

June 15, 2005



California
Society
Certified
Public
Accountants

Janice Fredericks
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Sent by e-mail to: bvstds@aicpa.org

Re: Proposed Statement on Standards for Valuation Services – Exposure Draft 03/30/05

Dear Ms. Fredericks,

On behalf of the California Society of Certified Public Accountants Litigation Sections (Litigation Sections) I want to commend and thank the Business Valuation Committee, its members and staff, and everyone at the AICPA who have worked tirelessly on this project. The Statement on Standards for Valuation Services (Standards) has been a long project and we appreciate the opportunities we've been afforded to comment and provide input throughout the process. We believe that the collaboration of the AICPA and State Societies on the Standards have resulted in a much stronger product.

The Litigation Sections has spent significant time reviewing the Standards Exposure Draft and believe it to be a fine document. We reviewed and addressed the seven issues identified under "Areas Requiring Particular Attention by Respondents" as well as performed a final review of the Standards. Following are the Litigation Sections comments.

Issue 1 – Interaction with Other Standards

There currently exist business valuation standards promulgated by other recognized valuation or appraisal organizations. Those standards do not agree with each other in all respects. The Consulting Services Executive Committee has compared this proposed business valuation standard (the proposed Statement) with the standards of those organizations and believes the proposed Statement, while improving practice, will not result in conflicts with those standards. Do you agree? If not, please describe specific areas where you believe that following the proposed Statement could result in a conflict with other standards, or areas where you believe that following other standards could result in a conflict with the proposed Statement.

Litigation Sections Comments:

1. We agree that there does not appear to be a conflict with standards of other valuation organizations. However, there appear to be conflicts with existing CPA standards - SSARS and SSAEs.
2. We heard from our members, particularly those in business valuation and family law, that practitioners, not currently doing accounting, auditing and attest engagements (A&A), may be subject to added A&A education and peer review requirements as a result of certain services performed in connection with a valuation assignment. This is perceived by practitioners, especially those with small business clients, as putting them at a competitive disadvantage with non-CPA practitioners. Although the Steering Committee understands that different senior technical committees within the AICPA issue A&A standards, this standard needs to clearly and accurately describe the intersection with these other standards. We believe that proper guidance and appropriate continuing education addressing this issue should be given priority.

3. Although compilations are defined and addressed in Q & A #6, there still appears to be a conflict with accounting and review standards. There is a “real world” struggle between accounting and review standards and the valuation standards which centers on the practical definition of a “financial statement”; if a member organizes a client’s records in the form of a “financial statement” he or she will be subject to the compilation standards. Many of our members are concerned that there is not a clear, operational definition of what qualifies as a “financial statement”, subject to the compilation standards, and what qualifies as a financial presentation which is not subject to the compilation standard.
4. Upon reviewing the prospective financial statement answer for Question 23, provided in the Appendix A, we believe the answer given does not accurately reflect the requirements of existing Attestation Standards.

Existing Question 23 and its answer [emphasis added]:

Q23: In the course of performing a valuation under this Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs)?

*A23: No. Chapter 1, “Attest Engagements,” of SSAE No. 10, Attestation Standards: Revision and Recodification (AICPA, Professional Standards, vol. 1, AT sec. 101), as amended (AT sec. 101.01) states that the attestation standards apply when a practitioner is “engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter..., that is the responsibility of another party.” [Footnote omitted] If the valuation analyst has not been engaged to examine, compile, **assemble**, review, or apply agreed-upon procedures to prospective financial information and does not issue an examination, compilation, **assembly**, or agreed-upon report on prospective financial information, the SSAEs do not apply.*

The “no” answer is appropriate because the CPA is not subject to the attestation standards simply by the nature of his/her engagement. The answer is accurate, but only to a certain extent. However, the answer is incorrect because the commentary after the quote from AT 101 goes too far. The commentary after the quote extends the “No” answer to the “assembly” of prospective financial information. You will note that exemption from the Attestation Standards described in the quote of AT 101.01 **does not include assembly**.

The source of concern is AT section 301, as follows [emphasis added]:

AT SECTION 301

Effective when the date of the practitioner’s report is on or after June 1, 2001, unless otherwise indicated.

Introduction

.01 This section sets forth standards and provides guidance to practitioners who are engaged to issue or do issue examination (paragraphs .29 to .50), compilation (paragraphs .12 to .28), or agreed-upon procedures reports (paragraphs .51 to .56) on prospective financial statements.

*.02 Whenever a practitioner (a) **submits, to his or her client or others, prospective financial statements that he or she has assembled, or assisted in assembling, that are or reasonably might be expected to be used by another (third) party**¹ or (b) reports on prospective financial statements that are, or reasonably might be expected to be used by another (third) party, **the practitioner should perform one of the engagements described in the preceding paragraph**. In deciding whether the prospective financial statements are or reasonably might be expected to be used by a third party, the practitioner may rely on either the written or oral representation of the responsible party, unless information comes to his or her attention that contradicts the responsible party’s representation. If such third-party use of the prospective financial statements is not reasonably expected, the provisions of this section are not applicable*

unless the practitioner has been engaged to examine, compile, or apply agreed-upon procedures to the prospective financial statements.

According to AT 301.02, if a practitioner (1) assembles (or assists in assembling) prospective financial statements and (2) submits them to his/her client which (3) “reasonably might be expected to be used by another (third) party”, the practitioner should perform an examination, compilation or agreed-upon procedures engagement on those assembled prospective financial statements. This causes the practitioner to have to adhere to the Attestation Standards.

There are certainly many variations on what can happen on a particular engagement, what is needed for a particular engagement, what options a practitioner has, etc., but we are attempting to address the “technical answer” as it relates to the intersection with the Attestation Standards. The requirements in the Attestation Standards cited above will exist regardless of what the [BV] Standards says.

We recommend that in Q23 the erroneous commentary after the AT 101 quote be removed, and instead an applicable quote be inserted from AT 301.02 to alert the practitioner that if they assemble and submit a prospective financial statement they are required to perform one of the attest engagements, if 3rd party reliance “reasonably might be expected.” We believe that there needs to be professional education and guidance on this.

Issue 2 – Documentation of understanding with the client

Under paragraph 17 of this exposure draft, a valuation analyst should establish an understanding with the client, preferably in writing, regarding the valuation engagement to be performed. The understanding is required to be documented in writing—if not in a written understanding with the client then by appropriate memoranda or notations in the workpapers. Do you believe the final Statement should permit oral understandings and be silent as to the preferability of oral versus written understandings with the client, permit oral understandings and recommend written understandings with the client as a best practice, or require that all understandings with the client be in writing?

Litigation Sections Comments:

We agree with the proposed standard as written.

Issue 3 – Use of specialists

Paragraphs 22 and 23 of this exposure draft prescribe “procedures” for the valuation analyst to perform when using the work of a specialist, such as an outside real estate or equipment appraiser. The procedures differ based on who engages the specialist. When using an outside specialist engaged by the valuation analyst or the valuation analyst’s firm, the valuation analyst is required to evaluate the specialist’s qualifications and describe in the valuation report how the specialist’s work was used in the valuation. However, when using an outside specialist engaged by a party other than the valuation analyst or the valuation analyst’s firm, the valuation analyst is required only to describe in the valuation report how the specialist’s work was used in the valuation. In practice it is typically more often the case that the specialist is engaged by a party other than the valuation analyst or the valuation analyst’s firm. Many believe that it would not be practicable for the valuation analyst to evaluate the qualifications of outside specialists not hired by the valuation analyst or the valuation analyst’s firm, whereas a valuation analyst hiring a specialist may be held responsible to at least hire someone competent and with experience in the particular area. However, as pointed out in paragraph 69(h), irrespective of who hires a specialist, the valuation analyst should include in his or her representation a statement that the valuation analyst has performed no corroborating procedures to confirm the validity of an outside specialist’s work. Do you agree with the different procedural requirements for the valuation specialist based on who hires the specialist, or do you believe the requirements should be the same irrespective of who hires the valuation specialist, and why? If you believe the requirements should be the same, explain what you believe the specific requirements should be and address their practicality. Additionally, do you believe the requirements should include procedures related to the objectivity of the specialist?

Litigation Sections Comments:

Yes – there is a distinction between a specialist hired by the expert vs. a specialist hired by the client and it should be well defined.

We are recommending the following changes to number 22 and 23.

1. Change Paragraph 22 as follows [insert **bolded**]: In the course of the valuation engagement,...the work **product** of a specialist...When the valuation analyst uses the work **product** of a **retained** specialist...
2. Change Paragraph 23 as follows: Delete everything after ...the necessary skill or knowledge in the particular field. Although we believe that NACVA wants #23 eliminated completely, we believe the 1st sentence is applicable.

Issue 4 – Post-valuation events

A "post-valuation event" is defined as an event that could affect the valuation and that occurs subsequent to the valuation date but prior to the issuance of a valuation report. Under paragraph 45(b) of this exposure draft:

- A valuation is not updated to reflect post-valuation events that are indicative of conditions that were not known or knowable to market participants at the valuation date, including conditions that arose subsequent to the valuation date.
- The valuation report would typically not include a discussion of those events because a valuation is performed as of a point in time—the valuation date—and events occurring subsequent to that date are not relevant to the value determined as of that date. However, in situations in which a valuation is performed in conjunction with a purchase or sale of a subject interest and the value of the subject interest is meaningful to the purchaser beyond the valuation date, the events may be of such nature and significance as to warrant disclosure in a separate section of the report in order to keep users from being misled. Such disclosure should clearly indicate that the events are provided for informational purposes only and do not affect the determination of value. Do you agree that the above disclosure is appropriate in the purchase or sale situations described above? Alternatively, do you believe:

- (a) the above-described disclosure is appropriate in additional situations—for example, for *all* post-valuation events that are indicative of conditions that were not known or knowable to market participants at the valuation date, including conditions that arose subsequent to the valuation date, or
- (b) the above-described disclosure is appropriate in fewer or no situations?

Litigation Sections Comments:

1. The terms "purchase" or "sale" need to be clarified since it might be interpreted to include every matter where something of value is disputed between two or more parties.
2. It needs to be clear that there is no requirement to, nor a prohibition against, post-valuation-date events in reports other than buy/sell reports. It should also be clarified that it applies only to post-valuation-date events that come to the analyst's attention and that it is not a requirement for the analyst to search them out. Additionally it should allow the analyst to talk about post-valuation events that are not included in the report since the event may occur after the report has been submitted.
3. In establishing the valuation date in family law cases, both sides have presented data and argued the facts to establish the valuation date. Once a Court decision on the valuation date is issued, practitioners are generally precluded by that decision from considering post-valuation-date events in their analysis and determination of value. This portion of the standard may conflict with the legal requirements in those jurisdictions.
4. In shareholder dissolution cases disclosure of post-valuation-date events such as new processes that may be developed by a company may violate confidentiality rules and can not be disclosed.
5. Therefore, in paragraph 45 b, eliminate the text starting with and including the third sentence (which starts with "Moreover,"). At minimum this information does not belong in this section since it deals with reporting, but if kept must address the above issues.

Issue 5 – Oral valuation reports

Paragraph 50 of this exposure draft requires that, with an exception for reporting in litigation, valuation reports be in writing. It was thought that the proposed Statement could not adequately establish standards of quality and due professional care with respect to oral reports, and therefore the risks associated with oral reports could not be kept to an acceptable level under the proposed Statement. Do you believe the final Statement should permit oral reports and be silent as to the preferability of oral versus written reports, permit oral reports and recommend written reports as a best practice, or require that all reports be in writing? If you believe oral reports should be permitted, please include in your reasoning a discussion of how such reports would be in the public interest as well as how they would provide sufficient risk management for the valuation analyst.

Steering Committee Comments:

1. Yes, the Standards should permit the use of oral reports.
2. The use of oral reports has been addressed properly in the document and the Q&A.
3. We heard from our members that oral reports for settlement purposes need to be identified as permissible.
4. Calculations in a settlement conference may be in the form of an oral report and are in the public's best interest in order to settle a case rather than litigate the case in court.
5. Public Interest - Oral reports would be in the public's interest because public interest also equals service to clients in order to make proper business decisions.
6. Risk Management - Oral reports are often used in informal meetings that would fall under other services and not a valuation engagement. The work is not considered a valuation, but a calculation and indication of value and can be presented in an oral report. If the client relies on it, the engagement would be considered a consulting engagement and not a valuation engagement. The work is not a valuation conclusion and not being relied upon by a third party.

Issue 6 – Guideline language for conclusion or indication of value

Paragraphs 70, 71, 78, and 79 of the proposed Statement provide elements and guideline language for purposes of summarizing the conclusion or indication of value for the two types of valuation engagements described in paragraph 24. Do you believe that such guideline language will improve the reporting and facilitate the understanding of the results of a valuation engagement, or do you believe that such guideline language is unnecessary, or that it should be recommended but not required?

Litigation Sections Comments:

1. Some practitioners meet with clients and jot down or verbalize the indication of value based on their experience to help the client decide if a more formal/complete report is required. We should preserve the right to do that. Oral reports should be allowed for a calculation report.
2. See comment #6 under Issue #5 above.

Issue 7 – Glossary

The International Glossary of Business Valuation Terms is included verbatim as Appendix C of this exposure draft. A second, separate glossary of additional terms used in this exposure draft and related to business valuation is included as Appendix D. The International Glossary of Business Valuation Terms includes a number of terms not used in this Statement and points out, where applicable, differences between the United States and Canada in the use of certain terms. Do you prefer that the Statement include two separate glossaries in this fashion, or would you prefer a single glossary (for example, a combined glossary of some or all terms from the International Glossary of Business Valuation Terms and other terms)? Do you believe the final glossary(ies) should include only terms used in the Statement, or should it (they) include, as is the case in the exposure draft, other terms?

Litigation Sections Comments:

The Standards should include only one glossary and it should be Appendix C - International Glossary of Business Valuation Terms. This glossary has been agreed to by five professional organizations and should be used in its entirety. Strike Appendix D – Glossary of Additional Terms. Other terms should not be included in the glossary since there isn't uniform agreement on their definition. If there are terms contained in Appendix D that are not properly explained and clarified in the body of the Standards, then they should be clarified in the Standards not in a new glossary.

Other Litigation Sections Comments:

1. The Q & A must have the equivalent authority of the standard. Members of our Steering Committee recall that it was previously stated that instead of addressing some of the issues in the body of the standards that the items would be addressed in a Q & A which would be Appendix A of the standards.
2. Please note that there is conflict information regarding this in the Standards. On page 36 it states that the Q & A is only for exposure draft purposes yet Question and Answer section, Appendix A, is referred to through out the "standard" portion of the document (e.g., Paragraph 53).
3. Paragraph 16 – Interpretation No. 101-3: The first sentence needs to end after the word client in the third line. Remove "including:" and everything after it. This change would make the document

- perpetual and not require changes to these Standards when a change to Interpretation No. 101-3 is made.
4. Paragraph 21: The example used for when a restriction or limitation should be disclosed in the valuation report should be removed. A business valuation related to litigation is exempt from the reporting provision as identified in Paragraph 53 – Reporting Exemption for Litigation. Since there is no written reporting requirement in litigation there cannot be a specific requirement to disclose something in report.
 5. Paragraph 33 – Valuation Approaches: For the second bullet point “Asset-based approach or cost approach” remove the information in parenthesis because those items are more like practice tips not professional performance standards.
 6. Paragraph 38 – Market Approach: After the first three bullet points, change the sentence that starts with “The three most common...”, to read” Market approach valuation methods for intangible assets include:”, then followed by the 3 bullet points provided. Stating “the three most common...are” infers that there is agreement that these are the most common ones and that other approaches are not appropriate. Additionally, this level of detail relates more to the underlying body of knowledge and is not appropriate for a professional standard dealing with a CPA’s conduct.
 7. Paragraph 40 – Strike the last sentence because it’s not necessary for this standard to have this level of detail.
 8. Paragraph 71: Strike all of it. This is not helpful because any deviation from the specific language would appear to be a deviation from the Standards. The qualitative requirements of the Standards should be all the practitioner needs to draft language appropriate to the engagement. If this is kept in the document it should be included in a nonauthoritative appendix as suggested guidance; similar to the approach of USPAP and ASA.

We are thankful for the opportunity to comment on the Standards and provide our input and recommendations in an effort to have a document that will be helpful to practitioners across the country. This has been a long process and we express our sincere appreciation to everyone involved in the development of these Standards for their hard work and commitment. Should you have any questions please feel free to contact me at (310) 395-0599 or andy@mintzercpa.com.

Sincerely,



Andrew M. Mintzer, CPA
Chair, Litigation Sections
California Society of CPAs

cc: Thomas F. Burrage, CPA/ABV, AICPA BV/FLS Committee, AICPA
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