



Accredited in Business Valuation Examination Candidates' Reference Guide

**A Guide for AICPA members preparing for the AICPA
Accredited in Business Valuation Examination**

**American Institute of Certified Public Accountants
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INTRODUCTION

The AICPA has established a certification program for certified public accountants (CPAs) who specialize in business valuation (BV). The Accredited in Business Valuation (ABV) credential is granted exclusively to CPAs who are members of the AICPA with considerable experience in BV who wish to demonstrate their knowledge, skill and experience by earning the credential. The ABV program is maintained under the advisement of the AICPA ABV Credential Committee. The Accreditations Team of the AICPA administers the program. They maintain all records and provide communications to candidates and credential holders. The exam is developed by a task force of exam writers in conjunction with the AICPA Exams Team and under the guidance of the AICPA ABV Examination Committee.

This guide provides information of interest and use to AICPA members who wish to sit for the ABV Examination. Accordingly, it includes details on program eligibility requirements, detailed procedures about taking the examination, as well as useful tips and guidance.

THE ABV EXAMINATION

Content of the Examination

The ABV Examination tests a comprehensive range of BV topics. It has been developed through various sources to reflect a broad body of knowledge that BV practitioners should possess. There are five major topical areas that provide a framework or “blueprint” for the knowledge and skill tested on the ABV examination. The subject matter of the examination is summarized in **Appendix A, Content Specification Outline**. To help the ABV candidate prepare for the examination, the outline specifies the scope of the examination and the weight each section will be given.

Examination Format

The ABV Examination is a nondisclosed examination. This means that the questions and answers are not published nor are candidates permitted to remove any examination materials from the testing site. The ABV examination is computerized and consists of two parts, Section I and Section II. The ABV Examination (Section I and II) will provide coverage of the entire BV body of knowledge as outlined in the 2003 ABV Content Specification Outline (CSO). Both sections are four hours long and both Sections contain two types of questions, Multiple-Choice and Case Study.

NOTE: It is to your advantage to attempt to answer all questions even if you are uncertain of the answer.

Multiple-Choice Questions

A multiple-choice question consists of a stem that includes factual data, or describes a situation and four options -- the correct answer and three incorrect choices. The following illustrates a multiple-choice question:

The weights used in the Weighted Average Cost of Capital (WACC) should be:

- a. Based on book value
- b. At the optimal capital structure when valuing a minority interest
- c. Based on market values
- d. At the current capital structure when valuing a controlling interest

Additional examples are presented in **Appendix B, Illustrative Examples of ABV Examination Questions.**

Case Study Questions

The ABV Examination will also contain a variety of case studies that vary in length and number of multiple-choice questions associated with each. The fact pattern for each case study will contain sufficient information to enable the candidate to answer each question. These questions are designed to test the candidate's analytical reasoning skills and ability to apply valuation theory and methodology. Illustrative examples of the types of questions associated with case-studies are presented in **Appendix B, Illustrative Examples of ABV Examination Questions.**

PREPARING FOR THE EXAMINATION AND/OR REVIEW COURSE

The key to passing the examination is a combination of broad working experience in BV combined with the ability to apply this knowledge in a practical fashion. The exam emphasizes practical application and general business knowledge as opposed to book theory. Accordingly, it is our recommendation, although not a requirement, that candidates choose to sit for the exam only after they have completed the required ten (10) BV engagements.

The first step is to review the ABV Examination Content Specification Outline (CSO). To help you prepare for the examination, the outline specifies the scope of the examination and the weight given each major content area. The Content Specification Outline applies to both the full day exam and the ABV Exam, Section I. Once you identify areas requiring additional study, you can prepare through self-directed readings (see **Appendix D, Suggested Additional Sources of Study**) or by attending one of the AICPA-sponsored ABV Exam Review Courses offered by participating state societies. Current information is posted at <http://www.aicpa.org/abvinfo>. (Then click on the choice for '2003 ABV Examination Review Course.')

Even if the candidate attends the AICPA's ABV exam review course, a significant amount of independent reading and study will be necessary to prepare for the exam. The AICPA's review course is intended to be a summary-overview of selected BV topics contained in the CSO. The taking of the review course does not guarantee that the candidate will successfully pass the ABV exam. The review course is not meant to teach topics to the candidate for the first time. Rather, it is designed to provide candidates with a structured way to review various valuation topics and to assist the candidates in identifying areas in which they require additional study prior to taking the exam.

TRAINING PROGRAMS

Candidates may train in the body of knowledge for BV by attending two three-day basic programs cosponsored by the AICPA and state societies. For the experienced business valuation practitioner, the AICPA and state societies offer six one-day advanced BV programs across the United States. Call 1-888-777-7077 for the dates and locations of these training programs or visit <http://www.aicpa.org/abvinfo> and select “2003 AICPA/State Society Business Valuation Training.”

The two three-day basic programs are the following:

- ***Fundamentals of Business Valuation, Part-1 (FBV1)*** This course provides an introduction to the valuation process and focuses on the most accepted approaches to evaluating the worth of a company. Program highlights include Uniform Standards of Professional Appraisal Practice (USPAP) and AICPA standards; quantitative and qualitative analysis of the company; the income approach and specific risk; valuation of employee stock ownership plans (ESOPs); divorce valuation; and valuing the professional practice.
- ***Fundamentals of Business Valuation, Part-2 (FBV2)*** This course builds on the skills developed in the first program. Its’ highlights include asset-based approaches; the market approach; models used to estimate discount and premium valuation adjustments; reconciling alternative indicators; quality valuation report writing; and providing litigation support.

The advanced BV programs are as follows:

- ***Discounts and Premiums in a Business Valuation Environment (ADP)***
This course focuses on understanding and applying discounts and premiums including the conditions affecting the marketability of a company including:
 - Analysis of discount for lack of marketability studies
 - Analysis of minority interest and control premium studies and publications
 - Other important discounts, including: key person/thin management discount; investment company discount, blockage; market absorption; voting versus non-voting; small company risk discount; lack of diversification; and Rule 144
 - Valuation of limited partnerships
- ***Research and Analysis: Critical Techniques in a Business Valuation Engagement (ARA)***
This course focuses on research and analysis critical to any valuation engagement and provides the tools for the application of either the income, asset, or market approaches to business valuation including:
 - Advantages of electronic data gathering
 - External versus internal data gathering
 - Importance of data gathering
 - General search strategies
 - Economic research
 - Industry analysis
 - Guideline company analysis
 - Financial statement data
 - Sources of data for the market approach
 - Data sources for rates of returns, premiums, and discounts

- ***Advanced Cost of Capital Computations in a Complex World (ACCC)***

This course focuses on alternative methods for the calculation of the cost of capital, the preparation of computations, and the development of skills to use and understand Ibbotson Data Topics, which include:

- Development of cost of capital for common equity
- The Build-Up Model and Capital Asset Pricing Model (CAPM)
- Weighted Average Cost of Capital calculations (WACC)
- The Discounted Cash Flow method of estimating cost of capital
- Variations of the Equity Risk Premium
- Proper use of BETA, - when to use and when not use it and variations in computation
- Use of Ibbotson Data – SBBI Valuation Edition, Cost of Capital Quarterly, Beta Book and the online Cost of Capital Center
- Applications in valuation and project selection
- Common errors in estimating and using cost of capital
- Defending cost of capital calculations in court

- ***Small Business Valuation Case Study: Let's Work Through the Issues! (SBCS)***

This course is based on a real-life litigation appraisal using real-life data and analysis.

Program highlights include:

- Addressing critical issues inherent in small company valuation engagements
- Data-gathering and valuation methodologies in small business settings
- Separating relevant and irrelevant information
- Planning the appraisal engagement
- Assessing the risk associated with future profitability projections
- Determining when not to use public company multiples
- Handling owner compensation issues
- Addressing issues related to small business marketability and discounts
- Analyzing small business case studies and report writing

- ***Exploring Issues in Valuing Stock Options and Other Assets You Can't See (EIVSO)***

The explosion of the Internet has created a fertile environment for the issuance of employee stock options (ESOs) as new companies attempted to lure new employees away from old jobs. In addition, the vast creation of intangible assets by many of the same companies has led to an increased need for intangible asset valuations. This course focuses on the unique issues related to the valuation of ESO's and other intangible assets.

- The specific principles that apply to accounting for employee stock options (ESOs)
- The complexities of valuing ESOs in high-tech companies
- Selection of a valuation methodology for ESOs that reflect the true value
- Location of the intangibles, such as goodwill, non-compete agreements, unique technology, patents, skilled employees, customer base, and management
- Valuation of the unseen assets
- Valuation tips from the pros and practical real life examples

- ***Splitting Up is Hard to Do: Advanced Valuation Issues in Divorce and Other Litigation Disputes (AVI)***

This course will explore in-depth, the valuation issues dealing with divorce, shareholder disputes, and other business related litigation.

- Valuation methodology in divorce contests, shareholder disputes, and other business related litigation

- The variations among different states and their laws in the interpretation of the fair value standard in business litigation
- Differences in shareholder dissent actions and minority oppression lawsuits
- Issues unique to divorce
- Determination of the date of valuation and the standards of value in divorce
- Community property versus equitable distribution and the effects of the differences on valuation
- Covenants not-to-compete
- The appropriateness of applying discounts and premiums

EXAMINATION PROCEDURES:

Registering for the Exam

After submitting your ABV Application/Assessment Tool, you will be notified by the AICPA of your eligibility to sit for the exam and you will receive an invoice for the ABV application fee of \$400 via email. After you have submitted your payment, you will be eligible to take the ABV Examination. In the middle of September, you will receive an Authorization to Test (ATT) letter and a list of test sites from the Chauncey Group International (CGI). After receiving your ATT letter, you should schedule your test date as quickly as possible. The number for Prometric National Testing Service Group is 1-800-864-8080. You may register through this telephone number, through Prometric's web site, www.2test.com or through the numbers provided on the list of test sites that accompanies the ATT Letter. You may register ONLY after you receive the ATT letter. You may schedule an appointment to test at any time within the testing window. For the November 2003 ABV exam that window is November 3 – 15, 2003. It is important that you call the minute you know when you want to take the exam because these appointments are made on a first-come, first-served basis.

Candidates who schedule an appointment 30 to 60 calendar days prior to the exam administration will be guaranteed an appointment. Candidates may schedule an appointment 14 to 29 calendar days prior to a test administration, but are not guaranteed an appointment. Appointments will not be accepted within 13 calendar days of the test administration.

When you call to register the Prometric representative will need the following information to accept a registration:

- The name of the exam for which you are registering—those candidates registering for the full day ABV Examination will be registering for the AICPA ABV Exam, and those candidates registering for the four hour exam will be registering for the AICPA ABV 1 Exam.
- Your name and address,
- Home and office telephone numbers, and
- Candidate ID number, which you will find on the ATT letter you receive from CGI.

The representative will ask you for your preference for the testing date. Test centers are typically open from 8:30 a.m. to 5:30 p.m., but many have extended hours. On the bottom of your ATT, you will find space to write the date, time, confirmation number, and location of your testing appointment. You are responsible for remembering this information. No confirmation of your appointment will be sent to you. **If you fail to arrive for your appointment or cancel without giving the required notice, you will forfeit your \$400 application fee.**

Changing Your Examination Appointment

There is no guarantee that you will be able to reschedule your originally scheduled appointment. First, YOU MUST CANCEL YOUR EXISTING APPOINTMENT BEFORE YOU RESCHEDULE. This includes scheduling a new date or changing your test center location. To do this you must call the Prometric Candidate services Call Center at

1-800-864-8080 no later than noon of the second business day prior to your scheduled appointment. Saturday is considered a business day. If you are scheduled to test at 9 a.m. on Monday you must call by noon on Friday to cancel your appointment. You must speak to a representative. Leaving a message on an answering machine is not an acceptable method of canceling or rescheduling your appointment.

Candidate's Cancellation and No Shows

Candidates may cancel a scheduled examination up to **Two (2) business days before** the exam day. To do this you must call the Prometric Candidate services Call Center at 1-800-864-8080. Any cancellation made less than 2 business days prior to the exam date will be assessed a \$200 dollar (\$200) cancellation fee. If for any reason a candidate cannot appear at the test site and does not call the Prometric Call Center, more than 2 business days prior to the exam, the full amount of the exam fee will be forfeited.

Taking the Exam

Call the site to be sure you know their exact location. If possible, go to the site before you take the exam so you are familiar with where you are going and how long it takes you to get there. If you drive to the location, check on parking. Is parking available at the site or must you use a parking lot near the location? Make sure you have enough cash to pay for parking if you must use a lot.

Reporting to the Testing Site

You should arrive at the testing center, at least 30 minutes before the scheduled appointment to allow time for check-in. When you arrive at the test site, report to the center administrator. Friends and relatives who accompany you to the test site will not be permitted to wait in the testing area or contact you while you are taking the examination.

Personal Identification

You must bring the following with you to be admitted to the examination:

- ATT letter from CGI
- Two forms of identification – one photo bearing, both with a signature.

The following are examples of acceptable forms of photo identification:

- Driver's license
- Employee ID card
- State ID card
- Passport

The following are examples of acceptable forms of other identification with a recent signature:

- Credit cards
- Library Card

Examination Security and Breaks

The following are additional security measures that will be taken at the testing site:

- You will be required to sign the log sheet each time you enter and leave the testing area.
- You will be required to read and sign an ABV Confidentiality Statement.

- You will be observed at all times while taking the examination. This observation may involve direct observation by a proctor.

A forty-five minute lunch break is scheduled between the Section I and Section II for those required to take the full day exam. If you must leave the room during the examination, raise your hand to notify the administrator. Timing will not stop during such unscheduled breaks. You may be required to show the administrator your identification to be readmitted to the testing room.

Personal Items/Reference Materials.

You won't be able to take any personal belongings into the testing room. Most test centers provide small lockers for storage of personal possessions. Brief cases, attaché cases, backpacks, and totes may not fit into the storage lockers. You will not be allowed to take books or papers of any kind into the exam room. You may not eat, drink, or use tobacco during the examination. You may not take your cell phone, pager or palm devices into the exam room. In other words, everything you need to take the exam is supplied for you in the workstation.

The test center provides scratch paper and pencils. The scratch paper is counted and given to you during the check-in process. It is collected, counted and destroyed when you finish your test.

Calculators

You may wish to bring a calculator to the testing site. Candidates will not be allowed to bring laptop personal computers (PC's) or hand-held PC's into the testing room. The only calculators permitted on-site are ones without text storage capability. Either the **Hewlett Packard model HP-12C** or the **Texas Instruments model TI-BA II Plus** are permitted.

The workstations contain a computer, monitor, mouse, banker light, and an adjustable chair so that you can be as comfortable as possible. You'll be given a short tutorial at the beginning of the exam that tells you when to press a key or when to click the mouse. It will tell you, for instance, that you can change your answers by using the arrow keys. When you finish the tutorial, you will start the exam. Timing of the exam does not start until you tell the program you are ready. As you answer questions, the time remaining is shown on the screen. When you finish the exam you're given the option of exiting or going back. If you exit, your test is complete. If you do not finish in the length of time you are given, the program will exit for you, just as a proctor would take up paper exam when the time is up.

Misconduct

There are some pretty stiff rules about "misconduct" so if you engage in misconduct and fail to heed the administrator's warning to discontinue the offensive behavior, you may be dismissed from the test center. Misconduct includes:

- Giving or receiving assistance of any kind
- Using any prohibited aids
- Attempting to take the examination for someone else
- Failing to follow testing regulations or the instructions of the test administrator
- Creating a disturbance of any kind
- Removing or attempting to remove examination questions and/or responses (in any format) or notes about the examination form the testing room
- Tampering with the operation of the computer or attempting to use it for any function other than taking the examination
- Removing or attempting to remove scratch paper from the test center

Special Conditions Appointments

If you require special accommodations, please send an e-mail to the AICPA at abv@aicpa.org. You may additionally be asked to provide a written letter explaining the special accommodations, accompanied by a physician's letter. When you receive your ATT letter contact the Special Conditions Department at the Candidates Services Call Center, 1-800-864-8080. When you call to register a Prometric customer service representative will ask if you have any special conditions or requirements. You will then be transferred to the Special Conditions Department. Prometric requires 30 days notice to schedule examinees requiring special accommodations. This allows them time to arrange for the resources necessary to accommodate your special needs.

Exit Survey

When you complete the exam, you will be asked to complete a brief survey that will provide information to help improve the testing process.

Results of the exam

You will receive your results by mail in middle to late February 2004.

Examination Tips

Knowledge of the subject matter is essential for success on the examination. However, there are some examination-taking techniques that can improve performance. Candidates should remember to use these techniques when preparing for and taking the examination. The following are some suggested techniques:

- **Be punctual.** Plan to arrive at the examination room well in advance of the starting time. Allow time for any unforeseen delays.
- **Budget your time.** Consider the number of multiple-choice and case study questions on Section I and the number of multiple-choice and case study questions Section II, as well as the time allotted for each part of the exam so that you are able to address each question.
- **Answer all questions.** All multiple-choice questions should be answered with the best answer. There is no penalty for incorrect answers, and grades are based solely on the total number of correct answers.
- **Read the case-study question.** Carefully read the entire case-study question to get a general idea of the subject matter being tested, and then reread the question and underscore the pertinent information. Some candidates approach a case-study question by reading the requirements first and then by reading the situation for the information it contains. This procedure may enable candidates to identify the data more rapidly and to classify the information for pertinence. The case-study questions are intended to be straightforward. Assumptions are rarely necessary.

You will receive a copy of the case studies in hard copy at your workstation to facilitate your completion of the case study questions. Because these questions are computer-graded, no consideration is given to hand-written comments or calculations pertaining to them on the hard copies of the case studies. The hard copies of the case studies will be collected at the end of the exam for security purposes, but no comments and calculations on these hard copies will be reviewed or considered by the examination graders.

Test Results

Grades will be reported on a scale of zero through 100. A grade of seventy-five (75) has been set as the passing grade. You will be notified by mail of your test results in middle to late February, 2004.

NOTE: No results will be given over the phone.

After Passing the Examination

After the candidate passes the examination, a letter will be sent notifying the candidate of his or her passing of the exam. This letter will detail the next steps the candidate needs to address, such as reference letters or the remaining business experience or life long learning requirements that the candidate needs to meet in order to be certified. Once all the requirements have been met, an ABV certificate will be sent to the member, and he or she will be eligible to use the ABV credential in compliance with the rules of the state in which they practice. You are not certified until you receive this notice. The successful candidate's state society also will be notified that the candidate has been granted the ABV credential so that this information can be promoted in the states' newsletters.

Additional Questions

For questions about the ABV Credential program contact the AICPA Accreditations Team at 212-596-6211 or send an email to: abv@aicpa.org. The same information included in this guide can also be accessed through our website at: <http://www.aicpa.org/abvinfo>.

Appendix A

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS ACCREDITED IN BUSINESS VALUATION EXAMINATION

The content of the Accredited in Business Valuation (ABV) examination has been developed to test a candidate's understanding of the business valuation body of knowledge generally accepted by the business valuation community as taught in the AICPA's business valuation courses and contained in Appendix D of the *ABV Examination Candidates' Reference Guide*. The content of each of the five topical sections is described in outline form and provides an overview of the knowledge and skills tested on the ABV examination. The percentage following each major content area in the outline represents the approximate weighting for that content area. The examination questions are intended to test each content area and its logical extensions.

The examination will be divided into two sections. Both Section I and Section II will consist of multiple-choice questions and case studies with multiple-choice responses. The multiple choice questions are intended to test technical knowledge concerning business valuation. The case studies are intended to test the practical application of business valuation knowledge.

I. The Engagement – 3-6%

This section covers knowledge related to defining the engagement, writing the engagement letter and the basic business valuation process.

- A. Purposes for business valuation/standards of value
 - 1. Definitions of standards of value (commonly used)
 - a. Fair market value
 - b. Fair value
 - c. Investment value
 - d. Intrinsic (fundamental) value
 - 2. Relationship between purpose of the valuation and standard of value
- B. Ownership characteristics
 - 1. Lack of control (minority) versus control
 - 2. Marketable versus non-marketable
- C. Premise of value
 - 1. Going concern
 - 2. Liquidation
- D. Engagement letters
 - 1. Purpose
 - 2. Content

II. Professional and Regulatory Standards – **3-6%**

This section covers knowledge of the American Institute of Certified Public Accountants (AICPA) professional standards and guidelines, the Uniform Standards of Professional Appraisal Practice (USPAP), tax guidelines and federal laws related to business valuations.

A. AICPA

1. Code of Professional Conduct
 - a. Rule 101 – Independence
 - b. Rule 102 – Integrity and Objectivity
 - c. Rule 201 – General Standards
 - d. Rule 301 – Confidential Client Information
2. Statement on Standards for Consulting Services (SSCS) No. 1 – Consulting Services: Definitions and Standards.
3. Consulting services – non-authoritative literature (including, but not limited to practice aids)
4. Statements on Standards for Accounting and Review Services
5. Statements on Standards for Attestation Engagements

B. USPAP

1. Applicability
2. USPAP sections and interrelationships
3. Standard 9 – performance requirements
4. Standard 10 – reporting requirements

C. Internal Revenue Service (IRS) Authority

1. Revenue Rulings
2. Revenue Procedures
3. Private Letter Rulings
4. Other IRS pronouncements

D. Sarbanes–Oxley Act of 2002 and related Securities and Exchange Commission (SEC) rules

III. Qualitative and Quantitative Analysis – **15-20%**

This section covers knowledge of sources of data, techniques and methods used to analyze business interests, value drivers and risk assessment.

A. Sources of data

1. Macroeconomy
2. Industry

3. Competitive analysis
 4. Subject company
- B. Economics
1. National economic data
 2. Industry economic data
 3. Industry structure
 4. Firm economics (cost structure, pricing power, marginal analysis)
 5. Relationship of economic activity to valuation
- C. Qualitative analysis
1. Macroenvironment
 2. Industry
 3. Competitive analysis
 4. Subject company
- D. Quantitative analysis
1. Financial statements
 - a. Common size
 - b. Trend analysis
 - c. Ratios
 - d. Dupont formula
 2. Adjustments to financial statements
 - a. Normalizing
 - b. Control vs. minority
 - c. Separation of operating and non-operating items
 - d. Off-balance sheet items
 3. Quantitative techniques
 - a. Understanding of measures of central location (including, but not limited to, arithmetic, harmonic and geometric means)
 - b. Understanding of measures of dispersion (including variance and standard deviation)
 - c. Understanding of statistical strengths of numerical relationships (including covariance, correlation, coefficient of determination and coefficient of variation)
 - d. Understanding of linear regression

IV. Valuation Analysis – **55-65%**

This section covers knowledge of the three primary approaches to value and related hybrid methods. It also covers levels of value, discounts, premiums and the reconciliation of indicated values.

- A. Levels of value appropriate to the engagement

1. Synergistic value
2. Control value
3. Non-controlling marketable value
4. Non-controlling non-marketable value

B. Valuation approaches

1. Income approach

- a. General theory
- b. Sources of data
- c. Commonly used methods
 - (1) Capitalized economic income/cash flow method (CCF), including Gordon growth model (constant growth model)
 - (2) Discounted economic income/cash flow method (DCF), including Gordon growth model (two-stage model)
- d. Direct equity model versus invested capital model
- e. Types of benefit streams and selection
- f. Cost of capital concepts and methodology, and other pricing models.
 - (1) Capital asset pricing model (CAPM) and beta (β) including unlevering and relevering betas
 - (2) Build-up method
 - (3) Weighted average cost of capital
 - (4) Understanding of security market line
 - (5) Understanding of option pricing theory
- g. Selection of appropriate time periods (including mid-year convention)

2. Market approach

- a. General theory
- b. Sources of data
- c. Commonly used methods
 - (1) Transactions in subject company's stock
 - (2) Guideline publicly traded company method
 - (3) Guideline merged and acquired company (transaction) method
- d. Selecting guideline companies
- e. Equity versus invested capital (including multiples)
- f. Selection of appropriate time periods
- g. Selection of appropriate multiples

3. Asset approach

- a. General theory
- b. Sources of data
- c. Commonly used methods
- d. Considerations in liquidation
- e. Valuing intangible assets: approaches and methods

- f. Tax-effecting the balance sheet
 - 4. Hybrid/other methods
 - a. General theory
 - b. Sources of data
 - c. Commonly used methods
 - (1) Industry formulas (“rules of thumb”)
 - (2) Excess earnings (cash flow) method
- C. Discounts, premiums and other adjustments
 - 1. Levels of value and effect on discounts and premiums
 - 2. Discount for lack of control (DLOC) and control premium
 - a. Sources of data
 - b. Ownership characteristics
 - c. Magnitude
 - 3. Discount for lack of marketability (DLOM)
 - a. Sources of data
 - b. Ownership characteristics
 - c. Restrictions on transferability
 - d. Magnitude
 - 4. Discounts and premiums—understanding the empirical studies
 - 5. Allocation between voting and non-voting stock
 - 6. Other valuation discounts and adjustments
- D. Reconciliation of indicated values

V. Related Topics – **13-18%**

This section covers knowledge of other important topics pertaining to business valuation. These include financial reporting, litigation and dispute resolution services, case law, intellectual property and other intangible assets, family limited partnerships (FLPs), limited liability companies (LLCs), employee stock ownership plans (ESOPs), special types of securities, and reporting.

- A. Financial Reporting
 - 1. Fair value
 - 2. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) Nos. 141 and 142
- B. Litigation and dispute resolution services
 - 1. Types of service
 - a. Shareholder disputes

- b. Marital dissolutions
 - c. Commercial damages: lost profits vs. loss of value
 - d. Bankruptcy
 - e. Other services (including, but not limited to, eminent domain, ad valorem taxation)
- 2. Federal Rules of Civil Procedure (Rule 26)
- 3. Roles of the valuation analyst in litigation services
 - a. Expert witness
 - b. Consultant
 - c. Other practitioner role
- 4. Scope of services
 - a. Fact-finding (including discovery and analysis of data)
 - b. Document management
 - c. Expert testimony
- C. Case law
 - 1. Case law directly related to business valuation (including, but not limited to, income taxation, estate and gift taxation and ESOPs)
 - 2. Daubert v. Merrill Dow Pharmaceuticals
 - 3. Kumho Tire Co. v. Carmichael
- D. Intellectual property and other intangible assets
 - 1. Valuation approaches and methods
 - 2. Valuing specific intangible assets
- E. FLPs and LLCs
 - 1. Unique FLP/LLC issues
 - 2. Data sources for discounts
- F. ESOPs
 - 1. Leveraged vs. unleveraged
 - 2. Appropriate methods
 - 3. U.S. Department of Labor Adequate Consideration Regulations
 - 4. Discounts for lack of marketability
 - 5. Fairness issues
 - 6. Income tax considerations
 - 7. Types of securities
- G. Special classes of securities
 - 1. General understanding of preferred stock
 - 2. General understanding of convertible instruments
 - 3. General understanding of stock options and other derivative instruments

H. Reporting

1. Types of reports
2. Report organization and content

Appendix B

ILLUSTRATIVE EXAMPLES OF ACCREDITED IN BUSINESS VALUATION EXAMINATION QUESTIONS

Multiple-Choice Questions

Note: Each Section of the ABV Examination will consist of approximately 100 multiple-choice questions and several case studies, each containing a fact pattern followed by a number of multiple-choice questions. (The answers to the following questions appear at the end of this appendix.)

1. Which of the following best describes engagement letters in valuation assignments?
 - a. They are required by AICPA professional standards.
 - b. They are more important in litigation assignments than for other purposes.
 - c. They define the range of value being sought.
 - d. They document the scope of the assignment.

2. Which of the following statements best describes what Revenue Ruling 59-60 says about a sound valuation?
 - a. An appraisal will be based upon all the relevant facts and to a lesser extent appraiser judgment.
 - b. An appraisal using scientific approaches will result in one value indication.
 - c. An appraisal recognizes that if general economic conditions change, the value of a closely held business whose profitability is stable will not change.
 - d. An appraisal will be based upon a combination of relevant facts, common sense, informed judgment, and reasonableness.

3. Which of the following is a significant concern in using on-line sources of data?
 - a. On-line data often include errors.
 - b. Print data are generally more outdated than on-line data.
 - c. On-line data are usually more extensive than print data.
 - d. On-line data are usually timelier than print sources.

4. Assume that you're valuing a 30 percent interest. Which of the following adjustments is or are appropriate?
 - I. Minority interest discount.
 - II. Discount for lack of marketability.
 - a. I only
 - b. II only
 - c. Both I and II
 - d. Neither I nor II

5. Which of the following statements regarding the cost of capital is **incorrect**?
 - a. It is a function of the investment.
 - b. It is a function of the investor.
 - c. It is forward-looking.
 - d. It is stated in nominal terms.

6. Financial factors that affect value include all of the following **except**:

- a. Management depth.
 - b. Turnover.
 - c. Profitability.
 - d. Leverage.
7. Under the asset-based approach, which method is most commonly used in determining the value of general-purpose tangible personal property?
- a. Replacement cost new.
 - b. Depreciated replacement cost.
 - c. Reproduction cost new.
 - e. Reproduction cost: depreciated.
8. When may the opinion of a valuation professional employed in litigation be withheld from the opposing party?
- a. The valuation professional is employed as a consultant to the litigant's attorney.
 - b. The client engages the valuation professional as an expert witness.
 - c. The client requests that the opinion of value not be disclosed.
 - d. The expert's engagement letter restricts distribution of their report.

Case Study Multiple-Choice Questions

Note: Each case study presents a factual setting to which candidates are asked to apply their knowledge of valuation concepts and methodologies; the ability to analyze financial information; consider relevant market data; determine the proper discounts and premiums; and linkages between approaches, standards of value, and purpose for the valuation. Candidates must exercise professional judgment in considering alternative approaches to value as they seek to reach a conclusion of value.

The following questions are unanswerable without the relevant fact patterns, and therefore are provided only to illustrate the style of questions asked and type of analysis to be performed. The difficulty of the questions should in no way be considered to represent the level of difficulty of the ABV Examination, or the scope or the number of questions that are developed from each factual setting. **No suggested answers are provided for these case study multiple-choice questions.**

1. What inference can you draw related to the guideline company's leverage posture?
 - a. Relatively low levels of long-term debt
 - b. Relatively high levels of long-term debt
 - c. Long-term debt is consistent with industry averages
 - d. Cannot be determined from the data provided

2. Which of the following would most probably approximate "the subject's price/book value" multiple?
 - a. 1.5
 - b. 2.0
 - c. 2.5
 - d. 3.0

3. Excluding the specific company adjustment, what would the difference be between the Build-up Method and CAPM Method?

- a. 0.5
 - b. 1.0
 - c. 2.5
 - d. 3.0
4. When comparing trends in the key ratios of the subject company over time, it appears that
- I. The company has become less leveraged
 - II. The company's earnings are becoming more volatile
- a. I only
 - b. II only
 - c. Both I and II
 - d. Neither I nor II
5. Based on what is known about the subject and the industry, which one of the following concerns appear to be most justified?
- a. Subject's reliance on short-term financing
 - b. Competition is creating increasing pressure on profit margins
 - c. Subject's declining interest coverage
 - d. Sales growth may be exceeding growth in working capital

ANSWERS TO ILLUSTRATIVE EXAMINATION QUESTIONS

The answer to each of the multiple-choice questions and the area of the Content Specific Outline that is being tested are as follows:

- 1. d (Area I - The Engagement)
- 2. d (Area II - Professional & Regulatory Standards)
- 3. a (Area III - Qualitative & Quantitative Analysis)
- 4. c (Area IV -- Valuation Analysis)
- 5. b (Area IV - Valuation Analysis)
- 6. a (Area IV -- Valuation Analysis)
- 7. b (Area IV -- Valuation Analysis)
- 8. a (Area V -- Related Issues)

Appendix C

SUGGESTED AREAS FOR CONTINUING PROFESSIONAL EDUCATION*

1. Cash Flow Valuation

Analyze the Historical Performance of the Business
Forecast Future Performance
Estimate the Cost of Capital
Estimate the Continuing Value
Calculate and Interpret the Results

2. Specialized Valuation Skills and Training

Security Market Options
Research Techniques and Research Tools
Company, Industry, and Economic Data Analysis
Valuation Calculations and Conclusions
Engagement Reporting
Code of Professional Conduct and Professional Standards

3. Analysis of Financial Information

Linkage between Purpose for the Valuation, Standard of Value, Ownership Characteristics,
and Normalized Earnings
Normalizing Earnings
Sources and Uses of Industry Financial and Operating Data

4. Financial Forecasting

Statistical Techniques: Simple and Multiple Regression, Time Series Analysis,
Exponential Smoothing
AICPA Prospective Financial Reporting Guidelines
Determining and Documenting Significant Forecast Assumptions
Company and Industry Data
Sources and Uses of Economic Data

5. Estimating Cost of Capital (Discount and Capitalization Rates)

Understanding the Sources and Limitations of Data
Security Market Line
Market Efficiency
Theoretical Underpinning of Discount and Capitalization Rates:
Capital Asset Pricing Model
Multi-Factor Models
Difference and Similarities of CAPM and the Build-Up Method
Sources of Small-Firm Risk Premiums, Firm-Specific Risk Premium and
Other Adjustments to Cost of Capital - When and How

Beta:

Understanding the Sources and Calculations, R-squared and Other Potential Limitations
Estimating Beta for Privately Owned Company, including Guideline Companies'
Levered Beta (bL) and Guideline Companies' Proxy Unlevered Beta (bu)

- **Note: This is not an all inclusive list nor specific titles, but subject areas that may be offered through the AICPA, State Societies, or other appraisal organizations.**

- 6. Selecting and Evaluating Guideline Company Data**
 - Screening and Selection Process
 - Goodness of Fit Issues
 - Guideline Companies: Data to Use and the Proper Use of the Data
 - Linkages between the Standard of Value, Purpose for the Valuation, Selection of Guideline Companies and Specific Data
 - Court Cases Involving Acceptance and Rejection of Guideline Company Data
- 7. Determining the Proper Valuation Discounts or Premiums**
 - Reasons for Discounts and Premiums such as Marketability and Control Issues
 - Standard of Value, Purpose for the Valuation, Ownership Issues, and the Proper Usage of Discounts
 - The Sources for Estimating Discounts such as: Identifying and Understanding the Empirical Research of Liquidity and Control Issues
 - Methods used to Select and Apply Proper Discounts
- 8. Linkages between Approaches, Standards of Value, Purpose of Valuation, and Discounts**
 - Income Methods
 - Market Methods
 - Asset Based Methods
 - Liquidity and Marketability Issues
 - Control and Minority Ownership Positions
 - Fair Market Value, Investment Value, Fair Value
- 9. Entity and Specialized Industry Issues**
 - ESOP Companies
 - Family Limited Partnerships
 - Medical Practices
 - Professional Service Business
 - Other Service Businesses
 - Start-Up, Research and Development (R&D), or Technology-Based Businesses
 - Initial Public Offering (IPO) Candidates
 - Merger and Acquisition (M&A) Valuation Engagements
 - Real Estate or other Holding Companies
 - Specialized Industries (Construction, Retail, Restaurants, etc.)
- 10. Report Preparation and Engagement Administration**
 - USPAP Reporting Standards
 - Proper Documentation of Research
 - Presentation of and Support for the Valuation Conclusion
 - Sufficient and Competent Evidential Matter
 - Guidelines for Work paper and Supporting Documentation
 - Engagement Letters and Letters of Representation
- 11. Litigation and Dispute Resolution Services**
 - Rules of Evidence
 - Qualification of Experts
 - The Role of the Consulting Expert and Testifying Expert
 - Depositions and Court Testimony
- 12. Attendance at Annual AICPA Conferences and Conferences of Other Professional Organizations Containing Valuation-related Topics.**

Appendix D

SUGGESTED ADDITIONAL SOURCES OF STUDY (2003)

Books

- Copeland, Tom, Tim Koller, & Jack Murrin. 2000. *Valuation: Measuring and Managing the Value of Companies* (3rd Ed.). New York: John Wiley & Sons.
- Damodaran, Aswath. 1994. *Damodaran on Valuation: Security Analysis for Investment and Corporate Finance*. New York: John Wiley & Sons.
- DeFusco, Richard A., Dennis W. McLeavey, Jerald E. Pinto, & David E. Runkle. 2001. *Quantitative Methods for Investment Analysis*. Charlottesville, Va.: Association for Investment Management and Research.
- Ehrbar, Al. 1998. *EVA: The Real Key to Creating Wealth*. New York: John Wiley & Sons.
- Feder, Harold A. 2000. *Succeeding As An Expert Witness: Increasing Your Impact and Income* (3rd Ed.). Glenwood Springs, Colo.: Tageh Press.
- Fishman, Jay E., Shannon P. Pratt, J. Clifford Griffith, & D. Keith Wilson. 2003 *Guide to Business Valuations*, (14th Ed.). Fort Worth: Practitioners Publishing Company.
- Gwartney, James D., Richard L. Stroup, & Russell S. Sobel. 2002. *Economics: Private and Public Choice* (10th Ed.). HBJ College & School Division.
- Hawkins, George B., & Michael A. Paschall. 2003. *CCH Business Valuation Guide*. Chicago: CCH Incorporated.
- Hitchner, James R. 2003. *Financial Valuation: Application and Models*. New York: John Wiley & Sons.
- Ibbotson Associates. 2003. *Stocks, Bonds, Bills and Inflation - Valuation Edition*. New York: John Wiley & Sons.
- *IRS Valuation Training for Appeals Officers Coursebook*. 1998. Chicago: Commerce Clearing House.
- Kleeman, Robert E., Jr., R. James Alerding & Benjamin D. Miller. 1999. *The Handbook for Divorce Valuations*. New York: John Wiley & Sons.
- Knight, James A. 1997. *Value-Based Management: Developing a Systematic Approach to Creating Shareholder Value*. New York: McGraw-Hill.
- Mankiw, N. Gregory. 2003. *Principles of Economics* (3rd Ed.). Mason, Ohio: South-Western Publishing.
- Mercer, Christopher Z. 2002. *Quantifying Marketability Discounts* (2nd Ed.). New York: John Wiley & Sons.
- Miles, Michele G. 2001. *The Business Appraiser & Litigation Support*. New York: John Wiley & Sons.
- Porter, Michael E. 1998. *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. New York: The Free Press.
- Porter, Michael E. 1998. *Competitive Advantage: Creating and Sustaining Superior Performance*. New York: The Free Press.
- Pratt, Shannon P. 2003. *Business Valuation Body of Knowledge: Exam Review and Professional Reference* (2nd Ed.). New York: John Wiley & Sons.
- Pratt, Shannon P. 2002. *Cost of Capital: Estimation and Applications* (2nd Ed.). New York: John Wiley & Sons.
- Pratt, Shannon P. 2000. *The Market Approach to Valuing Businesses*. New York: John Wiley & Sons.
- Pratt, Shannon P. 2000. *Judges and Lawyers' Business Valuation Handbook*. Chicago: American Bar Association.
- Pratt, Shannon P. 2001. *Business Valuation Discounts and Premiums*. New York: John Wiley & Sons.
- Pratt, Shannon P., Robert F. Reilly and Robert P. Schweihs. 2000. *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* (4th Ed.). Chicago: Irwin Professional Publishing.
- Pratt, Shannon P., Robert F. Reilly and Robert P. Schweihs. 1998. *Valuing Small Businesses and Professional Practices* (3rd Ed.). New York: McGraw-Hill.
- Rappaport, Alfred. 1997. *Creating Shareholder Value: A Guide for Managers and Investors* (Revised Ed.). New York: The Free Press.

- Reilly, Robert F., & Robert P. Schweihs. 1999. *The Handbook of Advanced Business Valuation*. New York: McGraw-Hill.
- Reilly, Robert F., & Robert P. Schweihs. 1999. *Valuing Intangible Assets*. New York: John Wiley & Sons.
- Smith, Gordon V., & Russell L. Parr. 2000. *Valuation of Intellectual Property and Intangible Assets* (3rd Ed.). New York: John Wiley & Sons.
- Trugman, Gary R. 2002. *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses* (2nd Ed.). New York: AICPA.
- Weil, Roman L., Michael J. Wagner, & Peter B. Frank. 2001. *Litigation Services Handbook: The Role of the Financial Expert* (3rd Ed.). New York: John Wiley & Sons.
- Zipp, Alan. 2002. *Business Valuation Methods*. New York: AICPA.

AICPA publications and pronouncements related to business valuation

- Consulting Services Division. 2003. *AICPA Consulting Services Special Report 03-1—Application of AICPA Professional Standards in the Performance of Litigation Services*
- Consulting Services Division. 1996. *AICPA Consulting Services Practice Aid 96-3 - Communicating in Litigation Services: Reports*. 1996. New York: AICPA. Product No. 055000.
- Consulting Services Division. 1993. *AICPA Consulting Services Special Report 93-2 - Conflicts of Interest in Litigation Services Engagements*. 1993. New York: AICPA. Product No. 048563.
- Frank, Peter B., & Michael J. Wagner. 1993. *AICPA Consulting Services Practice Aid 93-4 - Providing Litigation Services*. New York: AICPA. Product No. 055145.
- Miller, Warren D. 1999. *Assessing Unsystematic Risk: Part I. CPA Expert*, Vol. 5, No. 3 (Summer 1999), pp. 1-5.
- Miller, Warren D. 2000. *Assessing Unsystematic Risk: Part II - The Macroenvironment. CPA Expert*, Vol. 6, No. 1 (Winter 2000), pp. 1-5.
- Miller, Warren D. 2000. *Assessing Unsystematic Risk: Part III - Market Structure. CPA Expert*, Vol. 6, No. 3 (Summer 2000), pp. 1-5.
- Miller, Warren D. 2002. *Assessing Unsystematic Risk: Part IV—Industry Dynamics. CPA Expert*, Vol. 8, No. 1 (Winter 2002), pp. 1-5.
- Trugman, Gary R. 1993. *AICPA Consulting Services Practice Aid 93-3 - Conducting a Valuation of a Closely Held Business*. New York: AICPA. Product No. 055148.

Appendix E

INTERNATIONAL GLOSSARY OF BUSINESS VALUATION TERMS

To enhance and sustain the quality of business valuations for the benefit of the business valuation profession and the users of the services of its practitioners, the below identified societies and organizations whose members provide business valuation services 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, as appropriate to the scope of the engagement, 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 the business valuation practitioners who are members of the listed societies, organizations, and others performing valuations of business interests or securities by further memorializing the body of knowledge which 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**

Adjusted Book Value – the value that results after one or more asset or liability amounts are added, deleted, or changed from their respective financial statement amounts.

Appraisal – See **Valuation**.

Appraisal Approach – See **Valuation Approach**.

Appraisal Date – See **Valuation Date**.

Appraisal Method– See **Valuation Method**.

Appraisal Procedure – See **Valuation Procedure**.

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

Benefit Stream – any level of income, cash flow, or earnings generated by an asset, group of assets, or business enterprise. When the term is used, it should be supplemented by a definition of exactly what it means in the given valuation context.

Beta – a measure of systematic risk of a security; the tendency of a security's returns to correlate with swings in the broad market.

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

Business – See **Business Enterprise**.

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

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 security or portfolio of securities equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the security or portfolio.

Capitalization – a conversion of a single period stream of benefits into value.

Capitalization Factor – any multiple or divisor used to convert anticipated benefits into value.

Capitalization Rate – any divisor (usually expressed as a percentage) used to convert anticipated benefits 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 definition of exactly what it means in the given valuation context.

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

Control Premium – an amount (expressed in either dollar or percentage form) by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise, that reflects the power of control.

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

Cost of Capital – the expected rate of return (discount rate) that the market requires in order to attract funds to a particular investment.

Discount – a reduction in value or the act of reducing value.

Discount for Lack of Control – an amount or percentage deducted from the pro rata share of value of one hundred percent (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 Rate – a rate of return (cost of capital) used to convert a monetary sum, payable or receivable in the future, into present value.

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

Effective Date – See **Valuation Date**.

Enterprise – See **Business Enterprise**.

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 reflecting increases or decreases in debt financing.

Equity Risk Premium – a rate of return in addition to a risk-free rate to compensate for investing in equity instruments because they have a higher degree of probable risk than risk-free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings – that amount of anticipated benefits that exceeds a fair rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated 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 obtained 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”.}

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

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.

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 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, privileges, and have economic benefits for the owner.

Invested Capital – the sum of equity and debt in a business enterprise. Debt is typically a) long-term liabilities or b) the sum of short-term interest-bearing debt and long-term liabilities. When the term is used, it should be supplemented by a definition of exactly what it means 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.

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

Liquidation Value – the net amount that can 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 fifty percent (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.

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

Marketability Discount – See **Discount for Lack of Marketability**.

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

Minority Interest – an ownership interest less than fifty percent (50%) of the voting interest in a business enterprise.

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

Net Cash Flow – a form of cash flow. When the term is used, it should be supplemented by a qualifier (for example, “Equity” or “Invested Capital”) and a definition of exactly what it means in the given valuation context.

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. {NOTE: in Canada, tangible assets also include identifiable intangible assets}

Non-Operating Assets – assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is “Redundant Assets”}

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; e.g. going concern, liquidation.

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

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 – {NOTE: in Canada, 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.

Residual Value – the prospective value as of the end of the discrete projection period in a discounted benefit streams model.

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

Risk Premium – a rate of return in addition to a risk-free rate to compensate the investor for accepting risk.

Rule of Thumb – a mathematical relationship between or among variables based on experience, observation, hearsay, or a combination of these, usually applicable to a specific industry.

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; e.g. 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. When using the capital asset pricing model, systematic risk is measured by beta.

Terminal Value – See **Residual Value**.

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

Unsystematic Risk – the portion of total 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 – the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, see Investment Value}

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 F

TERMINOLOGY IN ABV EXAMINATION

Participants will receive a handout of the following formulas and definitions at the Exam site. Please note that this is not a complete list of all formulas and definitions the candidate should know for the examination.

Unless otherwise stated, when ratios involve a comparison of balance sheet to income statement values, the balance sheet values should be the average of the beginning and ending balances.

Beta. A measure of systematic risk of a security.

Levered Beta — Published betas for publicly traded stocks that already reflect the capital structure (i.e., the degree of financial leverage) of each respective company.

Relevered Beta — Adjusted beta based on a different capital structure.

Unlevered Beta — The beta that the company would have if it had no debt.

Capital Structure. The composition of the invested capital of a business entity.

Capitalization Rate. Any divisor (usually expressed as a percentage) used to convert anticipated benefits into value.

Cost of Capital. The amount of expected return that is required to attract investment. It depends on the general level of interest rates and the amount of premium for risk (above the risk-free rate) that the market demands, as well as the risks attributable to the subject business.

DCF. Discounted cash flow.

Debt-Free Net Income (DFNI). Net income (after tax) plus interest expense (net of related tax deduction) related to invested capital holders.

Debt-Free Cash Flow (DFCF). DFNI plus depreciation and amortization less capital expenditures less **incremental** debt-free working capital.

Debt-Free Working Capital. Current assets less current liabilities, excluding short-term interest-bearing debt.

Direct to equity. Cash flows attributable directly to equity.

Discount rate. A yield rate used to convert anticipated future payments or receipts into present value. Also referred to as *rate of return* or *cost of capital*. A **cash** flow discount rate unless stated otherwise.

Earnings Cap Rate. The cap rate attributable to earnings.

Earnings Discount Rate. The discount rate attributable to earnings.

Economic income or benefit stream. Any measure of income inflow to the subject that can be converted into value through either discounting or capitalization at appropriate rates. This could include net **income**, net cash flow, etc.

ESOP. Employee stock ownership plan.

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 obtained by **capitalizing** excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See Excess Earnings.

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

Invested Capital. The sum of equity and debt in a business enterprise. Debt is typically a) long-term liabilities or b) the sum of short-term interest-bearing debt and long-term liabilities. When the term is used, it should be supplemented by a definition of exactly what it means in the given valuation context.

Invested capital method. Debt-free method.

Net Assets. Total assets less total liabilities.

Net Cash Flow to Equity. Cash available for distribution to equity investors without jeopardizing the ongoing operations. Also known as *free cash flow*.

Net Cash Flow to Invested Capital. Cash available to service interest-bearing debt and for distribution to equity investors.

Net Income. Revenue less expenses, including taxes. Also referred to as *net earnings* or *net profits* or *income after taxes*.

Net Working Capital or Working Capital. Current assets less current liabilities.

Put Option. An option that allows the shareholder to require the issuing corporation to buy back the stock at some fixed or determinable price.

REITs. Real estate investment trusts.

Return/Rate of Return. The total yield to an investor, reflecting all dividends, interest, or other cash and cash equivalents received, plus or minus any realized or unrealized appreciation or depreciation in the investment's value. An amount of income/loss and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Systematic Risk. The risk that is common to all risky securities and cannot be eliminated through diversification. When using the capital asset pricing model, systematic risk is measured by beta.

Terminal Value. Sometimes also called *residual value* or *future value*, it is the prospective value as of the end of the discrete forecast period.

Unsystematic Risk. The portion of total risk specific to an individual security that can be avoided through diversification.

Valuation Multiples or Ratios. Valuation ratios, e.g., P/E ratios. Based on guideline public companies or transaction information. A factor wherein a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Formulas and Definition of Variables

Unless otherwise stated, when ratios involve a comparison of balance sheet to income statement values, the balance sheet values should be the average of the beginning and ending balances.

Financial Ratios

Accounts receivable turnover

sales \div accounts receivable

Average collection period

365 days \div accounts receivable
turnover ratio

CAG = Compound Annual Growth

Current ratio

current assets \div current liabilities

Debt-free working capital turnover

sales \div debt-free working capital

Dividend payout ratio

dividends paid \div net income

Du Pont formula

$$\frac{\text{net income}}{\text{equity}} = \frac{\text{net income}}{\text{sales}} \times \frac{\text{sales}}{\text{assets}} \times \frac{\text{assets}}{\text{equity}}$$

Equity to total assets

total equity \div total assets

Fixed charge coverage

(earnings before interest, taxes, and lease payments \div (interest + current portion of long-term debt + lease payments))

Interest-bearing debt to equity

interest-bearing debt \div equity

Inventory turnover

cost of goods sold \div inventory

Pretax income to sales

pretax income \div sales

Pretax return on assets

pretax income \div total assets

Pretax return on common equity

pretax income \div common equity

Quick or acid test ratio

(cash + cash equivalents + investments, e.g., marketable securities + receivables) \div current liabilities

Return on assets

net income after tax \div total assets

Return on common equity

net income after tax \div common equity

Sales to fixed assets (fixed asset turnover)

sales \div fixed assets

Sales to total assets or total asset turnover

sales \div total assets

Times interest earned

earnings before interest and taxes \div interest expense

Total debt to total assets

total liabilities \div total assets

Working capital turnover

sales \div net working capital

Valuation Formulas and Notation System

CAPM Capital Asset Pricing Model (Theoretical)

$$k_e = R_f + (R_{Pm})B$$

Modified CAPM Capital Asset Pricing Model (used to value smaller businesses)

$$k_e = R_f + (R_{Pm})B + R_{Ps} + R_{Pu}$$

Build-up Method

$$k_e = R_f + (R_{Pm}) + R_{Ps} + R_{Pu}$$

Beta

$$B_u = B_l \div \{1 + [(1-t)(D/E)]\}$$

$$B_r = B_u \{1 + [(1-t)(D/E)]\}$$

Weighted Average Cost of Capital (WACC)

$$WACC = W_e(k_e) + W_d(k_d)$$

After-Tax Interest on Debt

$$k_d = \text{Marginal Borrowing Rate} (1 - \text{Marginal Tax Rate})$$

Capitalization Rate

$$\text{Cap Rate} = \text{Discount Rate} - \text{Long-Term Growth Rate}$$

Definition of Variables

PV Present Value.

Cost of capital and rate of return variables:

ke Discount rate for common equity capital (cost of common equity capital). Unless otherwise stated, it generally is assumed that this discount rate is applicable to net cash flow available to common equity.

kd After-tax discount or interest rate for debt.

t Tax rate (expressed as a percentage of pretax income).

Rf. Risk-free rate. The rate of return available in the market on an investment that is free of default risk.

E(Ri) Expected rate of return on security *i*.

B Beta A coefficient, usually used to modify a rate of return variable. Betas from public companies are levered betas.

Bl Levered beta.

Bu Unlevered beta.

Br Relevered beta.

RPm Equity risk premium for the “market” (large company premium). Usually used in the context of a market for equity securities, such as NYSE or S&P 500. Return in excess of risk-free rate.

RP_s Risk premium for “small” stock (small stock premium), over and above **RP_m** (e.g., average size of lowest quartile of NYSE as measured by market value of common equity).

RP_u Risk premium for unsystematic risk attributable to the specific company (specific company risk).

Income variables:

NCF Net cash flow to equity or to invested capital.

EBIT Earnings before interest and taxes.

EBITDA (or EBDIT)

Earnings before depreciation, interest, and taxes. (“Depreciation” in this context usually includes amortization.)

Weightings:

We Weight of common equity in capital structure.

Wd Weight of debt in capital structure.

Growth:

g Long-term rate of growth.