

## THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS ISSUES A NEW BUSINESS VALUATION STANDARD, SSVS No. 1

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*After years of deliberation involving numerous groups within its organization, the AICPA recently issued SSVS No. 1: "Valuation of a Business, Business Ownership Interest, Security, and Intangible Asset." SSVS No. 1 applies to all AICPA members (regardless of their technical discipline) when they perform an engagement to estimate value when the member (1) applies valuation approaches and methods and (2) uses professional judgment. This AICPA standard is effective for valuation engagements accepted after January 1, 2008. This discussion will summarize (1) the engagement acceptance considerations, (2) the valuation analysis requirements, and (3) the valuation reporting requirements of the new AICPA standard. While this business valuation (BV) standard only applies to AICPA members, it may ultimately benefit all BV analysts and all BV clients. This is because both BV clients and parties that rely on BV reports (i.e., bankers, regulators, government agencies, courts, etc.) may come to expect all valuation practitioners to prepare analyses and reports to incorporate the professional "best practices" that are required by the AICPA standard.*

### INTRODUCTION

The American Institute of Certified Public Accountants (AICPA) consulting services executive committee (CSEC) recently issued Statement on Standards for Valuation Services No. 1 (SSVS No. 1) "Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset."

SSVS No. 1 (or "the Statement") is effective for all business valuation (BV) engagements accepted by AICPA members after January 1, 2008. Earlier adoption of SSVS No. 1 on the part of AICPA members is encouraged by the CSEC.

Although it only applies to AICPA members, SSVS No. 1 is expected to benefit:

1. all AICPA member BV practitioners;
2. all AICPA members' valuation clients;
3. the general business valuation profession;

*"Even though the application of SSVS No. 1 is only required for AICPA members, the general acceptance of these professional standards may ultimately spread through the capital markets, financial, accounting, legal, regulatory, federal taxation, and judicial communities.."*

4. courts, regulators, government agencies, investors, financial institutions, and other parties who rely on business valuations; and
5. the valuation clients of all BV practitioners (whether the practitioners are AICPA members or not).

This list of expected beneficiaries is based on the premise that any new set of professional standards in the valuation community "raises the

bar" for all valuation practitioners. Even though the application of SSVS No. 1 is only required for AICPA members, the general acceptance of these professional standards may ultimately spread through the capital markets, financial accounting, legal, regulatory, federal taxation and judicial communities.

Sooner or later, all BV clients will come to expect valuation analyses and/or valuation reports that are of a quality comparable to those prepared in accordance with SSVS No. 1. Accordingly, the AICPA adoption of this BV standard

may ultimately cause “all boats to rise when the tide comes in” in the business valuation profession. Therefore, the AICPA adoption of SSVS No. 1 may ultimately benefit all BV practitioners’ valuation clients—and all parties who rely on business valuation reports.

This discussion will summarize the valuation engagement considerations, valuation analysis requirements, and valuation reporting requirements of SSVS No. 1. In addition, this discussion will summarize the application—and the implications—of SSVS No. 1 to business valuations prepared by AICPA members.

## PURPOSE AND OBJECTIVE OF SSVS No. 1

After years of deliberation, the AICPA issued the SSVS No. 1 BV standard in order to:

1. provide AICPA members with BV professional guidance
2. represent the best practices in the performance of BV professional services;
3. improve the consistency of AICPA member’s BV practice;
4. improve the quality of AICPA member’s BV practice;
5. enhance the transparency of BV analyses and BV reports;
6. encourage the standardization of the BV reporting content and format;
7. enhance the reliance on the BV process by clients, report readers, judicial finders of fact, the capital market investment community, and others; and
8. encourage well-documented and unambiguous BV engagement expectations between AICPA members and their valuation clients.

Valuation analysts generally perform business valuations for numerous purposes, including transactions, financings, taxation, financial accounting, bankruptcy, ESOP formation and compliance, management information and planning, intergenerational wealth transfer, litigation support, and many other purposes. And, business valuations are performed by AICPA members from various technical disciplines, including management consulting, litigation services, personal financial planning, tax, and audit.

All AICPA members, regardless of their technical discipline, will have to comply with the SSVS when they perform an engagement to estimate value that results in an expression of either:

1. a conclusion of value or
2. a calculated value.

## THE APPLICATION OF SSVS No. 1

SSVS No. 1 applies when any AICPA member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (collectively called the “subject interest in the statement”) when that AICPA member:

1. applies valuation approaches and valuation methods (as described in the Statement), and
2. uses professional judgment as an essential component of estimating value.

In fact, SSVS No. 1 states that “the use of professional judgment is an essential component of estimating value.” Any AICPA member who performs such an engagement to estimate value is referred to in the Statement as a “valuation analyst.”

SSVS No. 1 does not apply to AICPA members in the following situations:

- The value of the subject interest is provided to the AICPA member by the member’s client or by a third party and the AICPA member (1) does not apply valuation approaches and methods and (2) does not report on the value of the subject interest.
- The AICPA member performs an engagement to calculate value as part of an audit or review engagement.
- Internal use assignments from employers to employee AICPA members not working in the practice of public accounting.
- Engagements that are exclusively for the purpose of determining economic damages (unless such a determination is used to estimate the value of a subject interest).
- Mechanical computations that do not rise to the level of engagement to estimate value (i.e., where the AICPA member does not apply valuation approaches and methods and use professional judgment).
- Where it is not practical or reasonable for the AICPA member to obtain or use relevant information and the AICPA member is unable to apply valuation approaches and methods.

*“. . . business valuations are performed by AICPA members from various technical disciplines, including management consulting, litigation services, personal financial planning, tax, and audit.”*

- A jurisdictional exemption, when the Statement differs from published governmental judicial or accounting authority.

## BUSINESS VALUATION ENGAGEMENT CONSIDERATIONS

In determining his/her professional competence to perform a particular BV engagement, the Statement indicates that the AICPA member is required to consider the following:

1. the subject entity and the subject industry
2. the subject interest
3. the valuation date
4. the scope of the valuation engagement, including
  - the purpose of the engagement
  - any assumptions and limiting conditions
  - the applicable standard of value
  - the type of report to be issued
  - the intended use and users of the report
  - any restrictions on use of the report
5. any governmental regulations or other professional standards that apply to the engagement.

Before accepting the engagement, the AICPA valuation analyst should establish an understanding with his or her client, where that understanding can be oral (with workpaper documentation) or written. Any scope restrictions on the valuation analyst's work or on data availability should be disclosed in the valuation report.

The AICPA valuation analyst may rely on third-party specialists (such as real estate or equipment appraisers) in the valuation. However, the AICPA valuation analyst must disclose, in the assumptions and limiting conditions, the level of responsibility for the work of any third-party specialists.

## TWO TYPES OF ENGAGEMENTS

SSVS No. 1 describes two types of engagements:

1. a valuation engagement and
2. a calculation engagement.

A valuation engagement calls for the AICPA valuation analyst to estimate the value of the subject interest. In a valuation engagement, the AICPA member (1) must follow

the development section of the SSVS and (2) is free to apply the appropriate valuation approaches.

In a valuation engagement, the results are expressed as a "conclusion of value"—either as a single amount or as a range of values.

In a calculation engagement, the AICPA valuation analyst and his or her client agree on (1) the valuation approaches and methods to use and (2) the extent of the procedures to perform. In the calculation engagement, the AICPA member calculates value using the agreed upon procedures.

In a calculation engagement, the results are expressed as a "calculated value"—either as a single amount or as a range of values.

## VALUATION ENGAGEMENT DATA REQUIREMENTS

In any valuation engagement, SSVS No. 1 indicates that the minimum information that the AICPA member needs in order to analyze the subject interest depends on the following:

1. the nature of the subject interest
2. the scope of the valuation engagement
3. the valuation date
4. the intended use of the valuation
5. the applicable standard of value
6. the applicable premise of value
7. any assumptions and limiting conditions
8. any applicable government regulations or other professional standards

According to SSVS No. 1, the AICPA valuation analyst should obtain and analyze ownership information in order to:

1. determine (a) the type of ownership interest and (b) whether the ownership interest is a controlling, majority-owned, or minority-owned ownership interest;
2. analyze (a) the ownership interests of other owners and (b) the impact of that ownership on value of the subject interest;
3. understand (a) the classes of ownership interest and (b) the rights assigned thereto; and
4. understand the rights included in or excluded from each intangible asset.

In reaching the conclusion of value in a valuation engagement, the AICPA member is required to:

*"SSVS No. 1 describes two types of engagements: (1) a valuation engagement and (2) a calculation engagement."*

1. correlate, reconcile, and assess the reliability of the results from the different valuation approaches and methods, and
2. determine whether the value conclusion should be based on a single valuation method or on a combination of valuation methods.

SSVS No. 1 defines a “subsequent event” as an event that occurs subsequent to the valuation date but prior to the date of issuance of the valuation report. According to the Statement, the AICPA valuation analyst should distinguish between two types of subsequent events.

First, the analyst should consider in the valuation analysis events that are indicative of conditions that were known or knowable as of valuation date.

Second, the analyst should not consider in the valuation analysis (but the analyst may disclose in the valuation report) any subsequent event that is not indicative of conditions that were known or knowable as of the valuation date.

According to the Statement, the AICPA member’s considerations with regard to a calculation engagement should include the following:

1. the identity of the client
2. the identity of the subject interest
3. the ownership control and the marketability elements of the subject interest
4. the purpose and intended use of the calculated value
5. the intended users of report and any limitations on the report use
6. the valuation date
7. the applicable standard of value
8. the applicable premise of value
9. the sources of information used
10. any valuation approaches and methods agreed on with the client
11. the disclosure of any subsequent events.

*“SSVS No. 1 defines a ‘subsequent event’ as an event that occurs subsequent to the valuation date but prior to the date of issuance of the valuation report.”*

*“The use of a ‘rule of thumb’ pricing multiple or other mechanism is not considered an appropriate valuation method under SSVS No. 1.”*

No. 1 indicates that the AICPA valuation analyst should consider all three generally accepted valuation approaches.

That is, for a business, business ownership interest, or security valuation, the AICPA member should consider:

1. the income approach,
2. the market approach, and
3. the asset-based approach.

For an intangible asset valuation, the AICPA member should consider:

1. the income approach,
2. the market approach, and
3. the cost approach.

The use of a “rule of thumb” pricing multiple or other mechanism is not considered an appropriate valuation method under SSVS No. 1. However, a “rule of thumb” may be used as a reasonableness check in the valuation analysis. The rule of thumb generally should not be the only method used to value the subject interest.

The Statement indicates that, in a business or security valuation, the AICPA member should consider whether any valuation adjustment should be made to the pre-adjustment value indication, including:

1. a discount for lack of marketability,
2. a discount for lack of ownership control, or
3. a premium for ownership control.

And, in a business or security valuation, the AICPA member should specifically consider the existence of non-operating assets, nonoperating liabilities, and any excess/deficient operating assets. In addition, the AICPA member should consider the impact of a lack of ownership control on the value of such assets/liabilities.

## TYPES OF VALUATION REPORTS

According to the Statement, a valuation report is a communication to a client containing the conclusion of value or the calculated value of the subject interest. The Statement allows that valuation reports may be either written or oral.

There is an exemption from the reporting provisions in the Statement for certain controversy proceedings, whether the matter proceeds to trial or it settles before trial.

## VALUATION APPROACHES AND METHODS

According to the Statement, the AICPA valuation analyst should use all valuation approaches and methods that are appropriate to the subject engagement. Accordingly, SSVS

For a valuation engagement resulting in a conclusion of value, the Statement allows for two types of reports:

1. the detailed report
2. the summary report

For a calculation engagement resulting in a calculated value, the Statement only allows for one type of report: the calculation report.

For both types of engagements (i.e., valuation engagements and calculation engagements), oral reports are acceptable under the Statement.

### The Detailed Report

According to the SSVS No. 1, the detailed report should provide sufficient information to permit the report user to understand the data, reasoning, and analyses underlying the indicated value conclusion.

Therefore, according to the Statement provisions, a detailed report should include the following sections:

1. a letter of transmittal
2. a table of contents
3. an introduction
4. the sources of information
5. an analysis of the subject entity and the related nonfinancial information
6. financial statement/information analysis
7. the valuation approaches and methods considered
8. the valuation approaches and methods used
9. any valuation adjustments made
10. any nonoperating assets and liabilities; any excess/deficient operating assets
11. the representation of the AICPA valuation analyst
12. the reconciliation of estimates and conclusion of value
13. the professional qualifications of the AICPA valuation analyst

*“For a valuation engagement resulting in a conclusion of value, the Statement allows for two types of reports: (1) the detailed report and (2) the summary report.”*

1. the identity of the client
2. the purpose and intended use of the valuation
3. the intended users of the valuation
4. the identity of the subject entity
5. a description of the subject interest
6. subject interest ownership characteristics and the degree of marketability
7. the valuation date
8. the valuation report date
9. the type of report issues (i.e., a summary report)
10. the applicable standard of value
11. the applicable premise of value
12. the sources of information used in the valuation
13. any assumptions and limiting conditions
14. any restrictions/limitations on scope of work or data availability
15. any hypothetical conditions assumed
16. a description of any specialist’s work relied on and the level of responsibility that the AICPA valuation analyst assumes for the specialist’s work
17. the valuation approaches and methods used
18. a reconciliation of value estimates and a conclusion of value
19. any disclosure of subsequent events
20. any jurisdictional exception
21. the representation of the AICPA valuation analyst
22. the signature of the valuation analyst or the analyst’s accounting firm

### The Oral Report

SSVS No. 1 indicates that a calculation report is the only type of report that should be used to report the results of a calculation engagement. Of course, the report should state that it is a calculation report.

According to the Statement, the calculation report should identify the following:

1. any hypothetical conditions used
2. any jurisdictional exception
3. any assumptions and limiting conditions
4. a description of any specialist’s work relied on and the level of responsibility that the AICPA valuation analyst assumes for the specialist’s work

### The Summary Report

According to SSVS No. 1, the summary report should provide a summary of the information that would otherwise be provided in a detailed report.

According to the Statement provisions, a summary report should include the following information:

## 5. a disclosure of any subsequent events

In addition, the Statement provides that the calculation report should summarize the calculated value, including the following:

1. an identification of the subject interest
2. an identification of the calculation date
3. the valuation report date
4. a statement that the AICPA valuation analyst is not obligated to update the calculation
5. a description of the calculation procedures
6. a statement that the calculation was performed in accordance with the SSVS No. 1 standard
7. a description of the subject interest characteristics, including the characteristics of ownership control and marketability
8. a statement that the estimated value is a calculated value
9. a general description of the calculation engagement
10. the calculated value
11. the signature of the valuation analyst or the analyst's accounting firm

*“. . . this Statement should provide professional guidance, practice consistency, analytical transparency, improved client communication, structured engagement service levels, and well-defined valuation reporting options.”*

### The Oral Report

SSVS No. 1 allows for an oral report to be used in either (1) a valuation engagement or (2) a calculation engagement. The Statement indicates that an oral report should include all information necessary to relate the scope, assumptions, limitations, and results of the engagement.

Of course, the oral report should be made in a way so as to limit any misunderstanding between the valuation analyst and the oral report recipient. And, the AICPA valuation analyst should document the substance of the oral report in the engagement workpapers.

### SUMMARY AND CONCLUSION

SSVS No. 1 applies to all AICPA members. The Statement is effective for any valuation engagement accepted by an AICPA member after January 1, 2008. Of course, the AICPA has encouraged early adoption of SSVS No. 1.

The application of SSVS No. 1 is expected to provide benefits to AICPA members, to their valuation clients, to parties who rely on AICPA-member-prepared valuation reports, and to the general business valuation community.

SSVS No. 1 allows for two types of engagements: (1) a valuation engagement and (2) a calculation engagement.

And, SSVS No. 1 allows for several types of valuation reports. For a valuation engagement, the Statement permits two types of reports:

1. a detailed report and
2. a summary report.

For a calculation engagement, the Statement only permits one type of report: a calculation report.

And, for all engagements, oral reports are permitted by the Statement.

SSVS No. 1 applies to all engagements to estimate value when the AICPA member:

1. applies valuation approaches and methods and
2. uses professional judgment in that application.

Based on years of deliberation and debate encompassing numerous groups within the AICPA, this Statement should provide professional guidance, practice

consistency, analytical transparency, improved client communication, structured engagement service levels, and well-defined valuation reporting options.

These benefits of the Statement should accrue to AICPA members, to their valuation clients, and to other parties who rely on valuation reports prepared in accordance with SSVS No. 1.

Perhaps more importantly, SSVS No. 1 may ultimately benefit (1) the general business valuation community and (2) all parties who rely on business valuation reports. As the SSVS No. 1 requirements become “generally accepted” among non-CPA valuation analysts, the general quality, consistency, transparency, and “best practices” aspects of this business valuation standard will accrue to all valuation analysts—and to their valuation clients.

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