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# **INTERNAL REVENUE SERVICE BUSINESS VALUATION GUIDELINES**

## **1. INTRODUCTION**

The Engineering Program Handbook (IRM 4.3.16) states that accomplishment of the objective of the IRS Engineering Program requires on-going risk analysis, quality factual development and communication with taxpayers in an effort to resolve issues.

The purpose of this document is to provide guidelines applicable to IRS Valuation Engineers, Appraisers, Valuation Specialists and others engaged in valuation practice (hereinafter referred to as “Valuators”) relating to the development, resolution and reporting of issues involving business valuations and similar valuation issues. Valuators must be able to reasonably justify any departure from these guidelines. This document incorporates by reference, the Code of Conduct, applicable to all IRS employees, and all provisions of IRM 4.3.16 relevant to the development, resolution and reporting of such valuation issues.

## 2. DEVELOPMENT GUIDELINES

### 2.1. Planning.

- 2.1.1. The first step in a quality examination is the pre-examination planning process and cost/benefit or risk analysis. See Section 1.7 of IRM 4.3.16.
- 2.1.2. Valuators will adequately plan and their managers will supervise the staff involved in the valuation process.
- 2.1.3. Quality planning is a continual process throughout the valuation assignment.

### 2.2. Identifying.

- 2.2.1. In developing a valuation conclusion, Valuators must define the assignment and determine the scope of work necessary by identifying the following:
  - 2.2.1.1. Subject to be valued;
  - 2.2.1.2. Interest to be valued;
  - 2.2.1.3. Effective date of valuation;
  - 2.2.1.4. Purpose of valuation;
  - 2.2.1.5. Use of valuation;
  - 2.2.1.6. Standard of value;
  - 2.2.1.7. Premise or level of value;
  - 2.2.1.8. Assumptions;
  - 2.2.1.9. Limiting conditions;
  - 2.2.1.10. Scope limitations;
  - 2.2.1.11. Restrictions, agreements and other factors that may influence value;
  - 2.2.1.12. Sources of information.

### 2.3. Analyzing.

- 2.3.1. In developing a valuation conclusion, Valuators must obtain and analyze the relevant information necessary to accomplish the assignment, including:
  - 2.3.1.1. The nature of the business and the history of the enterprise from its inception.
  - 2.3.1.2. The economic outlook in general and the condition and outlook of the specific industry in particular.

- 2.3.1.3. The book value of the stock or interest and the financial condition of the business.
- 2.3.1.4. The earning capacity of the company.
- 2.3.1.5. The dividend-paying capacity.
- 2.3.1.6. Whether or not the enterprise has goodwill or other intangible value.
- 2.3.1.7. Sales of the stock or interest and the size of the block of stock to be valued.
- 2.3.1.8. The market price of stocks or interests of corporations or entities engaged in the same or a similar line of business having their stocks or interests actively traded in a free and open market, either on an exchange or over-the-counter.
- 2.3.1.9. Other information deemed to be relevant
- 2.3.2. The three generally accepted valuation approaches are the asset-based approach, the market approach and the income approach. Consideration should be given to all three approaches. Professional judgment must be used to select the approach(es) ultimately used and the method(s) within such approach(es) that best indicate the value of the business interest.
- 2.3.3. Historical financial statements should be analyzed and, if necessary, adjusted to reflect the appropriate asset value, income, cash flows and/or benefit stream, as applicable, to be consistent with the valuation methodologies selected by the Valuator.
- 2.3.4. The Valuator should select the appropriate benefit stream, such as pre-tax or after-tax income and/or cash flows, and select appropriate multiples to be consistent with the valuation methodologies selected.
- 2.3.5. The Valuator will decide upon the appropriate discount and/or capitalization rate after taking into consideration all relevant factors, such as:
  - 2.3.5.1. The nature of the business.
  - 2.3.5.2. The risk involved.
  - 2.3.5.3. The stability or irregularity of earnings.
  - 2.3.5.4. Other relevant factors.
- 2.3.6. As appropriate for the assignment, and if not considered in the process of determining and weighing the indications of value provided by other procedures, the Valuator should separately consider the following factors in reaching a final conclusion of value:
  - 2.3.6.1. Marketability, or lack thereof, considering the nature of the business, business ownership interest or security, the effect of relevant contractual and legal restrictions, and the condition of the markets;

- 2.3.6.2. Ability of the appraised interest to control the operation, sale, or liquidation of the relevant business;
- 2.3.6.3. Consistent with the standard of value in Section 2.2.1.6, other levels of value considerations, such as the impact of strategic or synergistic contributions to value; and
- 2.3.6.4. Such other factors which, in the opinion of the Valuator, are appropriate for consideration.

## **2.4. Workpapers.**

- 2.4.1. Workpapers must document the steps taken, techniques used, and provide the evidence to support the facts and conclusions in the final report. The workpapers must be organized and kept current throughout the examination, establishing a clear and concise audit trail.
- 2.4.2. Valuators will follow the mandatory workpaper auditing standards. They will ensure that workpapers are:
  - 2.4.2.1. Logically organized;
  - 2.4.2.2. Prepared to include a list or table of contents;
  - 2.4.2.3. Indexed;
  - 2.4.2.4. Bound or fastened (not loose);
  - 2.4.2.5. Labeled (i.e. Valuator, date, taxpayer and year);
  - 2.4.2.6. Neat and legible; and
  - 2.4.2.7. Stored on properly labeled and secured diskettes.
- 2.4.3. Valuators will maintain a detailed case activity record (Form 9984) which:
  - 2.4.3.1. Identifies actions taken and indicates time charged;
  - 2.4.3.2. Identifies contacts including name, phone number, subject, commitments, etc.; and
  - 2.4.3.3. Documents delays in the examination.
- 2.4.4. The case activity record, along with the supporting workpapers, should justify time spent is commensurate with work performed.

## **2.5. Reviewing.**

- 2.5.1. In reviewing a business valuation and reporting the results of that review, a Valuator must form an opinion as to the adequacy and appropriateness of the report being reviewed and must clearly disclose the nature of the review process undertaken.
- 2.5.2. In reviewing a business valuation, a Valuator must:

- 2.5.2.1. Identify the taxpayer and intended use of the Valuator's opinions and conclusions, and the purpose of the review assignment;
  - 2.5.2.2. Identify the report under review, the property interest being valued, the effective date of the valuation, and the date of the review;
  - 2.5.2.3. Identify the extent of the review process conducted;
  - 2.5.2.4. Form an opinion as to the completeness of the report under review within the scope of work applicable in the review assignment;
  - 2.5.2.5. Form an opinion as to the apparent adequacy and relevance of the data and the propriety of any adjustments to the data;
  - 2.5.2.6. Form an opinion as to the appropriateness of the valuation methods and techniques used and develop the reasons for any disagreement; and
  - 2.5.2.7. Form an opinion as to whether the analyses, opinions and conclusions in the report under review are appropriate and reasonable, and develop the reasons for any disagreement.
  - 2.5.2.8. In the event of a disagreement with the report's factual representations, underlying assumptions, methodology or conclusions, conduct additional fact-finding, research and/or analyses necessary to make corrections or revisions to arrive at a proper estimate of value.
- 2.5.3. In reviewing a business valuation, a Valuator should utilize a checklist, similar to the example attached to these guidelines, modifying as necessary to suit the specific assignment.

### **3. RESOLUTION GUIDELINES**

#### **3.1. Objective.**

- 3.1.1. The objective is to resolve the issue as early in the examination as possible. Credible and compelling work by the Valuator will facilitate resolution of issues without litigation.
- 3.1.2. The Valuator will determine who has authority to resolve issues within the taxpayer's organization and will discuss issues with the examiner or case manager prior to presenting findings to the taxpayer.
- 3.1.3. Managers of Valuators will be involved in resolving issues.

#### **3.2. Arriving at Conclusions.**

- 3.2.1. Once the Valuator has all the information to be considered in resolving the issue, the Valuator will use his/her professional judgment in considering this information to arrive at a conclusion.
- 3.2.2. Valuators may not have all of the information they would like to have to definitively resolve an issue. Valuators, therefore, must decide when they have substantially enough information to make a proper determination.
- 3.2.3. Valuators will employ independent and objective judgment in reaching conclusions and will decide all matters on their merits, free from bias, advocacy and conflicts of interest.



## 4. REPORTING GUIDELINES

### 4.1. Overview.

- 4.1.1. The primary objective of a valuation report is to provide convincing and compelling support for the conclusions reached.
- 4.1.2. Valuation reports should contain all the information necessary to ensure a clear understanding of the valuation analyses and demonstrate how the conclusions were reached.

### 4.2. Report Contents.

- 4.2.1. The type of report prepared depends on the needs of each case. See 1.7.7.1 of IRM 4.3.16.
- 4.2.2. Valuation reports should be well written, communicate the results and identify the information relied upon in the valuation process. The report should effectively communicate important thoughts, methods and reasoning, as well as identify the supporting documentation in a simple and concise manner, so that the user of the report can replicate the process followed by the Valuator.
- 4.2.3. Subject to the type of report being written, valuation reports should generally contain sufficient information relating to the items in Sections 2.2 and 2.3, above, to ensure consistency and quality of valuation reports issued by IRS Valuators.
- 4.2.4. Limited valuation reports written with respect to Section 2.5.2.8, above, shall contain, at a minimum, those items in Sections 2.2 and 2.3 necessary to support the revised assumptions, analyses, and/or conclusions of the Valuator.

### 4.3. Statement.

- 4.3.1. Each written valuation report must contain a signed statement that is similar in content to the following:

I am the person who has primary responsibility for the opinion of value contained in this report and attest that, to the best of my knowledge and belief:

- The reported analyses, opinions and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, impartial, unbiased professional analyses, opinions and conclusions.

- I have no present or prospective interest in the property that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- My compensation is not contingent on an action or event resulting from the analyses, opinions or conclusions in, or the use of, this report.
- My analyses, opinions and conclusions were developed, and this report has been prepared in conformity with the applicable Internal Revenue Service Valuation Standards

DRAFT  
Howard A. Lewis  
September 26, 2001

# INTERNATIONAL GLOSSARY OF BUSINESS VALUATION TERMS

## Exhibit BVG-1

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion, in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner that materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

American Institute of Certified Public Accountants  
American Society of Appraisers  
Canadian Institute of Chartered Business Valuators  
National Association of Certified Valuation Analysts  
The Institute of Business Appraisers

**Adjusted Book Value Method** – a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values (NOTE: In Canada on a going concern basis).

**Adjusted Net Asset Method** – see Adjusted Book Value Method.

**Appraisal** - see Valuation.

**Appraisal Approach** - see Valuation Approach.

**Appraisal Date** - see Valuation Date.

**Appraisal Method** - see Valuation Method.

**Appraisal Procedure** - see Valuation Procedure.

**Arbitrage Pricing Theory** – a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

**Asset (Asset-Based) Approach** - a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

**Beta** - a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

**Blockage Discount** - an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

**Book Value** – see Net Book Value.

**Business** - see Business Enterprise.

**Business Enterprise** - a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

**Business Risk** – the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See Financial Risk.

**Business Valuation** - the act or process of determining the value of a business enterprise or ownership interest therein.

**Capital Asset Pricing Model (CAPM)** - a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

**Capitalization** - a conversion of a single period of economic benefits into value.

**Capitalization Factor** - any multiple or divisor used to convert anticipated economic benefits of a single period into value.

**Capitalization of Earnings Method** – a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

**Capitalization Rate** - any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

**Capital Structure** - the composition of the invested capital of a business enterprise, the mix of debt and equity financing.

**Cash Flow** - cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

**Common Size Statements** – financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

**Control** - the power to direct the management and policies of a business enterprise.

**Control Premium** - an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise, to reflect the power of control.

**Cost Approach** - a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

**Cost of Capital** - the expected rate of return that the market requires in order to attract funds to a particular investment.

**Debt-Free** - we discourage the use of this term. See Invested Capital.

**Discount for Lack of Control** - an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

**Discount for Lack of Marketability** - an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

**Discount for Lack of Voting Rights** – an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

**Discount Rate** - a rate of return used to convert a future monetary sum into present value.

**Discounted Cash Flow Method** – a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

**Discounted Future Earnings Method** – a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

**Economic Benefits** - inflows such as revenues, net income, net cash flows, etc.

**Economic Life** - the period of time over which property may generate economic benefits.

**Effective Date** - see Valuation Date.

**Enterprise** - see Business Enterprise.

**Equity** – the owner's interest in property after deduction of all liabilities.

**Equity Net Cash Flows** - those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

**Equity Risk Premium** - a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

**Excess Earnings** - that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

**Excess Earnings Method** - a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See Excess Earnings.

**Fair Market Value** - the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "price" should be replaced with the term "highest price"}

**Fairness Opinion** – an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

**Financial Risk** – the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See Business Risk.

**Forced Liquidation Value** - liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

**Free Cash Flow** – we discourage the use of this term. See Net Cash Flow.

**Going Concern** - an ongoing operating business enterprise.

**Going Concern Value** - the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

**Goodwill** - that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

**Goodwill Value** - the value attributable to goodwill.

**Guideline Public Company Method** – a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business, and that are actively traded on a free and open market.

**Income (Income-Based) Approach** - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

**Intangible Assets** - non-physical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities and contracts (as distinguished from physical assets) that grant rights and privileges, and have value for the owner.

**Internal Rate of Return** – a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

**Intrinsic Value** – the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price or strike price of an option and the market value of the underlying security.

**Invested Capital** - the sum of equity and debt in a business enterprise. Debt is typically a) all interest bearing debt or b) long-term interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

**Invested Capital Net Cash Flows** - those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

**Investment Risk** - the degree of uncertainty as to the realization of expected returns.

**Investment Value** - the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is "Value to the Owner"}.

**Key Person Discount** - an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

**Levered Beta** - the beta reflecting a capital structure that includes debt.

**Limited Appraisal** – the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

**Liquidity** - the ability to quickly convert property to cash or pay a liability.

**Liquidation Value** - the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

**Majority Control** - the degree of control provided by a majority position.

**Majority Interest** - an ownership interest greater than 50% of the voting interest in a business enterprise.

**Market (Market-Based) Approach** - a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

**Market Capitalization of Equity** – the share price of a publicly traded stock multiplied by the number of shares outstanding.

**Market Capitalization of Invested Capital** – the market capitalization of equity plus the market value of the debt component of invested capital.

**Market Multiple** – the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

**Marketability** - the ability to quickly convert property to cash at minimal cost.

**Marketability Discount** - see Discount for Lack of Marketability.

**Merger and Acquisition Method** – a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

**Mid-Year Discounting** – a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

**Minority Discount** - a discount for lack of control applicable to a minority interest.

**Minority Interest** - an ownership interest less than 50% of the voting interest in a business enterprise.

**Multiple** - the inverse of the capitalization rate.

**Net Book Value** - with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

**Net Cash Flows** – when the term is used, it should be supplemented by a qualifier. See Equity Net Cash Flows and Invested Capital Net Cash Flows.

**Net Present Value** – the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

**Net Tangible Asset Value** - the value of the business enterprise's tangible assets (excluding excess assets and non-operating assets) minus the value of its liabilities.

**Non-Operating Assets** - assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is "Redundant Assets"}.

**Normalized Earnings** – economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

**Normalized Financial Statements** – financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

**Orderly Liquidation Value** - liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

**Premise of Value** - an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; e.g. going concern, liquidation.

**Present Value** – the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

**Portfolio Discount** - an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

**Price/Earnings Multiple** – the price of a share of stock divided by its earnings per share.

**Rate of Return** – an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

**Redundant Assets** – see Non-Operating Assets.

**Report Date** – the date conclusions are transmitted to the client.

**Replacement Cost New** – the current cost of a similar new property having the nearest equivalent utility to the property being valued.

**Reproduction Cost New** – the current cost of an identical new property.

**Required Rate of Return** – the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

**Residual Value** – the value as of the end of the discrete projection period in a discounted future earnings model.

**Return on Equity** – the amount, expressed as a percentage, earned on a company's common equity for a given period.

**Return on Investment** – see Return on Invested Capital and Return on Equity.

**Return on Invested Capital** – the amount, expressed as a percentage, earned on a company's total capital for a given period.



**Risk-Free Rate** – the rate of return available in the market on an investment free of default risk.

**Risk Premium** – a rate of return added to a risk-free rate to reflect risk.

**Rule of Thumb** – a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

**Special Interest Purchasers** – acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

**Standard of Value** – the identification of the type of value being used in a specific engagement; e.g. fair market value, fair value, investment value.

**Sustaining Capital Reinvestment** – the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

**Systematic Risk** – the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

**Tangible Assets** – physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

**Terminal Value.** see Residual Value.

**Transaction Method** - see Merger and Acquisition Method.

**Unlevered Beta** – the beta reflecting a capital structure without debt.

**Unsystematic Risk** – the risk specific to an individual security that can be avoided through diversification.

**Valuation** – the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

**Valuation Approach** – a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

**Valuation Date** – the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

**Valuation Method** – within approaches, a specific way to determine value.

**Valuation Procedure** – the act, manner, and technique of performing the steps of an appraisal method.

**Valuation Ratio** – a fraction in which a value or price serves as the numerator and financial, operating, or physical data serves as the denominator.

**Value to the Owner** – see Investment Value.

**Voting Control** – de jure control of a business enterprise.

**Weighted Average Cost of Capital (WACC)** – the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

# VALUATION REPORT CHECKLIST

## Exhibit BVG-2

### VALUATION REPORT CHECKLIST

Company: \_\_\_\_\_ Valuation Date: \_\_\_\_\_

Completed by: \_\_\_\_\_ Date: \_\_\_\_\_

This checklist can be used to assist internal accountants and analysts in preparing full written valuation reports that comply with professional requirements in those relatively rare cases when such reports are needed. The "Authoritative Reference" column cites the professional literature that requires each procedure. References preceded by "ASA" refer to *The Principles of Appraisal Practice and Code of Ethics* of the American Society of Appraisers. References preceded by "SR" refer to standards rules of the *Uniform Standards of Professional Appraisal Practice* of the Appraisal Foundation. "BVS" refers to BVS-VII, "Comprehensive Written Business Valuation Report," issued by the ASA Business Valuation Committee. "IBA" refers to Standard 5, "Formal Written Appraisal Reports" issued by the Institute of Business Appraisers. Analysts should consider the professional requirements that apply to their professions such as AICPA. An asterisk (\*) appearing in the "Authoritative Reference" column identifies an additional item recommended by the authors.

**INSTRUCTIONS:** Answer each question with a (✓) in the appropriate column: (a) Yes-item included in the report-, (b) No-item is applicable but is omitted from the report (any item checked "No" should be explained on the checklist or in a separate memorandum); or (c) N/A-the item is either not applicable or insignificant to the current engagement. A block (13) has been provided for each major disclosure caption. If the major caption is not applicable for this engagement, you may place a (✓) in the (13). Then it will not be necessary to check N/A for each question under the caption.

Authoritative Reference	PROCEDURE	Yes	No	N/A
	<b>GENERAL</b>			
*	1. Is the material in the report relevant and free of unnecessary boilerplate?			
*	2. Are all calculations mathematically correct?			
*	3. Do the data and analyses in the report lead logically to a well-supported conclusion?			
*	4. Does the report contain all relevant factors and data?			
*	5. Do the data and valuation methods used conform properly to the definition of value stated in the report?			
*	6. Is all technical jargon clearly defined?			
BVS and IBA	7. Does the report consider all the requirements relating to the circumstances of the engagement (IRS requirements, DOL Regulations, legal precedents, etc.)?			
	<b>INTRODUCTION</b>			<input type="checkbox"/>
	8. Is the following information disclosed:			
BVS and IBA	a. The client's name.			
ASA 8.1, BVS, IBA, and SR 10-	b. Subject company and ownership interest.			

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Authoritative Reference	PROCEDURE	Yes	No	N/A
<p>ASA 8.1, BVS, IBA, and SR 10-2</p> <p>ASA 8.2, BVS, IBA, and SR 10-2</p> <p>ASA 8.2, BVS, IBA, and SR 10-2</p> <p>ASA 8.2, BVS, IBA, and SR 10-2</p> <p>BVS, IBA, and SR 10-2</p> <p>BVS, 16A, and ASA 8.3</p> <p>ASA 8.1, BVS, IBA, SR 9-4, and SR 10-2</p> <p>ASA 8.1, BVS, IBA, SR 9-4, and SR 10-2</p> <p>ASA 8.1, BVS, ASA 8.3, BVS, and SR 10-2</p> <p>BVS</p> <p>BVS</p> <p>See Sec. 910</p> <p>See Section 910</p>	<p>c. Any special rights or restrictions relating to the subject interest.</p> <p>d. The valuation date.</p> <p>e. The purpose of the valuation.</p> <p>f. Definition of value used (fair market value, fair value, etc.).</p> <p>g. Report date.</p> <p>h. Sources of data used in the valuation.</p> <p style="text-align: center;"><b>COMPANY BACKGROUND</b></p> <p>9. Does the report provide general information about the company and its history? Such information may include:</p> <ul style="list-style-type: none"> <li>• Type of industry.</li> <li>• Products/services, markets, and customers.</li> <li>• Legal form.</li> <li>• State of incorporation.</li> <li>• Company history.</li> <li>• Company management.</li> <li>• Ownership (types of stock).</li> <li>• Competition.</li> <li>• Sensitivity to seasonal or cyclical factors.</li> <li>• Strengths and weaknesses.</li> </ul> <p>10. Does the report discuss relevant financial information about the company? Such information may include:</p> <ul style="list-style-type: none"> <li>• Financial condition, including major assets.</li> <li>• Profitability and earnings capacity.</li> <li>• Dividend-paying capacity.</li> <li>• Value of goodwill or other intangibles.</li> <li>• Transactions in the company's stock.</li> <li>• Outlook for the company.</li> </ul> <p style="text-align: center;"><b>FINANCIAL STATEMENT DATA</b></p> <p>11. Does the report include financial statement data that is relevant to the valuation?</p> <p>12. If the financial statement data was adjusted, are all the adjustments explained?</p> <p>13. If prospective financial information was used in the valuation:</p> <p style="margin-left: 20px;">a. Is that information presented in the report?</p> <p style="margin-left: 20px;">b. Are key underlying assumptions discussed?</p> <p>14. [CPAs <i>only</i>] If historical financial statements are presented, have AICPA requirements been met?</p> <p>15. [CPAs <i>only</i>] If prospective financial information is presented, have AICPA requirements been met?</p> <p><b>Practical Considerations:</b></p> <ul style="list-style-type: none"> <li>• A separate report on prospective financial information is only required for complete presentations intended for third-party use,</li> <li>• For partial presentations or internal use reports, the valuation report should include statements that prospective results may not be achieved and that the report is restricted to internal use (or specific named parties, if applicable).</li> <li>• Partial presentations should only be used for internal use or for parties with whom the company is directly negotiating.</li> </ul>			<p style="text-align: center;"><input type="checkbox"/></p> <p style="text-align: center;"><input type="checkbox"/></p>

Authoritative Reference	PROCEDURE	yes	No	N/A
<p>ASA 8.1, ASA 8.3, BVS, IBA, SR 9-4, and SR 10-2</p>	<p style="text-align: center;"><b>ECONOMIC AND INDUSTRY DATA</b></p> <p>16. Does the report discuss relevant economic and industry factors that affect the valuation? Such information may include:</p> <ul style="list-style-type: none"> <li>• National economic data.</li> <li>• Regional and local economic data.</li> <li>• Industry trends or financial data (including comparison to company data).</li> </ul>			
<p>IBA, SR 9-4, and SR 10-2</p> <p>ASA 8. 1, ASA 8.3, and SR 10-2</p>	<p style="text-align: center;"><b>SEARCH FOR COMPARATIVES</b></p> <p>17. Does the report discuss what steps were taken to search for comparative companies, the sources used, and the results of that search?</p> <p>18. If any comparatives were found, does the report provide relevant financial data for each comparative and discuss any adjustments made to that data?</p> <p>19. Is the report consistent with regard to:</p> <ul style="list-style-type: none"> <li>• a. Making similar adjustments for the subject company and comparatives?</li> <li>• b. Making appropriate adjustments to comparative data that relate to a time period that differs from subject company data?</li> </ul>			
<p>ASA 8.4, BVS, IBA, SR 9-5, and SR 10-2</p> <p>BVS, I BA, and ASA 8.4</p> <p>ASA 6.2, IBA, SR 10-1, and SR 10-2</p> <p>BVS, IBA, and SR 10-2</p>	<p style="text-align: center;"><b>VALUATION METHODS</b></p> <p>20. Does the report discuss all the relevant valuation methods that were considered in the engagement, which ones were selected, and the basis for that selection?</p> <p>21. Does the report provide a brief description of each method selected and how it was used?</p> <p>22. Are valuation calculations presented in enough detail that the reader can re-perform those calculations from the data given?</p> <p>23. Does the report explain how all key variables (discount rates, value multiples, etc.) were determined and used?</p> <p>24. Are risk factors relating to the subject company and ownership interest adequately analyzed, including their effects on variables?</p> <p>25. Is the report consistent with regard to:</p> <ul style="list-style-type: none"> <li>a. Applying valuation multiples to the proper parameter (earnings, net cash flow, etc.)?</li> <li>b. Applying discount or capitalization rates to the proper parameter?</li> </ul> <p>26. Does the report avoid mixing pretax and after-tax data where appropriate?</p>			□
<p>SR 9-5 and</p> <p>SIR 10-2 BVS, IBA, and SR 10-2</p>	<p style="text-align: center;"><b>VALUATION CONCLUSION</b></p> <p>27. Does the report discuss how the values indicated by the methods used were weighted to determine a final value estimate?</p> <p>28. If any adjustments for control, non-marketability, etc. were applied, does the report explain them and how they were determined?</p>			

Authoritative Reference	PROCEDURE	Yes	No	N/A
<b>ADDENDA MATERIAL</b>				
ASA 8.5, BVS, IBA, and SR 10-3	29. Does the report include a statement on the independence (or state why the accountant/analyst is not independent)?			
ASA 6-4, BVS, IBA, SR 10-1, and SR 10-3	30. Does the report include a list of the accountant/analyst qualifications?  31. Does the report contain a list containing the following assumptions and limiting conditions, where applicable: a. Reliance on information from management or others without verification. b. Restrictions on use of the report. c. Caveat that report is only valid for the date specified. d. Other matters unique to the engagement.			
BVS, IBA, and SR 10-3	32. If applicable, does the report include the certifications required by Uniform Standards of Professional Appraisal Practice? Practical Consideration: <ul style="list-style-type: none"> <li>• These certifications are only required if the accountant/analyst purports to have conducted the valuation and prepared the report in conformity with the <i>Uniform Standards of Professional Appraisal Practice</i>.</li> </ul> <p style="text-align: center;"><b>SIGNATURES</b></p>			13
ASA 8.8, BVS, IBA, and SR 10-2	33. Has the report been signed by the person who (a) performed or supervised the valuation and (b) assumes technical responsibility for it? Practical Consideration: <ul style="list-style-type: none"> <li>• If a CPA signs the firm's name on the report, then the report should disclose the name of the person responsible for the engagement.</li> </ul>			
ASA 8.8	34. If there are any collaborating appraisers who agree with the report's findings, have they also signed the report?			
ASA 8.8	35. If there are any collaborating appraisers who disagree with the report's findings, does the report include their dissenting opinions?			
<b>SPECIAL REPORTS</b>				
ASA 8.3	36. If this is a hypothetical valuation, does the report: a. Clearly indicate that the valuation is hypothetical? b. Explain why a hypothetical valuation was performed? c. State the assumed hypothetical conditions used?			
ASA 8.3	37. If this is a fractional valuation, does the report: a. Clearly indicate that the valuation is fractional? b. Provide restrictions on the report's use?			
ASA 8.3	38. If this is a preliminary report, does the report: a. Clearly indicate that the report is preliminary? b. Provide restrictions on the report's use?			