Standards Rule (SR) of USPAP (see sidebar "USPAP Standards Rule 9-4"). As specific guidelines not subject to the USPAP's *binding requirements*, the valuation procedures can be limited by invoking the Departure Provision. However, the valuer must, in all appraisals, comply with the binding requirements found in other SRs. Statement on Appraisal Standard No. 7 (SMT-7) of USPAP describes the differences between specific guidelines and binding requirements in more detail.

If the scope of the engagement is a limited appraisal, SR 10-2(h) requires that the written report disclose the permitted departures from the specific guidelines of Standard 9. The client and end users of appraisal services must realize that as the scope is reduced, the level of reliability in a limited appraisal decreases, and as a result, the client and end users are accepting a higher level of risk. A written engagement letter helps to ensure that the client understands and accepts the increased risk.

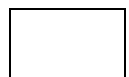
EXHIBIT t

Four Phases of a Business Valuation Engagement

	USPAP	SSCS
Phase 1-Engagement Acceptance A.. Meet Competency Requirements B. Disclose and Resolve Conflicts of Interest	<ul style="list-style-type: none"> • Competency Provision • SR 9-1 	<ul style="list-style-type: none"> • Professional Competence • Due Professional Care .. • Planning and Supervision • Communication with Client
Phase 2.- Engagement Arrangements A. Define the Valuation Assignment <ul style="list-style-type: none"> • Property to be Valued • Purpose and Use _ - • Effective-Date (date of value)- • Standard of Value • Scope: Complete-Appraisal or Limited Appraisal • Type of Report: (see. Phase 4) • Timing and Fees. B. Request Client Documents, Questionnaires, and Schedules C: Obtain Signed Engagement Letter	<ul style="list-style-type: none"> • Departure Provision • SR 9-2 • SW T . . 	<ul style="list-style-type: none"> • Understanding with Client
Phase 3 - Business Valuation Process (see Exhibit 3) A. Receive and Analyze Client Data B. Perform External Economic and Industry Research C. Make On-Site Visit and Interview Management D. Complete Internal and External Analyses, Adjust Historical Financial Statements, Consider Projected Financial Statements, Apply Valuation Approaches and Methods, Apply Premiums and Discounts (if appropriate), and Arrive at a Valuation Conclusion	<ul style="list-style-type: none"> • Departure Provision • SR 9-3 through SR 9-5 • SMT 7 	<ul style="list-style-type: none"> • Sufficient Relevant Data
Phase 4- Reporting A. Oral B. Written: <ul style="list-style-type: none"> • Self-contained Appraisal Report • Summary Appraisal Report • Restricted Appraisal Report C. Combination Oral and Written	<ul style="list-style-type: none"> • SR10-1 through SR 10-4 • SMT 7 	<ul style="list-style-type: none"> • Communication with Client

REPORTING

After the appraiser has completed the business valuation process and arrived at a valuation "opinion" or estimate of value, the process and result may be communicated to the client or other users either orally or in writing. The USPAP do not dictate the form, format, or style of appraisal reports. However, Standard 2 and SMT-7 describe three options for written reports of real estate



written reports currently defined in USPAP include:

A Self-contained Appraisal Report. The information presented under this reporting option is described in the greatest detail. Exhibit 5 provides an example of the report content in an engagement in which the scope is a complete appraisal. Complete appraisals used by third parties (for example, the IRS, the DOL, lenders) are most often reported under this option.

A Summary Appraisal Report. This reporting option involves a more concise presentation of information. Detailed information can often be summarized by bulleted points, tables, and graphs. The introduction and appendix sections shown in exhibit 5 would also be included in summary appraisal reports, regardless of the scope. Limited appraisals for shareholder buy-outs or employee buy-ins, or a complete appraisal in litigation, may warrant this written reporting option.

A Restricted Appraisal Report. This type of report presents a minimal amount of information, but includes the same introduction and appendix information shown in exhibit 5. This option may be appropriate in situations in which only the client is relying on the report, which is often the case in limited

appraisals. The ASB is currently considering adopting the three options, or similar reporting options, for other appraisal disciplines to include business valuations. The options for

appraisals done for planning purposes. This written report option may also be appropriate for complete and limited appraisals in litigation services engagements in which oral testimony or demonstrative exhibits supplement the written report.

Business valuation is one of the fastest growing areas of practice today. Furthermore, the changing marketplace is resulting in more complex business transactions. Business valuation standards provide guidance in the approach for evaluating data and reporting on a value conclusion, but even with such standards, valuers should not

lose sight of the wisdom from the past: A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment, and reasonableness must enter into the process

....

Revenue Ruling 59-60, Sec. 3. 01

USPAP-STANDARDS RULE, 94 .e

The specific guidelines, of -Standards Rule (SR)9=4: state:

In developing a business- or intangible, asset appraisal, an appraiser- must, observe, the following specific guidelines when applicable

a:- Consider all appropriate valuation methods and procedures:

b:: Collect and analyze, relevant data regarding:

i. The nature and history of the business

ii: Financial and- economic conditions affecting the business enterprise, its industry and general economy.

iii. Past results, current operations, and future prospects of the business enterprise.

iv. Past sales of capital stock or other ownership interest in the business enterprise being appraised.

v. Sales of similar businesses or capital stock of publicly held similar businesses.

vi. Prices, terms, and conditions affecting past sales of similar business assets.

SR 9- 4 of the USPAP generally follows the eight factors found in Revenue Ruling 59-60. When the IRS is the intended user of the valuation, the valuer should follow all of the specific guidelines of SR 9-4 without invoking the Departure Provision for any part of SR 9-4.

EXHIBIT 5

**Complete Appraisal. -
Self-Contained Appraisal Report**

**Report Content-
Introduction,**

Description of the Assignment
Summary Description of the Company;
Valuation Methods and Conclusion, ..

USPAP Reference

SR 9-2(a)
SR 10-2(a) through SR 10-2(e)

History ,
Product Lines, Services, and Suppliers
Customers .
;Competition - - ; ..
Facilities and Equipment
organization and Management
Stock Ownership ..
Financing :-.
Strengths and Weaknesses
Company Expectations

SR 9-4(a)
SR 9-4(h) (i)
SR 94 (b) (iii)

Economic and Industry Conditions

Economic Conditions
Industry Conditions

SR 9-4(b) (ii)

Financial Analysis of the Company

Historical Income Statement Comparison
Historical Balance Sheet Comparison
Historical Ratio Analysis
Ratio Analysis Compared to Industry Statistics

SR 9-4(b) (ii)
SR 9-4(b) (iii)

Search for Comparables

Prior Sales of Company Stock
Comparable Public Companies
Comparable External Transactions

SR 9-4(b)(iv)
SR 9f1(b)(v)
SR 9f1(b) (vi)

Valuation Methods and Conclusion

Income Approach and Methods
Asset-Based Approach and Methods
Market Approach and Methods
Premiums and Discounts (if appropriate)
Valuation Summary and Conclusion

SR 9-2 (b)
SR 9-3
SR 9-4 (a)
SR 9-5(a) & (b)
SR 10-2(i)

Appendixes*

Assumptions and Limiting Conditions
Sources of Information Relied Upon
Qualifications of the Appraiser
Certifications
Standard of Value Definition

SR 9-2 (b)
SR 10-1(b) & (c)
SR 10.2(f), (g) & (j)
SR 10-3

**Pursuant to SR IP-2(h) there would be an additional appendix entitled "Departure Provision Under USPAP" for limited appraisals.*

Business Valuation Standards and Guidelines

Code of Professional Ethics

Statement on Standards for Consulting Services No. 1
American Institute of Certified Public Accountants
Harborside Financial Center, 201 Plaza three
Jersey City, NJ 07311-3881
800-862-4272; fax 800-362-5066

Uniform Standards of Professional Appraisal Practice

Appraisals Standards Board
The Appraisal Foundation
1029 Vermont Avenue, NW, Suite 900
Washington, DC 20005-3517
202-347-7722; fax: 202347-7727

Principles of Appraisal Practice and Code of Ethics

American Society of Appraisers
P.O. Box 17265
Washington, DC 20041
800-ASA-VALU; fax 703-742-8471

Business Valuation Standards

Business Valuation Committee
American Society of Appraisers
2777 South Colorado Blvd., Suite 200
Denver, CO 80202
303-758-6148

Business Appraisal Standards

The Institute of business Appraisers, Inc.
P.O. Box 1447
Boynton Beach, FL 33425
407-732-3202

NACVA Professional Standards

National Assoc. of Certified Valuation Analysts
Suite 110, Brickyard Towers
1245 East Brickyard Road
Salt Lake City, UT 84106
801-486-0600; fax: 801-486-7500

Revenue Ruling 59-60; Valuation of Stocks and Bonds

Internal Revenue Service
1959-1, C.B. 237