Business Valuation Review Engagements in a Family Law Context

Lisa H. Tran

In a family law context, the valuation analyst ("analyst") may be retained by legal counsel to review the valuation of a business, business ownership interest, or security prepared by another analyst. The review of another analyst's business valuation report requires an understanding of generally accepted business valuation practices, including an understanding of relevant business valuation standards and procedures. This discussion addresses the applicable professional standards that analysts consider when completing a review of a business valuation report and provides analyst guidance with regard to some of the more common inconsistencies or errors identified during a review engagement.

Introduction

In many litigated matters, and particularly in family law matters, the valuation analyst ("analyst") may be asked to review the opposing analyst's valuation analyses, report, and opinions. This is because, in a family law setting, the marital dissolution parties may have differing views as to the value of certain marital estate assets.

This discussion applies to situations when the marital estate includes a family-owned or other closely held business, business ownership interest, debt or equity security, or intangible asset such as the value of a closely held business ownership interest held within the marital estate.

The process of reviewing another analyst's valuation report is not limited to simply identifying possible calculation errors within the underlying analysis. Rather, the review of another analyst's valuation report requires the reviewer to:

1. adhere to applicable business valuation professional standards and procedures when conducting a review engagement and
2. determine if the opposing analyst's work was developed in a manner consistent with generally accepted business valuation professional standards and practices.

This discussion focuses on the process of a review engagement. This discussion provides analyst guidance with regard to the applicable standards analysts follow when completing such engagements. This discussion also provides examples of common inconsistencies or errors identified during a business valuation review engagement.

The Review Engagement

As presented in "A New Perspective of Business Appraisal Review," an appraisal review is the "process of developing and communicating an opinion about the quality of all or part of the work of another appraiser."[1]

In general, a review engagement is intended to provide information to the users of the subject business valuation about the credibility of the work under review.

Further, as promulgated by the National Association of Certified Valuators and Analysts ("NACVA"), a business valuation review is, "the act or process of developing and communicating a [NACVA] member's opinion regarding the credibility of the work product of another valuation analyst. It is a type of service, whether in written or oral form, intended to provide to identified users that the report is credible."[2]

For purposes of this discussion, the terms "appraisal review" and "business valuation review" are used interchangeably. Nonetheless, family law counsel should be aware that there are meaningful differences in the processes and procedures required by each valuation professional organization ("VPO") for review engagements.

Accordingly, when tasked with a review assignment, it is important for the analyst to understand the differences in the processes and procedures between the VPOs when performing a review assignment.

Litigation circumstances often drive the need for a review engagement (i.e., such as in a family law matter where there is a high level of distrust between the marital dissolution parties). Nonetheless, the motivation for a review assignment may be as simple as a client seeking a second opinion, or "comfort," regarding a business or security valuation that has already been completed.

Rather than hiring another analyst to complete a new valuation (resulting in a significant additional expense), it is often more efficient to obtain a review opinion regarding the completeness, accuracy, reasonableness, and credibility of the initial business valuation report.

Further, and specifically in a family law context, a review engagement may have several different "stakeholders." These stakeholders may include judges, legal counsel ("counsel"), clients, the marital dissolution parties, and regulatory bodies.

The analyst can provide value in a review engagement by providing relevant opinions to these stakeholders, who may not have the theoretical or technical training in business valuation but need to make significant decisions based on the reliability of the valuation (such as in determining appropriate spousal support and equalization payments).

As further presented in "A New Perspective of Business Appraisal Review," "Stakeholders in the appraisal process look to a reviewer to provide them with assurance the opinion provided by a valuation analyst is reliable."[3]

The following section provides an overview of the applicable business valuation professional standards related to a review engagement.

Applicable Standards for a Review Engagement

When an analyst is hired to perform a review engagement, the analyst should first be familiar with the applicable professional business valuation professional standards. In order to provide a credible review report, the analyst should follow the applicable review engagement professional standards for the development and reporting of the review analysis.

These business valuation professional standards include the following:

1. *Uniform Standards of Professional Appraisal Practice* ("USPAP") promulgated by The Appraisal Foundation
2. The professional standards promulgated by the NACVA
3. The Statement on Standards for Valuation Services No. 1 ("SSVS") promulgated by the American Institute of Certified Public Accountants ("AICPA")

The following sections summarize each of the business valuation professional standards related to a review engagement.

Uniform Standards of Professional Appraisal Practice

USPAP was developed by the Appraisal Standards Board of the Appraisal Foundation and is applicable for certain business valuations. Specifically, as presented in USPAP:

> In developing an appraisal review, an appraiser must identify the problem to be solved, determine the scope of work necessary to solve the problem, and correctly complete research and analyses necessary to produce a credible appraisal review.[4]

As presented above, USPAP Standard 3, Appraisal Review, Development is directed toward developing a credible opinion of the quality of another analyst's work. While USPAP Standard 3 addresses the content and level of information required in a report to communicate the results of a review engagement, this standard does not provide guidance with regard to the form, format, or style of an appraisal review report.

Rather, USPAP Standard 3 requires the analyst to understand and correctly employ the methods and techniques necessary to produce a credible appraisal review.

As presented in USPAP Standard 3:

> (b) When necessary for credible assignment results in the review of a report, the reviewer must:
>
> i. Develop an opinion as to whether the report is appropriate and not misleading within the context of the requirements applicable to that work; and

ii. Develop the reasons for any disagreement.

Comment: Consistent with the reviewer's scope of work, the reviewer is required to develop an opinion as to the completeness, accuracy, adequacy, relevance, and reasonableness of the report, given law, regulations, or intended user requirements applicable to that work.[5]

However, USPAP Standard 3 does provide guidance in the instances where the reviewer provides his or her own opinion of value or review opinion. As further presented in USPAP:

(c) When the assignment includes the reviewer developing his or her own opinion of value or review opinion, the following apply:

i. The requirements of STANDARDS 1, 5, 7, or 9 apply to the reviewer's opinion of value for the property that is the subject of the appraisal review assignment.

ii. The requirements of STANDARD 3 apply to the reviewer's opinion of quality for the work that is the subject of the appraisal review assignment.[6]

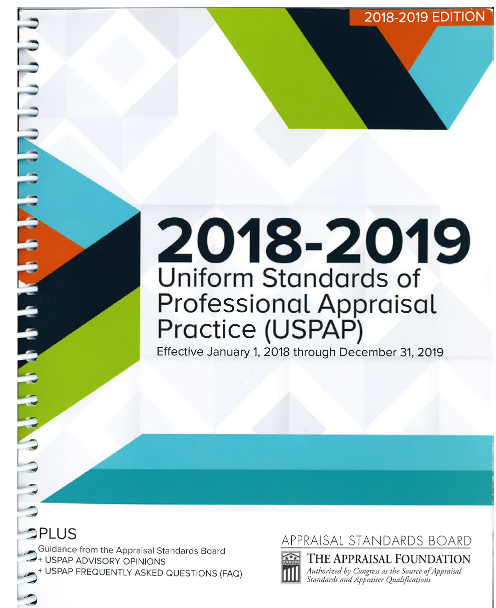
While there are additional USPAP requirements for when the reviewer develops his or her own opinion of value or review opinion, the reviewer is not required to explicitly replicate the steps completed by the original appraiser. Rather, those items in the report under review that the reviewer deems credible can be included in the reviewer's development process as an extraordinary assumption.

This means that, in a review engagement, the review report should only include the analysis and discussion related to those items for which there is any disagreement between the original analyst and the reviewer.

National Association of Certified Valuators and Analysts

NACVA is a VPO that has trained over 35,000 certified public accountants, and other business valuation and consulting professionals, in the fields of business valuation, financial litigation, and various other specialty services.

Standard VI—Business Valuation Review—of the Professional Standards promulgated by the NACVA ("NACVA Standard VI")[7] is applicable to review engagements where the subject interest is a business, business ownership interest, security, or intangible asset.



Based on NACVA standards, as previously mentioned, a business valuation review is intended to determine the credibility of the work product of another valuation analyst.

As presented in NACVA Standard VI:

The scope of a Business Valuation Review should be sufficient to provide a [NACVA] member a basis for rendering a credible Business Valuation Review opinion regarding the relevance, reliability, completeness, and reliable application of the business valuation methodology under review, and its consistency with generally accepted valuation practices.[8]

Further, while a NACVA business valuation review opinion is not a conclusion of value or calculated value, the analyst should understand that additional standards apply should the analyst provide an opinion other than whether the work under review is misleading or not misleading.

As presented in NACVA Standard VI:

The General and Ethical standards apply to all professional services performed by [NACVA] members.

(1) Under these Review Standards, if the [NACVA] member provides a Conclusion of Value or Calculated Value as a part of the Review of another valuation analyst's work, the member must follow NACVA's General Business Valuation Standards as outlined in paragraphs III. through V. above. In the context of preparing the Conclusion of Value or Calculated Value, the Litigation Engagement Reporting Standards as outlined in (paragraph V. D.) applies.

(2) If the [NACVA] member does not provide a Conclusion of Value or Calculated Value as part of the Business Valuation Review, the [NACVA] member need

> only provide an opinion, including the basis and reason for the opinion, as to whether the report under review is appropriate and not misleading within the context of the requirements applicable to that work, stating the reasons for any disagreement, following the Review Standards below.

Based on the NACVA standards (and somewhat similar to USPAP), the reviewer should provide an opinion, and support for said opinion, regarding whether the valuation under review is appropriate, reasonable, and not misleading. The review opinion can be presented in either a written report or an oral report.

And, as previously mentioned, the reviewer should opine whether the valuation under review is appropriate within the context of the requirements applicable to that valuation. The reviewer should also state and develop reasons for any disagreement with the business valuation under review, and follow the appropriate NACVA reporting standards for a review engagement.

American Institute of Certified Public Accountants

SSVS[9] provides guidance with regard to business valuations performed by members of the American Institute of Certified Public Accountants. However, if an AICPA member performs a review engagement, but does not develop an independent value conclusion or independent calculation of value, SSVS is not applicable.

SSVS does not cover review engagements and does not have a provision similar to USPAP Standard 3 or to NACVA Standard VI.

This means that an AICPA member may review an analyst work product (or business valuation) without adherence to SSVS. This review, without adherence to SSVS, can include the review of items such as the sources of information, business valuation approaches and methods, mathematical issues and calculations, logical inconsistencies, or clarity issues presented in the original analyst work product.

The AICPA member may provide corrected values resulting from the correction of any errors identified during the review process. However, "if the CPA also concludes that the corrected values represent the CPA's value conclusion, SSVS would apply."[10]

This means that if the analyst provides any suggested changes to the indications of value included in the original analyst report, then the analyst is required to follow (and comply with) SSVS. Said another way, SSVS would apply if the CPA develops a value conclusion that is presented as his or her opinion of value.

Review Engagement—The Process

Based on the guidance previously presented, when conducting a review engagement, the analyst should determine whether the work product under review provides a credible and reliable opinion of value that is consistent with generally accepted business valuation practices and procedures.

Generally, valuation stakeholders base the credibility of a business valuation, in part, on consideration of the inclusion of all known facts and circumstances as of the analysis (or valuation) date.

Credibility is understood to relate to the connection between:

1. the opinion of value and
2. the relevance, completeness, and application of generally accepted business valuation methodology.

For example, the elements of a credible opinion may include the following:

1. Adequate disclosure
2. Completeness
3. Nonadvocacy
4. Relevance
5. Reliability
6. Transparency

The reviewer should consider whether the business valuation under review presents or considers all material known facts and circumstances related to the applied valuation process. Further, the business valuation report should include sufficient relevant disclosures that help stakeholders understand the foundation for the original analyst's valuation conclusions.

In a review engagement, there are many questions the reviewer should be considering.

Did the original analyst include and assess all facts and circumstances known without limitation or exclusion? Are the data, assumptions, and supporting explanations in the valuation report presented in sufficient detail for a reader (i.e., stakeholder) to understand and duplicate the process?

Are the assertions, assumptions, and estimates included in the valuation report considered credible (i.e., logical and reasonable)? What was the original analyst's objective in formulating his or her opinion? Does the particular standard, method, or procedure form a supportive basis for the analyst's valuation opinion? Were the methods used in the valuation report appropriately applied?

The reviewer analyst should consider whether the approaches and methods applied in the business valuation were relevant to the objective and purpose stated in the valuation. This is because the reviewer's goal is to establish whether the original analyst appropriately performed the analysis based on the requirements of the engagement, including the stated purpose, standard of value, valuation date, and intended use.

In applying this "credibility" framework, the reviewer can appropriately scrutinize the original valuation report to determine if the valuation process undertaken resulted in a credible and reliable opinion of value.

As mentioned previously, the reviewer analyst should also develop and properly identify any reasons for disagreement with the original valuation report. When conducting a review engagement, the reviewing analyst should "identify and articulate the components of a valuation report that (1) require additional support, (2) are inherently inconsistent, (3) lack relevance to the purpose of the engagement, [and] (4) have an impact on credibility."[11]

Some of the methods and techniques that can assist the reviewer analyst in providing an appropriate, defensible business valuation review are presented below.

Review Engagement—The "Checklist"

In performing a review engagement, it is helpful for the analyst to understand the structure and content of a business valuation report. This understanding will provide the reviewing analyst with a "road map" of potential areas of inconsistency or error.

The narrative business valuation report typically contains a number of sections. These sections often include the following:

- A description of the subject business interests and the effective analysis (valuation) date
- The purpose and objective of the engagement
- The standard of value
- A description of the subject company and an analysis of historical and projected financial operating results
- A discussion of relevant industry and economic conditions
- A discussion of generally accepted business valuation approaches and methods
- A discussion of the selection and application of relevant business valuation approaches and methods
- A discussion of the value conclusion, including discussions of relevant valuation adjustments (e.g., control premium or discount for lack of control, discount for lack of marketability, blockage discount, key person discount, etc.)

Additionally, and consistent with most generally accepted business valuation standards, a business valuation report typically includes information such as the following:

1. The analyst's credentials
2. Assumptions and limiting conditions
3. An analyst's certification or representation

Based on the numerous components incorporated in a typical valuation report (such as those previously mentioned), a review "checklist" can serve as a useful tool when the analyst is engaged in a review assignment.

A review checklist can assist the reviewer in assessing the validity of the original analyst's report and reliability of the corresponding conclusions. It can also assist the reviewer in establishing whether

the report identifies and defines the components of the valuation analysis in an appropriate manner.

The following list presents some categories that the analyst can consider when reviewing a valuation report. The list is presented in a manner consistent with the order that a reviewer may expect to find the related information in a narrative valuation report.

- Definition of the valuation assignment
  - Definition of the subject property/entity (including the size of the subject ownership interest)
  - Purpose and objective of the valuation assignment
  - Standard of value
  - Characteristics of ownership (including control and marketability characteristics)
- Premise of value
- Effective date of the valuation and date of the valuation report
- Sources of information
  - Site inspection and interview
  - Company financial statements
  - Information known or knowable as of the valuation date
  - Past transactions
- Description of the subject company
  - Capitalization and ownership
  - Company background and operations
- Economic and industry data and analysis
- Analysis and adjustment of company financial statements
- Comparative ratio analysis
- Income approach and methods
  - Discounted cash flow method
  - Capitalization of net cash flow method
- Market approach and methods
  - Guideline publicly traded company method
  - Guideline merged and acquired company method
- Asset-based approach and methods
  - Asset accumulation method
  - Adjusted net asset value method (applying the capitalized excess earnings method)
- Valuation adjustments (discounts and premiums)
- Synthesis and conclusion
  - Overall assessment
  - Comprehensiveness
  - Accuracy
  - Coherence and cohesion
  - Internal consistency
  - Incisiveness
- Signature of the analyst or the analyst's firm
- Analyst's curriculum vitae
- Analyst's certification or representation
- Contingent and/or limiting conditions or assumptions

Further, the original valuation report may include specific definitions of terms, formulas, and standards of value, as they may vary based on the original assignment. Overall, the valuation report should be well documented, easily understood, and include sufficient information about the source materials considered.

This means that the valuation report should be adequately documented such that another qualified analyst—in this case the reviewer—would be able to locate the identified source materials and replicate the analysis included in the original valuation report.

Chapter 19 of *Valuing a Business*[12] and Chapter 25 of *The Lawyer's Business Valuation Handbook*[13] also present detailed checklists that can be considered for the purpose of reviewing a business valuation report. When using these checklists, it is important that the reviewer understands that not every item on these checklists will be applicable or relevant to every valuation engagement.

There may be items relevant to the original valuation report that are not included in the above checklists. This can sometimes include certain information that can only be found in the original analyst's work papers, or through a due diligence interview with the original analyst.

Applicable Standards for a Valuation Engagement or a Calculation Engagement

Obviously, one important aspect of a review assignment is establishing whether the valuation analysis and report were developed consistent with applicable business valuation professional standards.

The original valuation should clearly state what professional standards were applied in the development of the opinion of value and the report. These may include standards presented in USPAP, SSVS, or NACVA standards (as previously mentioned), or

American Society of Appraisers ("ASA") standards with regard to business valuation development and reporting.

Based on these applicable business valuation standards, the engagement will typically be either a valuation engagement or a calculation engagement. Further, and based on these applicable business valuation standards, the format of the written valuation report may be one of the following:

1. A detailed valuation report
2. A summary or restricted valuation report
3. A calculation valuation report

The original valuation report, based on these applicable business valuation standards, should identify the type of engagement and/or the type of report issued. This is one example of what the reviewing analyst should confirm when being retained on a review engagement (i.e., the reviewing analyst should confirm that the type of engagement is documented in a manner that complies with the business valuation professional standards applicable to that engagement, and the format of the original valuation report).

In a valuation engagement, the analyst selects and uses the valuation approaches and methods deemed to be appropriate to arrive at a reasonable conclusion of value with regard to the valuation subject company. The conclusion of value resulting from a valuation analysis may be presented in a detailed report or a summary/restricted report.[14]

The presentation of a valuation conclusion in a detailed report or a summary report typically is based on "the level of reporting detail agreed to by the analyst and the client."[15]

If the subject of the review is a valuation engagement report, the following professional standards related to a valuation engagement report may apply:

1. NACVA Professional Standards: II, General and Ethical Standards; II, Scope of Services (B)(1) Valuation Engagement; IV, Development Standards; and V, Reporting Standards (C)(1) Contents of Report for detailed reports and (C)(2) Contents of Report for summary reports
2. SSVS Section .21(a); Sections .23 through .45, for valuation engagements; Sections .48 (a) and (b); Sections .51 through .70, for detailed valuation engagement reports; and Sections .71 and .72, for summary valuation engagement reports
3. USPAP: Standards 9, Business Appraisal, Development, and Standard 10, Business Appraisal Reporting; specifically, Standard 10-2(a) for a detailed report and Standard 10-2(b) for a summary/restricted report
4. ASA: BVS-1, General Requirements for Developing a Business Valuation, and BVS-VIII, Comprehensive Written Valuation Report

In a calculation engagement, the analyst and the client agree up-front on the valuation approaches and methods to be used, along with the extent of the procedures to be performed in the engagement. A calculation engagement results in a calculation of value and is presented in a calculation report.

If the subject of the review is a calculation engagement report, the following professional standards related to a calculation engagement report may apply:

1. NACVA Professional Standards: II, General and Ethical Standards; III, Scope of Services (B)(2) Calculation Engagement; IV, Development Standards; and V, Reporting Standards (C)(3) Contents of Report for calculation reports
2. SSVS Section .21(b); Section .46, for calculation engagements; Section .48(c); and Section .73 through Section .77, for calculation reports

It is important to note that neither USPAP professional standards, nor ASA professional standards, have an alternative to a valuation engagement such as a calculation engagement.

Next, this discussion provides common errors and inconsistencies that the reviewing analyst can look for when conducting a review engagement.

Computational Errors

Many errors committed in a business valuation engagement are the result of:

1. a lack of understanding regarding business valuation principles and procedures or
2. the improper application of business valuation approaches and methods.

However, a reviewer has the responsibility to establish that the work under review is not only credible, but also free of computational errors.

Computational or mathematical errors generally fall in the category of:

1. mathematical calculation errors and
2. incorrect formulas.

While mathematical calculation errors are relatively self-explanatory, with the extensive use of computerized, linked worksheets to complete business valuations (such as Microsoft Excel), errors often result when worksheets are not properly linked or formulas are modified without subsequent confirmation and verification.

Incorrect formula errors seems to have increased significantly over the last several decades due to the increased use of these computerized, linked worksheets. This can present a relatively simple and direct critique by the reviewing analyst.

Additional human errors occur simply as a result of inputting incorrect numbers retrieved from third-party source documents (e.g., subject company financial information or publicly obtained documents).

A thorough review engagement includes the recalculation of all amounts and values presented in the subject report, including:

1. footing (summing vertically),
2. cross-footing (summing horizontally),
3. cross-referencing (confirming the consistency of amounts produced in multiple places), and
4. recalculating amounts and the value indications presented in the original report attached exhibits and schedules.

Proper Application of Generally Accepted Business Valuation Practices and Procedures

The specific valuation approaches, methods, and procedures applied to value a business will vary based on the facts and circumstances specific to each engagement. However, the basic principles of business valuation generally remain constant.

All other factors remaining the same, the use of generally accepted business valuation approaches, methods, and practices by multiple analysts should result in reasonably reconcilable conclusions of value for a subject company. This, of course, assumes (in part) that the following are the same:

1. Subject company
2. Definition of the assignment
3. Standard of value and premise of value
4. Valuation date
5. Access to the subject company information
6. Industry and economic conditions

Adherence to, and application of, generally accepted business valuation approaches, methods, and procedures provides a reasonable expectation of consistency in an analyst's work product. This consistency enables a reviewer to complete the review process in an orderly and time-efficient manner, using the applicable business valuation standards as a guide.

However, in many review assignments, it is important to note that the primary errors identified typically relate less to computational errors and more to inconsistencies in the application of standard business valuation practices and procedures.

The following section provides seven examples of common theoretical inconsistencies committed by analysts when preparing a valuation report.

Common Inconsistencies

First, in using the income approach, either the discounted cash flow ("DCF") method or the direct capitalization method, the analyst may inappropriately mismatch the discount rate and the expected earnings. Based on generally accepted business valuation standards and procedures, the discount rate should match conceptually to the definition of the normalized income (e.g., net cash flow) being discounted.

Further, the analyst may use the weighted average cost of capital to discount net cash flow to invested capital investors (i.e., debt and equity stakeholders) and the equity discount rate to discount net cash flow to equity investors.

Second, if the analyst does not understand that there are distinct conceptual differences between (1) the income approach, DCF method, and (2) the income approach, direct capitalization method, he or she may incorrectly apply these methods to the valuation analysis.

In general, the direct capitalization method is the relevant valuation method used within the income approach to value a company with stable, nonvolatile earnings (i.e., cash flow) and stable, nonvolatile earnings growth.

Conversely, the DCF method is typically the relevant valuation method for valuing a company with inconsistent earnings (i.e., cash flow) and/or inconsistent earnings growth.

Third, in the valuation of some closely held businesses within a family law context, an adjustment for executive compensation may be appropriate.

According to Internal Revenue Service Revenue Ruling 68-609, "If the business is a sole proprietorship or partnership, there should be deducted from the earnings of the business a reasonable amount for services performed by the owner or partners engaged in the business."

This can be an issue for the analyst as shareholder executives of successful closely held companies sometimes pay themselves compensation in excess of indicated, market-based compensation for the services rendered. If this executive compensation is not appropriately adjusted by the analyst, the indicated value of the subject company may be understated.

Conversely, in development-stage or unprofitable companies, shareholder executives may pay themselves below-market compensations. Failure to properly adjust this executive compensation could result in a business value that is overstated as a result of the understated operating expenses (and the resulting overstatement of earnings, leading to an indicated higher value).[16]

Fourth, some private companies may own assets that are not used in their core operations. If nonoperating assets are given separate consideration, any income generated, or expenses incurred, with regard to the nonoperating assets should be separated from the earnings (i.e., cash flow) used to complete an income-based valuation method of the subject company.

Sometimes, an analyst may separate the nonoperating assets from the overall value of the business but incorrectly include the income generated by these nonoperating assets in the earnings (i.e., cash flow) used to value the subject company, thereby artificially inflating the value conclusion.

Fifth, some analysts mistakenly believe that asset-based approach methods can be used only under a liquidation premise of value. In actuality, and based on generally accepted business valuation standards and practices, the asset-based approach can be used with all premises of value—that is, from a going concern premise of value to a liquidation premise of value.

However, the analyst should be aware that when applying the asset-based approach under a liquidation premise of value, the subject interest to be valued should have the ability (i.e., control) to liquidate the underlying assets of the subject company.

For example, as presented in the textbook *Guide to Business Valuations*:

> If the consultant plans to value a partial interest in the subject company using the NAV [asset-based approach, net asset value] method, there is another important consideration. The subject ownership interest should be able to cause the sale of the company's assets. Accordingly, the NAV method is more appropriate for valuing controlling interests than for minority interests.[17]

Sixth, when applying the different valuation methods, it is important for an analyst to understand the level of value indication each method initially produces, and whether the ultimate goal of the valuation analysis is to produce a controlling or noncontrolling level of value.

An income approach method can produce either a controlling or a noncontrolling indication of value depending on the earnings level, or cash flow, incorporated within the DCF analysis. Comparatively, the guideline publicly traded company method typically concludes a noncontrolling level of value, while the merged and acquired company method and the asset-based methods typically conclude values on a controlling interest basis.

When the analyst ultimately reconciles the indications of value resulting from each of the different valuation methods applied, it is required that the value indications are synthesized on a common basis, whether it be controlling or noncontrolling.

Seventh, when completing a business valuation, the analyst may be tempted to use hindsight as direct evidence of value. That is, the analyst may be tempted to consider events that occur subsequent to the effective valuation date in the analysis of the subject company. Consideration of subsequent events and related information, which is not known or knowable as of the effective valuation date, is typically inconsistent with developing a relevant value opinion as of a specific analysis (or valuation) date.

As presented in the *International Glossary of Business Valuation Terms*, and reproduced verbatim in SSVS, the "effective date," also referred to as the "valuation date" or the "appraisal date," is "the specific point in time as of which the valuator's opinion of value applies."[18]

Within the valuation profession, achieving the appropriate valuation objective established in an engagement is contingent on consideration of information that is known or knowable as of the effective valuation date.

However, certain valuation standards do indicate that an analyst may consider a subsequent event (i.e., an event occurring after the effective valuation

“It is a rare instance when a subject company and each of the selected guideline companies are identical based on their operating characteristics and financial performance.”

date) if the event was reasonably known or knowable as of the valuation date, and if the event occurs within a reasonable time frame relative to the effective valuation date.

Reasonableness of Assumptions and Conclusions

In conducting a review engagement, the analyst should always consider the reasonableness and appropriateness of the assumptions, adjustments, and conclusions presented in the valuation report.

For example, when applying the market approach, guideline publicly traded company method, is it reasonable to apply the average or median indicated guideline company multiples to the fundamentals of the subject company? The quick answer to the above question is typically no, for a number of reasons.

Simply relying on the average or median guideline company multiples without performing a comparative analysis between (1) the subject company and (2) each of the selected guideline companies implies that the subject company is identical to the guideline companies, which generally is not a reasonable assumption.

It is a rare instance when a subject company and each of the selected guideline companies are identical based on their operating characteristics and financial performance.

Another area where an analyst can easily err is in the estimation of the expected income (i.e., cash flow) that is applied in the income approach, direct capitalization method. Sometimes, an analyst will simply rely on the average of historical financial results to estimate the subject company expected future earnings/cash flow.

However, income approach methods used in business valuation are forward looking in nature. Relying on average historical operating results to estimate the future value of a subject business could severely overstate, or understate, the indicated value of the business.

By (1) completing a thorough review of the subject company’s past operating results and (2) considering prospective operating results for the subject company in light of expected industry and economic conditions, the analyst can establish a reasonable, credible foundation for estimating a normalized earnings (i.e., cash flow) level for the subject company over the long-term.

Further, once a value for the subject company has been estimated, the analyst can test the reasonableness of the value conclusion by reviewing the implied range of values derived from the various valuation methods employed. If properly applied and based on reasonable assumptions, the valuation methods used should ideally produce a relatively narrow range of values for the subject company.

If the different valuation methods applied result in material difference in the individual value indications, a review and potential modification of assumptions incorporated in the valuation process likely is warranted.

Lastly, the analyst can test the reasonableness of the overall value conclusion of a subject company by calculating certain implied valuation pricing multiples. These valuation pricing multiples for the subject company implied by the overall value conclusion should compare reasonably to identical pricing multiples for the selected guideline companies.

Said another way, the implied valuation or pricing multiples based on the overall value conclusion for the subject company should compare reasonably to the same pricing multiples for the selected guideline companies.

Preparing a Review Report

The final step in a review engagement is for the analyst to communicate the results of the review analysis. A valuation review report communicates these results.

According to NACVA standards, the reviewer’s findings and conclusions should be stated in the form of an opinion. According to NACVA Standard VII and USPAP Standard 3, when developing a valuation review and a written or oral valuation review report, the analyst should identify the following:

1. The client or intended user
2. The intended use of the opinion
3. The purpose of the appraisal review
4. The work under review and the characteristics of that work (ownership interest, valuation date, the original analyst, etc.)
5. Any extraordinary assumptions and hypothetical conditions necessary in the review
6. The scope of work necessary to produce a review in accordance with the scope of work rule

The analyst should also identify the characteristics of the property, or market area, in the work under review.

The review report content and level of information should be specific to the needs of the client and the intended users (i.e., stakeholders), the intended use, and the requirements applicable to the review engagement. The reporting requirements in USPAP Standard 3 (as previously discussed) represent the minimum level of information for a review report.

The analyst should supplement the report with information sufficient enough for the intended users (i.e., stakeholders) to fully understand the review report and the review report conclusions. Such additional information may include the disclosure of research and analysis performed, and research and analysis that was not performed.

Once the analyst has identified sufficient information regarding the work under review and the research and analysis performed, he or she should state his or her opinion and conclusions about the work under review, including the basis for the opinion offered.

As previously discussed, in stating his or her opinion, the review analyst should appropriately identify, explain, and document the reasons for any disagreement with the report under review.

Conclusion

Many business valuation report errors can be avoided if generally accepted business valuation standards and procedures are properly applied. Neglecting to do so can open up the analyst to credibility critiques should the business valuation report be reviewed by another analyst.

In performing a review engagement, the reviewer should:

1. follow applicable business valuation standards and procedures in conducting the review engagement and
2. determine if the opposing analyst's work was developed in a manner consistent with generally accepted business valuation practices and applicable standards.

As a result, it is important for the reviewer to understand the review engagement process and relevant standards in order to effectively serve clients (i.e., stakeholders) in a family law context.

Notes:

1. Francisco Rosillo, "A New Perspective of Business Appraisal Review," *Valuation Strategies* (January/February 2011).
2. National Association of Certified Valuators and Analysts *Professional Standards*, Standard VI (B).
3. Ibid.
4. Standard 3 in 2018-2019 *Uniform Standards of Professional Appraisal Practice* (Washington, D.C.: The Appraisal Foundation, 2018).
5. Ibid.
6. Ibid.
7. Statement on Standards for Valuation Services No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*, VS Sec. 100 (New York: American Institute of Certified Public Accountants, 2007), Standard VI.
8. NACVA *Professional Standards*, Standard VI (B).
9. Ibid.
10. Jay E. Fishman, Shannon P. Pratt, James R. Hitchner, and J. Clifford Griffith, *PPC's Guide to Business Valuations*, 28th ed. (Carrollton, TX: Thomson Reuters, 2018), 1-8.
11. Rosillo, "A New Perspective of Business Appraisal Review."
12. Shannon P. Pratt, "Reviewing a Business Valuation Report" (Chapter 22) in *Valuing a Business: The Analysis and Appraisal of Closely Held Companies*, 5th ed. (New York: McGraw-Hill, 2008), 535–544.
13. Shannon P. Pratt, "Chapter 25—Checklist for Reviewing a Business Valuation Report," *Business Valuation Review* 28, no. 2 (Summer 2009): 100–119.
14. A summary report presents the conclusion of value in a shortened, summarized version of a detailed report.
15. SSVS, VS Sec. 100, Section .48(b).
16. It is important to note that, in general, adjustments for executive compensation typically are made only when valuing controlling ownership interests. This is because only the controlling executive shareholder has the ability to adjust executive compensation.
17. Fishman, et al., *PPC's Guide to Business Valuations*, 28th ed., 7-2.
18. Ibid., *International Glossary of Business Valuation Terms*.

Lisa Tran is a vice president in the Portland, Oregon, practice office. Lisa can be reached at (503) 243-7510 or at lhtran@willamette.com.