

# ABV Examination Content Specification Outline



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## THE PATHWAY TO THE ABV CREDENTIAL

The content of the Accredited in Business Valuation (ABV®) Examination was developed to test a candidate's understanding of the business valuation body of knowledge generally accepted by the business valuation community. The content of each of the three topical sections is described in outline form and provides an overview of the knowledge and skills tested on the ABV Examination. The percentage range 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 consists of multiple-choice questions intended to test technical knowledge concerning business valuation and the practical application of business valuation knowledge. The exam is fully computerized and split into two test modules. Module 1, "Foundation," covers Section I and III and module 2, "Implementation," covers Sections II. Exam modules may be taken in any order.

A list of formulas and definition of variables is provided at the end of this document. These are the proscribed formulas and the definitions that are to be used on the examination. Candidates will be provided this list during the examination.

### High-Level Content Specification Outline

- I. Qualitative and Quantitative Analyses (25–30%) — Exam module 1 "Foundation"
  - A. Defining the Engagement
  - B. Sources of Economic and Industry Data
  - C. Macro-Economic and Environmental Analysis
  - D. Industry Analysis
  - E. Subject Entity Analysis
- II. Valuation Analysis (50–60%) — Exam module 2 "Implementation"
  - A. Valuation Approaches
  - B. Discounts, Premiums and other Adjustments
  - C. Conclusion of Value
- III. Related Topics (15–20%) — Exam module 1 "Foundation"
  - A. Professional Standards
  - B. Tax-Related Valuations
  - C. Financial Reporting
  - D. Litigation Services
  - E. Case Law
  - F. Intellectual Property and Other Intangible Assets
  - G. Employee Stock Ownership Plans (ESOPs)
  - H. Valuing Complex Securities

## DETAILED CONTENT SPECIFICATION OUTLINE

### Section I. Qualitative and Quantitative Analyses 25–30% — Exam module 1 “Foundation”

This section covers defining the engagement, sources of data, techniques and methods used to analyze business the interest, value drivers and risk assessments.

Topic/Content	Referenced Readings
<p>A. Defining the Engagement</p> <ol style="list-style-type: none"><li>Standards of Value (e.g., Fair Market Value, Fair Value — Financial Reporting, Investment Value, Intrinsic [Fundamental] Value)</li><li>Relationship Between Purpose of the Valuation and the Standard of Value</li><li>Understanding the Ownership Characteristics of the Interest Being Valued</li><li>Premise of Value for Business Interests (i.e., ongoing concern and liquidation)</li><li>Engagement Letters (e.g., purpose and content)</li></ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 3 and 4</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 2</p> <p>VS Section 100</p>
<p>B. Sources of Economic and Industry Data</p> <p>C. Macro-Economic and Environmental Analysis</p> <p>D. Industry Analysis</p> <ol style="list-style-type: none"><li>Industry Structure and Life-Cycle Analysis</li><li>Competitive Strategies and Analysis</li></ol> <p>E. Subject Entity Analysis</p> <ol style="list-style-type: none"><li>Entity Documents (e.g., operating agreements, buy-sell agreements and bylaws)</li><li>SWOT (strengths, weaknesses, opportunities and threats) Analysis</li><li>Firm Economics (cost structure and pricing power marginal analysis)</li><li>Historic and Forecast Financial Statements<ol style="list-style-type: none"><li>Common Size</li><li>Trend Analysis</li><li>Financial Ratios (a list of definitions, ratios and formulas provided during the exam is included at the end of this document)</li><li>DuPont Analysis; Return on Equity and Return on Assets</li></ol></li><li>Adjustments to Historic and Forecast Financial Statements<ol style="list-style-type: none"><li>Normalizing</li><li>Control vs. Non-control</li><li>Separation of Operating and Non-operating items</li><li>Off balance Sheet Items<ol style="list-style-type: none"><li>Other adjustments</li><li>Implied tax adjustments</li><li>Unusual and/or non-recurring items</li><li>GAAP based adjustments</li></ol></li></ol></li></ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 5, 6 and 8</p> <p><i>Financial Valuation: Applications and Models</i>, chapters 4 and 5</p>

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**Section II. Valuation Analysis 50–60% — Exam module 2 “Implementation”**

This section covers knowledge of the three primary approaches to value, levels of value, discounts, premiums and the conclusion of value.

Topic/Content	Referenced Readings
<p>A. Valuation Approaches</p> <ul style="list-style-type: none"><li>1. Income Approach<ul style="list-style-type: none"><li>a. General Theory</li><li>b. Sources of Data</li><li>c. Commonly Used Methods<ul style="list-style-type: none"><li>1) Capitalized Economic Income/Cash Flow Method (CCF), Including Gordon Growth Model (consistent growth model)</li><li>2) Discounted Economic Income/Cash Flow Method (DCF), including Gordon Growth Model (two-stage model)</li><li>3) Excess Earnings Method (hybrid method)</li></ul></li><li>d. Commonly Used Models — Direct Equity Model Versus Invested Capital Model</li><li>e. Types of Benefit Streams and Selection</li><li>f. Cost of Capital Concepts and Methodology and Other Models<ul style="list-style-type: none"><li>1) Capital Asset Pricing Model (CAPM) and Beta (B) including Unlevering and Relevering Betas</li><li>2) Build-up Method</li><li>3) Duff and Phelps Risk Premiums</li><li>4) Weighted Average Cost of Capital</li><li>5) Understanding the Security Market</li><li>6) Understanding Option Pricing Theory</li></ul></li><li>g. Selection of Appropriate Time (including mid-year convention)</li></ul></li></ul>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 12 and 13</p> <p><i>Financial Valuation: Applications and Models</i>, chapters 5 and 6</p>

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Topic/Content	Referenced Readings
<p>2. Market Approach</p> <ul style="list-style-type: none"> <li>a. General Theory</li> <li>b. Sources of Data</li> <li>c. Commonly Used Methods <ul style="list-style-type: none"> <li>1) Transactions in Subject Company's Stock</li> <li>2) Guideline Publicly Traded Company Method</li> <li>3) Guideline Merged and Acquired Company (transaction) Method</li> </ul> </li> <li>d. Selecting Guideline Companies</li> <li>e. Statistics Related to Valuation Analysis <ul style="list-style-type: none"> <li>1) Understanding Measures of Central Tendency (e.g., arithmetic, harmonic and geometric means and median)</li> <li>2) Understanding Measures of Dispersion (e.g., variance and standard deviation)</li> <li>3) Understanding Statistical Strengths of Numerical Relationships (including covariance, correlation, coefficient of determination and coefficient of variation)</li> <li>4) Understanding Linear Regression</li> </ul> </li> <li>f. Equity versus Invested Capital (including price multiples)</li> <li>g. Selection of Appropriate Time Periods</li> <li>h. Selection and Adjustment of Appropriate Multiples</li> </ul>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 9 and 10</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 8</p>
<p>3. Asset Approach</p> <ul style="list-style-type: none"> <li>a. General Theory</li> <li>b. Sources of Data</li> <li>c. Adjusted (Net) Asset Method</li> <li>d. Considerations in Liquidation</li> <li>e. Issues in Valuing Intangible Assets: Approaches and Methods</li> <li>f. Tax Affecting the Balance Sheet</li> </ul>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 11</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 9</p>

Topic/Content	Referenced Readings
<p>B. Discounts, Premiums and Other Adjustments</p> <ol style="list-style-type: none"> <li>1. Levels of Value Appropriate to the Engagement               <ol style="list-style-type: none"> <li>a. Control Strategic (public or private company)</li> <li>b. Minority/Control Standalone Liquid (public company)</li> <li>c. Control Liquid (private company)</li> <li>d. Control Standalone (private company)</li> <li>e. Minority Non-marketable (private company)</li> </ol> </li> <li>2. Discount for Lack of Control (DLOC) and Control Premium               <ol style="list-style-type: none"> <li>a. Sources of Data</li> <li>b. Ownership Characteristics</li> <li>c. Magnitude</li> </ol> </li> <li>3. Discount for Lack of Marketability (DLOM)               <ol style="list-style-type: none"> <li>a. Sources of Data</li> <li>b. Ownership Characteristics</li> <li>c. Restrictions and Transferability</li> <li>d. Magnitude</li> </ol> </li> <li>4. Discount and Premiums — Understanding the Empirical Studies</li> <li>5. Allocation Between Voting and Non-voting stock</li> <li>6. Other Valuation Discounts and Adjustments               <ol style="list-style-type: none"> <li>a. Market Absorption and Blockage Discounts</li> <li>b. Key Person/Thin Management Discounts</li> <li>c. Built-in Gains Tax Discount</li> <li>d. Nonvoting Stock Discount</li> </ol> </li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 14 and 15</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 10</p>
<p>C. Conclusion of Value</p> <ol style="list-style-type: none"> <li>1. Reconciliation of Indicated Values</li> <li>2. Reasonableness of Conclusion</li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 17</p>
	<p>VS Section 100</p>



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### Section III. Related Topics 15–20% — Exam module 1 “Foundation”

This section covers knowledge of other important topics pertaining to business valuation. These include regulatory standards and guidelines; financial reporting; litigation

and dispute resolution services; case law; intellectual property and other intangible assets; tax-related valuations; employee stock ownership plans (ESOPs); and complex securities.

Topic/Content	Referenced Readings
<p>A. Professional Standards</p> <ol style="list-style-type: none"><li>1. AICPA VS Section 100, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset (VS Section 100)</li><li>2. AICPA Code of Professional Conduct ET 1.200.001 “Independence Rule” and Interpretations of the “Nonattest Services” Subtopic [1.295] (Pronouncements and Regulations related to Independence Requirements when Providing Business Valuation Services to Attest Clients)</li></ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 2</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 12</p>
<p>B. Tax-Related Valuations</p> <ol style="list-style-type: none"><li>1. Internal Revenue Service (IRS) Authority (Related to Valuation)<ol style="list-style-type: none"><li>a. Revenue Rulings and Procedures<ol style="list-style-type: none"><li>1) Revenue Ruling 59-60 (fundamental valuation considerations and the definition of fair market value)</li><li>2) Revenue Ruling 68-609 (the excess earnings method)</li><li>3) Revenue Ruling 77-287 (DLOM for restricted stock)</li><li>4) Revenue Ruling 83-120 (preferred stock)</li><li>5) Revenue Ruling 93-12 (family attribution)</li></ol></li><li>b. Other IRS Pronouncements<ol style="list-style-type: none"><li>1) Internal Revenue Code (IRC) Section 2036 Transfers with retained life estate</li><li>2) Definition of a Qualified Appraiser and Appraisal</li></ol></li></ol></li><li>2. Family Limited Partnership (FLP) and Limited Liability Company (LLC) Considerations<ol style="list-style-type: none"><li>a. Internal Revenue Code (IRC) Chapter 14 (special rules for family transfers and FLPs)<ol style="list-style-type: none"><li>1) Internal Revenue Code (IRC) Section 2701</li><li>2) Internal Revenue Code (IRC) Section 2703</li><li>3) Internal Revenue Code (IRC) Section 2704</li></ol></li></ol></li><li>3. Pass-Through Entity Considerations</li></ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 4, 16, 18 and 21</p> <p><i>Financial Valuation: Applications and Models</i>, chapters 13, 14 and 15</p>

Topic/Content	Referenced Readings
<p>C. Financial Reporting</p> <ol style="list-style-type: none"> <li>1. Fair Value Measurements (FASB ASC 820)</li> <li>2. Business Combinations (FASB ASC 805)</li> <li>3. Goodwill and Other Intangibles and Measuring Impairment (FASB ASC 350)</li> <li>4. Accounting for the Impairment of Long-lived Assets (FASB ASC 360)</li> <li>5 Compensation — Stock Compensation (FASB ASC 718)</li> <li>6. Contingent Considerations</li> <li>7. AICPA Statement on Auditing Standards AU Sec. 336 (Using the Work of a Specialist) and AU Sec. 328 (Auditing Fair Value Measurements and Disclosures)</li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 19</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 24</p>
<p>D. Litigation Services</p> <ol style="list-style-type: none"> <li>1. Shareholder Disputes</li> <li>2. Marital Dissolutions</li> <li>3. Commercial Damages: Lost Profits vs. Loss of Value</li> <li>4. Federal Rules of Civil Procedure (Rule 26 General Provisions Governing Discovery; Duty of Disclosure)</li> <li>5. Federal Rules of Evidence (Rule 702 — Basis of Opinion Testimony by Experts)</li> <li>6. Roles of the Valuation Analyst in Litigation Services (i.e., Expert Witness and/or Consultant)</li> <li>7. Scope of Services <ol style="list-style-type: none"> <li>a. Engagement Letter Considerations for Litigation</li> <li>b. Fact Finding (including discovery and analysis of data)</li> <li>c. Document Management</li> <li>d. Expert Witness Testimony</li> </ol> </li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapters 17, 22, 24 and 26</p> <p><i>Financial Valuation: Applications and Models</i>, chapters 17, 19, 23 and 26</p>
<p>E. Case Law</p> <ol style="list-style-type: none"> <li>1. Directly Related to Business Valuation <ol style="list-style-type: none"> <li>a. Bernard Mandelbaum et al. v. Commissioner</li> <li>b. Delaware Open MRI Radiology Associates P.A. v. Howard B. Kessler, et al.</li> <li>c. Estate of Frazier Jelke v. Commissioner</li> <li>d. Gross v. Commissioner</li> </ol> </li> <li>2. Relating to Admissibility of Expert Opinions <ol style="list-style-type: none"> <li>a. Daubert, William, et al. v. Merrell Dow Pharmaceuticals, Inc.</li> <li>b. Kumho Tire Company, Ltd., et al. v. Patrick Carmichael, et al.</li> </ol> </li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 27</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 16</p>

Topic/Content	Referenced Readings
<p>F. Intellectual Property and Other Intangible Assets</p> <ol style="list-style-type: none"> <li>1. Valuation Approaches and Methods</li> <li>2. Valuing Specific Intangible Assets</li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 20</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 24</p>
<p>G. Employee Stock Ownership Plans (ESOPs)</p> <ol style="list-style-type: none"> <li>1. Appropriate Methods</li> <li>2. U.S. Department of Labor Adequate Consideration Regulations</li> <li>3. Marketability Considerations</li> </ol>	<p><i>Financial Valuation: Applications and Models</i>, chapter 18</p>
<p>H. Valuing Complex Securities</p> <ol style="list-style-type: none"> <li>1. Preferred Stock</li> <li>2. Convertible Instruments</li> <li>3. Stock Options and Other Derivative Instruments</li> <li>4. Debt</li> </ol>	<p><i>Understanding Business Valuation: A Practical Guide to Valuing Small to Medium-Sized Businesses</i>, chapter 25</p> <p><i>Financial Valuation: Applications and Models</i>, chapter 27</p>

## Resource Index

- *Understanding Business Valuation: A Practical Guide to Valuing Small to Medium Sized Businesses* by Gary R. Trugman; 5th ed.; 2017; New York: AICPA.
- *Financial Valuation: Applications and Models* edited by James R. Hitchner; 4th ed.; 2017; New Jersey: John Wiley & Sons.
- *AICPA VS Section 100, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset (VS Section 100)*
- *AICPA Code of Professional Conduct*

## Formulas and Definition of Variables

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

### Financial Ratios

**Accounts Receivable Turnover:** Sales ÷ Accounts receivable

**Average Annual Growth Rate (AAGR):**

Example: AAGR of Sales

{Sum of all Periods [(Current year sales ÷ Prior year sales) – 1] ÷ # of periods analyzed} × 100

**Average Collection Period:**

365 days ÷ Accounts Receivable Turnover

**Compound Annual Growth Rate (CAGR):**

Example: CAGR of Sales

{[(Current year sales ÷ Base year sales)<sup>(1 ÷ # of Periods analyzed)</sup> – 1] × 100

**Current Ratio**

Current assets ÷ Current liabilities

**Debt-Free Working Capital Turnover**

Sales ÷ Debt-free working capital

**Dividend Payout Ratio**

Dividends paid ÷ Net income

**DuPont Formula** (Net income ÷ Equity) = (Net income ÷ Sales) × (Sales ÷ Assets) × (Assets ÷ Equity)

**EVA Formula (Economic Value Added)**

EVA = NOPAT – \$ WACC

EVA = EBIT × (1 – t) – WACC × capital invested

EVA = (Equity) × (ROE – Ke)

**Fixed-Charge Coverage**

(Net income before taxes + Interest charges + Long-term lease payments) ÷ (Interest charges + Long-term lease payments)

**Gross Profit Margin**

Gross profit ÷ Net sales

**Interest-Bearing Debt to Equity**

Interest-bearing debt ÷ Total equity

**Inventory Turnover**

Cost of goods sold ÷ Inventory

**Long-Term Debt to Equity**

Long-term debt ÷ Total equity

**Net Profit Margin**

Net income after tax ÷ Net Sales

**Operating Profit Margin**

Operating profit ÷ Net sales

**Pretax Income to Sales**

Pretax income ÷ Net sales

**Pretax Return on Assets**

Pretax income ÷ Total assets

**Pretax Return on Common Equity**

Pretax Income ÷ Common equity

**Quick (Acid-Test) Ratio** (Cash + Cash equivalents + Short-term investments, e.g., marketable securities, + Receivables) ÷ Current liabilities

**Return on Common Equity**

Net income ÷ Common equity

**Return on Investment**

Net income + Interest (1 – Tax rate) ÷ (Equity + Long-term debt)

**Return on Total Assets** Net income + Interest (1 – Tax rate) ÷ Total Assets

**Sales to Fixed Assets (Fixed Asset Turnover)**

Sales ÷ Fixed assets

**Sales to Total Assets (Total Asset Turnover)**

Sales ÷ Total assets

**Times Interest Earned**

Earnings before interest and taxes ÷ Interest expense

**Total Debt to Total Assets**

Total debt ÷ Total assets

**Total Debt to Total Equity**

Total debt ÷ Total equity

**Total Equity to Total Assets**

Total equity ÷ Total assets

**Working Capital Turnover**

Sales ÷ (Current assets – Current liabilities)

**Valuation Formulas and Notation System After-Tax Cost of Debt**

$k_d$  = Marginal Borrowing Rate (1–Marginal Tax Rate)

**Beta**

$B_U = B_L \div \{1 + [(1-t)(W_d/W_e)]\}$

$B_R = B_U\{1 + [(1-t)(W_d/W_e)]\}$

**Build-Up Method**

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

**Capitalization Rate**

Cap Rate = Discount Rate – Long-Term Growth Rate

**CAPM Capital Asset Pricing Model (Theoretical)**

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

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

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

**Weighted Average Cost of Capital (WACC)**

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

**Definition of Variables**

PV = Present Value.

**COST OF CAPITAL AND RATE OF RETURN VARIABLES:**

**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.

**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. Also expressed as  $k_i$  or as  $E(R_i)$ , expected rate of return on security  $i$ .

**kd** = After-tax cost of debt

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

**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<sub>s</sub>** = 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<sub>u</sub>** = Risk premium for unsystematic risk attributable to the specific company (specific company risk)

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

**INCOME VARIABLES:**

**EBIT** = Earnings before interest and taxes

**EBITDA** = Earnings before interest, taxes, depreciation, and amortization

**NCF** = Net cash flow (to equity or to invested capital)

**Weightings:**

**W<sub>e</sub>** = Weight of common equity in capital structure

**W<sub>d</sub>** = Weight of debt in capital structure

**GROWTH:**

**g** = Long-term rate of growth



