BUSINESS VALUATION

PRACTICE MANAGEMENT TOOLKIT

AICPA Forensic and Valuation Services Section
Notice to Readers

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Foreword

Over the last few years, specifically since the demise of Arthur Andersen, LLP and the enactment of the Sarbanes-Oxley Act of 2002, the business valuation (BV) industry has grown rapidly as smaller CPA firms have entered the field. These new entrants have been increasing their BV offerings with the notion that this type of work is more lucrative than traditional accounting. At the same time, although the larger firms are concentrating the bulk of their efforts on attestation and tax engagements, they are still heavily involved in valuation for financial reporting purposes for their nonattest clients. The result is a much more dynamic BV marketplace. However, with competition growing, you will need to be skillful at marketing yourself, your skill sets, and your firm to make meaningful headway as a stand-alone business or as a specialized discipline within a firm. Additionally, you will need to have sufficient processes in place to ensure the quality of your work product.

BV combines an art and a science. If you are a BV practitioner of some sort today, this has already become apparent to you. The same holds true for the marketing of BV services because no precise or absolute way to promote your capabilities and services exists. Various channels exist that give professionals the opportunity to showcase their BV services, depending on the focus of their specialties and the scope of services offered. The art, however, lies in the effectiveness of professionals utilizing these available channels to market their services.

This toolkit provides general guidance on the many issues to be considered in operating a successful practice. The Forensic and Valuation Services section of the AICPA is committed to the success of its members. The issuance of Statement on Standards for Valuation Services No.1, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset (AICPA, Professional Standards, VS sec. 100), in June 2007 provides authoritative guidance to the CPA valuation practitioner. Information on this important standard is provided in chapter 4 of this toolkit but is not a substitute for actually reading the standard. References to additional resources are also provided in the following chapters.
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The Product of Business Valuation

Introduction

The use of engagement letters, although not required, is recommended to protect the practitioner and reduce the potential for misunderstandings with the client. Managing client expectations about what, when, and how services will be provided is not always an easy task. A clearly written engagement letter communicates the expectations of all parties concerned and minimizes the risk of misunderstanding the scope and number of misunderstandings.

Engagement Letters and Client Representations

It is important to recognize from the outset that an engagement letter is a contract. As such, a practitioner should seek the advice of an independent attorney or risk management advisor when drafting such a document and, of course, before executing such a document. This risk management consultation does not necessarily need to be done on every assignment, but engagement letters should be updated on a regular basis.

The primary purpose of the engagement letter is to document the understanding of the parties with respect to the following:

- Who has entered into the agreement
- Purpose of the valuation assignment
- Valuation standard(s) expected to be applied
- Effective date of the valuation
- Description of the asset or liability to be valued (for example, business, business ownership interest, security, intangible asset)
- Target timeline for the services to be performed
- Services the practitioner will and will not be performing (for example, “We will not audit or review…”)


• Form of work product expected to be produced\(^1\)
• Materials, actions, responsibilities, and so on, expected from the client
• Fee arrangements (for example, retainer, drawdown methodology, differentiated rates, flat fee)
• Assumptions and limiting conditions that affect the valuation analysis
• Dispute resolution terms that would apply to the client and valuation analyst

Other Caveats
The practitioner must be aware of independence concerns if the practitioner, or his or her firm, performs attest (for example, audit or review) related services. The practitioner must document, in writing, the client’s agreement to perform certain functions in connection with the valuation project. These client functions include the following:

• Make all management decisions and perform all management functions
• Designate an individual possessing suitable skill, knowledge, and experience, preferably within senior management, to oversee the services
• Evaluate the adequacy and results of the services performed
• Accept responsibility for the results of the services
• Establish and maintain internal controls, including the monitoring of ongoing activities

Planning and Supervision
Rule 201, General Standards (AICPA, Professional Standards, ET sec. 201 par. .01), requires the CPA to adequately plan and supervise the performance of professional services, including valuation engagements. A simple spreadsheet or checklist\(^2\) is highly recommended to plan the procedures to be followed in each engagement and to estimate the amount of time allowed for completing each procedure. Such a tool is invaluable from an overall project management point of view. It also provides for the delegation of tasks to less experienced professionals, time budgeting, follow-up upon completion of the project, client billing, and working within the prescribed budget.

Be sure to build in time for review and for the iterative process of gathering, updating, and analyzing the information that is common to a valuation engagement. Although the review

\(^1\) At times, the work product ultimately produced is affected by changes in circumstances, particularly when the valuation project is in connection with a litigation matter. The practitioner should consider contingencies that may prevent the performance of his or her obligations and establish alternatives if such conditions occur. Sample engagement letters can be found on the Forensic and Valuation Services (FVS) website. Sample engagement letters can also be found in the Valuation Standard and Implementation Toolkit located on the FVS website (www.aicpa.org/fvs; click on the Resources link to the left and find it under the Resources heading).

time can vary, 10 percent of the active engagement time would not be unreasonable as a baseline.

**Working Papers**

Regardless of the purpose of your engagement and the form of your final report, valuation standards require the analyst to follow accepted valuation procedures. The working paper file is your record of having followed appropriate procedures and standards. Just as would an audit or a tax file, a consistent, structured, and orderly working paper file provides numerous benefits, such as the following:

- Documents can be located quickly.
- An orderly file facilitates delegating and reviewing the work given to other professionals.
- The client file is always readily available for review or update.
- The integrity of the record of the valuation process is supported and enhanced.
- If you are subpoenaed, an orderly file enhances your professional credibility.

If your conclusion is communicated as an oral report, the orderliness and completeness of your working paper files become even more critical because no other record of your analytical and evidentiary processes exists. Such working papers could be imperative to defend your compliance with Ethics Rule 201. Additionally, the analyst should follow the requirements of paragraphs 44–45 of Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* (AICPA, Professional Standards, VS sec. 100), which address documentation in a valuation engagement. (See more information on SSVS No. 1 in chapter 4, “Quality Control for Business Valuation.”)

It is not unusual for an engagement file to lie dormant for months, sometimes years, before it becomes active again. In this instance, a reference system within the file provides an easily accessed summary of the valuation procedures that were completed, the underlying reasoning, and the sources of data input. An organized working paper system provides for cross-referencing (1) the completed report to the inputs used with (2) the conclusions reached during the course of the valuation analysis.

**The Work Product**

Completion of a valuation project generally involves the following two primary undertakings:

1. The actual development of the valuation analysis. SSVS No. 1, paragraph 21 addresses this issue and describes the two types of engagements that an analyst can undertake: a valuation engagement or a calculation engagement.
2. The written communication (whether it is submitted to the client or included in the working paper file). SSVS No. 1 addresses this issue in paragraphs 47–79 and describes
the types of reports, which include a detailed report, a summary report, a calculation report, and an oral report.

Efficient engagement performance will often include the use of standardized tools to prepare this work product.

Financial and Economic Analysis
Your financial analysis tools may come in the form of purchased software or internally developed templates. The following factors may be considered in acquiring or developing these tools:

- Do you understand how the underlying computations work?
- How much of the valuation body of knowledge is incorporated into the toolkit?
- Can the tool be modified for changes in the valuation body of knowledge in order to account for new data sources or techniques?
- Can you use the toolkit to train and develop less experienced staff or to teach valuation theory to others?
- Does the toolkit allow you to control the quality of your work product?
- Does it comply with SSVS No. 1?

If used properly, purchased valuation software and report writing packages may be good options for the beginning practitioner. See chapter 6, “Sources of Information and Research,” for a partial list of resources.

*Caveat emptor—Software is not a substitute for expertise!*

Serious questions may arise in the valuation profession as they do in other disciplines. Is it better to thoroughly understand one valuation method and create your own applicable model? Or, is it better to use a preexisting tool that generates several standardized methods that are less specific to the engagement? No simple answer exists. Keep in mind that using a tool from another source—whether a purchased package or a template provided by another practitioner—has the potential to generate substantial, incremental work or cause errors in the final valuation product.

More seasoned practitioners and valuation analysts may choose to create their own valuation models. Internally developed tools allow the practitioner to experiment with advances in financial analysis techniques, build in new sources of data, take advantage of developed expertise, and add a working paper or two. Such internally developed tools are particularly useful if the analyst finds himself or herself repeatedly making calculations that are not built into an older or off-the-shelf tool. In your time budget, allow for a thorough math check of your computations by a suitably experienced colleague or peer. Sources are also available for
assisting in the development of an economic analysis at the industry, regional, and national levels.

**Report Writing**

Creating a valuation report that is easy to read, theoretically sound, and efficiently generated is a challenge. As noted previously, using a tool from another source may be a good option for a beginner practitioner. The ideal tool will have multifaceted benefits, including the following:

- Compliance with valuation reporting standards
- Quality control
- Efficient production
- Uniformity throughout a firm that has several valuation analysts

No universally prescribed format for a valuation report exists. The AICPA standard indicates a number of topics to be addressed, depending on the type of report being prepared. The details of what should be included in the various types of reports can be found in paragraphs 51–79 of SSVS No. 1.

If you use purchased report writer software, consider how often the tool is upgraded and what the changes are. Is it upgraded each time a change is made to professional standards? Is it upgraded to encompass changes in the business valuation body of knowledge? If modifications are made by your firm to the software template, will these changes be overwritten when an upgrade to the software is provided? The answers to these and similar questions are important to ensure the best quality product is produced.

Once answered, the practitioner may conclude that his or her valuation product can be better managed through different means. Practitioners should be aware that no shortcut exists to generating a theoretically sound valuation report, but tools do exist or can be created to aid in streamlining the process.

**Reviewing the Work Product**

Before the final valuation conclusion is communicated to your client, it is wise to have your work reviewed. It is important to the quality of the work to obtain a thorough technical and editorial review.

In a technical review, have the reviewer confirm that all appropriate procedures have been completed. Confirm that the arithmetic is accurate. Confirm that the underlying theory is appropriate to the circumstances of the engagement. If your firm does not yet have another valuation analyst on staff, do not hesitate to request a technical review from a colleague in another firm. This procedure is important regardless of whether you have used purchased software or an internally developed model. If a third party specialist is utilized, be sure to

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follow all ethics rules with regard to informing the client and maintaining confidential information.\(^4\)

In an editorial review, have the reviewer confirm that the conclusion has been presented in a logical and sequential manner so that the reader can clearly understand the procedures that were completed and why. Confirm that the language used is appropriate for the audience. Confirm that grammar and spelling are correct and that nothing has been included in the report that is superfluous, irrelevant, or inaccurate. This procedure is especially important when using purchased report writer software or when “rolling over” a report from a previous engagement to use for the current matter.

When in doubt, the best tool to use for these reviews is another experienced practitioner.

**Summary**

As previously noted, engagement letters are the foundation for documenting (1) the relationship between the practitioner and the client and, (2) the roles to be fulfilled during an engagement. Also, many tools exist that can be used to better ensure an efficient process and a quality work product. Whether you choose to buy tools or build your own is a decision that should be made based on the practitioner’s (or firm’s) preferences and level of experience and expertise. Regardless of the alternatives chosen, tools do not eliminate the need for a thorough review of the working papers, the level of analysis, and the final report.

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\(^4\) The AICPA Code of Professional Conduct, including conduct relating to confidential client information, can be found at www.aicpa.org/research (click on the Standards link to the left of the screen then locate it on the Standards page).