



# AN ATTORNEY'S GUIDE TO UNDERSTANDING BUSINESS VALUATION STANDARDS

## Things you will learn from this whitepaper:

1. Are there professional standards that govern the business valuation process?
2. What organizations provide these standards?
3. How do these standards influence quality service from valuation experts?
4. Why are these standards important when working with a valuation analyst?

## This whitepaper will have special interest to:

1. Attorneys and Judges involved in litigation matters that require the valuation of a business.
2. Business mediators & arbitrators.
3. Business owners, partners, and shareholders.
4. Parties engaged in the dissolution of an economic partnership.

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## Table of Contents

Introduction .....	3
The Importance of Business Valuation Standards.....	3
Uniform Standards of Professional Appraisal Practice (USPAP).....	4
American Society of Appraisers (ASA).....	5
Institute of Business Appraisers (IBA).....	5
National Association of Certified Valuation Analysts (NACVA).....	6
American Institute of Certified Public Accountants (AICPA) .....	6
Conclusion .....	7

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ACCOUNTANTS,  
CONSULTANTS &  
BUSINESS VALUATORS

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TO UNDERSTANDING BUSINESS VALUATION  
STANDARDS**

**Introduction** Reputations and public perception are often associated with performance and adherence to rules that govern an activity. Lance Armstrong, once, the darling of cycling, is expected to lose more than \$50 million dollars of future sponsorships and endorsements as a result of his admissions to violating his sport's standards. Many also believe that his well-documented doping activities will leave him stripped of a once untarnished professional reputation. Armstrong is not alone; there have been many other examples of people purposely violating their professions' standards in an attempt to gain an upper-hand.

Professional standards serve as a road map for both providers and users. In the business valuation industry, standards have been developed by a number of its credentialing organizations. In this whitepaper, "An Attorney's guide to Understanding Business Valuation Standards," we have outlined the organizations and premises of their professional standards. Attorneys need to be familiar with these standards so that they can illustrate the creditability of their expert, or better understand the possible deficiencies of opposing professional opinions.

Business valuation analysts are often retained to determine how much an asset is worth. In some instances, this effort is utilized to help remedy a shareholder dispute, or it may be an integral part of dissolving a marriage. For valuation analysts to have an important role in this process, they must be viewed as a credible, independent source. Valuation analysts are held to certain standards established by their credentialing organizations. Ultimately, these standards are intended to secure the creditability and quality to their work-product. Working with a credentialed business valuation analyst that adheres to these standards is important to both attorneys and their clients. In fact, judges and jurors are also aware of the importance.

Family businesses or privately held companies are not often sold when resolving a conflict. However, the value of the business still must be determined to a reasonable degree of certainty so that the parties are able to allocate assets appropriately when determining the estimated value of the shared asset.

## **The Importance of Business Valuation Standards**

Business valuation is a combination of science and art. Many criteria enter into the valuation of a business and it can be difficult to decide what criteria should be considered and how much weight should be given to a particular factor. Furthermore, businesses are often unique in terms of its branding, industry, human resources, and clientele. There are numerous methods of valuing a business, and without some uniformity, the estimation of a company's value may be deemed less accurate.

In order to provide a uniform approach, a variety of business valuation considerations have been developed. These considerations, which have matured into standards, have been developed individually by the organization that credentials experts. Each of these criteria are dependent upon and derived from the Internal Revenue Service Ruling 59-60, which was issued in 1959, and set forth an outline for valuing ownership interests in closely held businesses. This IRS ruling lists eight fundamental factors to consider, including:



- 1) The nature of the business and the history of the business since its inception
- 2) The condition and economic outlook of the industry and of the business
- 3) The asset/book value of the stock and the business' financial state
- 4) The earning capacity of the business
- 5) The company's capacity to pay dividends
- 6) Whether the business has intangible assets or intangible value, such as good will
- 7) The size of the block of stock in the business that must be valued, as well as information about past stock sales
- 8) The market price of a share of stock for similar corporations that are traded regularly or traded on public exchanges

Other standards which derived from this ruling are an attempt to provide further insight and guidance into how business valuation analysts approach their engagements. The following is a condensed overview of these organizations and their principles.

## **Uniform Standards of Professional Appraisal Practice (USPAP)**

Uniform Standards of Professional Appraisal Practice, henceforward referred to as USPAP, is one of the most widely used standards. USPAP standards date back to 1987 and were developed by the Appraisal Foundation to address the problems with real estate valuation that contributed to the 1980's Savings & Loan crisis. USPAP sets appraisal standards not just for business valuations, but also for real estate appraisals and other types of valuation engagements. Standards 9 and 10 of USPAP, which were last modified in 2000, are the standards that establish the guidelines for the valuation of a business.

Standard 9 of USPAP requires an appraiser, valuing a business or other intangible assets, to begin by identifying the problem and the scope of work to be performed. Rule 9-1 also includes a requirement that the appraiser should be aware of and correctly employ accepted appraisal methods. In other words, USPAP does not tell the appraiser exactly how to perform the appraisal, but instead outlines the use of a credible, recognized, and appropriate approach to business valuation.

Among other things, USPAP also requires the appraiser to:

- Identify the clients and users of the valuation
- Identify the effective date
- Identify relevant information on the character of the business
- Outline any extraordinary assumptions made in the valuation, and
- Detail the hypothetical conditions that were necessary in valuing the business

Standard 9 of USPAP also contains extensive provisions setting the outside parameters and establishing the general framework for how an appraiser is to value a business. Standard 10 focuses on requirements for the reporting of the appraisal.

The American Society of Appraisers, known as ASA, developed its standards in 1992 and, after USPAP standards, are the oldest accepted standards in business valuation. ASA standards were most recently revised in 2008.



## American Society of Appraisers (ASA)

Under the ASA requirements, an appraiser must gather, analyze, and adjust certain information relevant to valuing a business. This effort includes considering the following:

- The characteristic of the business and its ownership
- Restrictions on transfer of business ownership
- The history of the business as well as its future outlook
- Financial information from the past
- The assets and liabilities that belong to the business
- The nature of industries that could impact the business
- Economic factors that could impact the business
- Any information on market value in relevant markets including stock exchanges
- Prior transactions involving the business or its intangible assets, and
- Other information the appraiser determines relevant

Using the information collected, the appraiser should apply appropriate valuation methods to estimate the value of the business.

The Institute of Business Appraisers, hereafter the IBA, is the oldest professional society solely devoted to the appraisal of closely-held businesses. The IBA was established in 1978 and is a pioneer in business appraisal education and professional accreditation.

## Institute of Business Appraisers (IBA)

To uphold the core principles of the IBA, they established standards that its credentialed experts are required to follow. Professional judgment, an essential component of the valuation process, and IBA's standards, are beneficial to valuation professionals and clients alike. These standards provide general and ethical guidelines that help provide accurate and quality services from the analyst whilst providing a sense of security and trust. The standards set forth by the IBA require consideration of the following:

- Integrity and Objectivity
- Professional Competence
- Due Professional Care
- Understandings and Communications with Clients
- Planning and Supervision
- Sufficient Relevant Data
- Acts Discreditable
- Client Interest, and
- Financial Interest

The IBA also provides standards for other domains that uphold the integrity of a professional analyst in all aspects of the appraisal process. Development Standards and Reporting Standards secure reliable and unbiased services of consistency and quality in valuation reports performed by the IBA's professionals.



## National Association of Certified Valuation Analysts (NACVA)

The National Association of Certified Valuation Analysts, here on NACVA, established in 1990, supports the needs of certified public accountants and other business professionals to provide valuation and financial forensics consulting for business and intangible assets. As a growing association, NACVA and IBA merged on July 1, 2012 combining the pioneering ideas and theories of IBA with the progressive movement of NACVA creating a strong, quality-producing organization.

As per the collaboration, the standards that NACVA maintain are of the same as the IBA. As aforementioned, Development Standards and Reporting Standards are placed to cover all phases of the valuation process. The Development Standards are categorized as follows:

- General
- Expression of Value
- Reliability of Data
- Scope Limitations
- Use of Specialist
- Approaches and Methods
- Identification
- Fundamental Analysis, and
- Documentation

The Development Standards pertain to the valuator's approach, research, and development of an engagement. These principles help assure that the valuator analyzes the engagement in a non-bias matter, that the data provided is reliable, and the approaches and methods are in accordance with the case. The Reporting standards are responsible for the validity of a report when expressing a Conclusion of Value or a Calculated Value and to establish minimum reporting criteria. The Reporting Standards are considered as:

- General
- Contents of Report
- Summary Reports, and
- Litigation Engagements Reporting Standards

The American Institute of Certified Public Accountants, hereafter referred to as the AICPA, was established in 1887 and has 125 years of serving the public interest. It is the world's largest association representing accounting professionals, and has nearly 386,000 members in 128 countries around the world.

## American Institute of Certified Public Accountants (AICPA)

As with the IBA and NACVA, the AICPA revolves around the nucleic idea that the use of professional judgment is necessary to estimating value. AICPA professionals are to follow its standards when performing engagements to estimate value that culminate in the expression of a Conclusion of Value or a Calculated Value. The standards of the AICPA consider the following:

- Professional Competence.
- Nature & Risks of the Valuation Services and Expectations of the Client
- Objectivity and Conflict of Interest
- Conduct Independence and Valuation



- Establishing an Understanding with the Client
- Scope Restrictions or Limitations, and
- Using the Work of Specialists in the Engagement to Estimate

With the compliancy of the analysts, the AICPA Standards provide guidance for analysts to perform services that are considered fair, ethical, and competent.

## Conclusion

Although there are a number of credentialing organizations, each with their own standards, no one set of standards are exclusionary to the other. With so many available standards for valuing a business, the credibility of any valuation will depend upon the use of an accepted standard as well as the credentials of the professional who performs the valuation. The American Society of Appraisers, the Institute of Business Appraisers, the National Association of Certified Valuation Analysts, and the American Institute of Certified Public Accountants all maintain a stringent credentialing process.

Choosing a valuation expert with membership in an appropriate organization and experience in business valuation is essential to have the opinion of your expert respected. The valuation expert must exercise independent judgment and have no interest in the business that he/she is appraising. For attorneys, working with a credible opinion from an expert that follows professional standards is imperative. These standards put forth by the aforementioned credentialing organizations ensure that experts work with morals, ethics, validity, reliability, credibility, and knowledge in their analyses.

For more information on this topic please feel free to contact our office for assistance.

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