

ASA CANDIDATE BV REPORT REVIEW CHECKLIST

of Basic Report Requirements and General Report Quality

This checklist offers convenient criteria for reviewing business, professional practice or intangible asset appraisal reports submitted as part of the ASA advancement procedure. It is intended to help you evaluate the appraisal report you will submit to the Board of Examiners, and it will be used by an examiner in reviewing your report work product. Not all elements on the checklist are required or appropriate for every appraisal report. This checklist is applicable **only** to the ASA advancement process and is **not** intended to be used for any other purpose. However, for purposes of demonstrating your appraisal expertise, we suggest that you select appraisals that include many of the elements covered in this checklist.

The checklist was developed by modifying Dr. Shannon Pratt's "Quick Review Checklist" as published in *Judges & Lawyers Business Valuation Handbook*. Please note that certain items are identified as "Pass/Fail" items. For the purpose of the ASA accreditation, any report that fails to pass one of these particular elements will be rejected immediately, regardless of the quality of the rest of the report.

In order to successfully meet the report review criteria, the report submitted must be:

1. A comprehensive business valuation report;

Please note that as of January 1, 2008:

The report submitted must contain the use of both the income AND the market approaches in the same report (this must be in a report of an operating business, not of a holding company, FLP or intangible asset valuation). Based on the facts and circumstances, it is up to the candidate as to which method(s) within each those approaches that is used (e.g., merger and acquisition or guideline public company methods under the market approach, or the capitalization or discounted future income methods under the income approach). However, the report must contain at least one method under each of those two approaches.

Please note that since January 1, 2006 FLP or LLC "discount" reports are not accepted by the BV International Board of Examiners.

It is preferred by the ASA that the submitted report be copies of actual reports prepared for an actual client, and it is required that the Candidate be the primary preparer (substantially responsible) of the report. It is recognized by the ASA that a Candidate may work in a practice area or for a company or government agency where there is a policy or firm report format that specifically precludes the inclusion of one or more of the pass/fail items noted below in appraisal reports. In such a case, the Candidate is allowed to expand the original report to make it a demonstration report. A *demonstration report* is a report prepared by the Candidate, for an actual client, that has been expanded to include items required by the ASA that were not included in the original report because of a company policy. If a Candidate submits a demonstration report, then he or she must clearly indicate that it is a demonstration report and state why a demonstration report is being submitted, including the company policies that limited the completeness of the report.

This checklist provides flexible guidelines to the standard elements often contained in a complete valuation report. Nonetheless, the report writer must recognize that the process of reviewing an appraisal report is, like business valuation itself, more an art than a science; hence, any one report may and will be scored differently by different reviewers.

The comment section at the end of this checklist provides the report writer with targeted feedback on issues of importance to the reviewer. Therefore, the comment section of this checklist is an integral part of the review process and should be studied closely by the report writer.

Candidates are required to fill out page references for each gradeable item listed throughout this checklist. If the component is not applicable to your report, please so indicate by writing “n/a.” (Please note that the graders reserve the right to make the final determination as to whether any particular component is applicable.)

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IDENTIFICATION OF PROPERTY

| | | | |
|-------|------|------|---|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Name of company (and DBA if applicable) |
| _____ | | | _____ State of incorporation or registration |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Form of ownership (e.g., C corp., S corp., limited partnership, general partnership, etc.) |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Portion to be appraised (e.g., number of shares, percentage general or limited partnership interest, etc.) |

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IDENTIFICATION OF CLIENT

| | | | |
|-------|------|------|--|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Name and standing of party hiring the appraiser |
|-------|------|------|--|

RELEVANT DATES

| | | | |
|-------|------|------|---|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Effective valuation date _____ |
|-------|------|------|---|

| | | | |
|-------|------|------|---|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Date report prepared _____ |
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PURPOSE OF APPRAISAL

| | | | |
|-------|------|------|---|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Is the purpose of the appraisal clearly stated? (<i>Circle the factors considered</i> —gift tax, estate tax, charitable contribution or redemption, marital dissolution, ESOP, buyout of owners, issuance of new stock, dissenting stockholder suit, minority dissolution suit, other.) |
|-------|------|------|---|

| | | | |
|-------|------|------|--|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Is the standard (definition) of value appropriate to the stated use of the appraisal? |
|-------|------|------|--|

OWNERSHIP CHARACTERISTICS

(Actual or Assumed)

| | | | |
|-------|--|--|---|
| _____ | | | Degree of control (<i>Circle the factors considered</i> —100%, less than 100% but some degree of control, minority interest, other control/lack of control characteristics.) |
|-------|--|--|---|

| | | | |
|-------|--|--|--|
| _____ | | | Marketability issues (<i>Circle the factors considered</i> —publicly traded, closely held, put option, ESOP put option, buy/sell agreement, other restrictions on transfer, and other marketability factors.) |
|-------|--|--|--|

DEFINITION OF VALUE

| | | | |
|-------|------|------|---|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Definition of <i>standard of value</i> provided. |
|-------|------|------|---|

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- _____ *Standard of value* well defined. (Circle the factors considered—fair market value, fair value, investment value, intrinsic value, other.)
- _____ Source/authority of definition for *standard of value* provided. (Circle the factors considered—statute, buy/sell agreement, case law precedent, other.)

BASIC COMPANY INFORMATION

- _____ History of company
- _____ Description of products/services
- _____ Description of the company’s markets (industry and/or geographical)
- _____ Description of competitive situation faced by the company
- _____ Description of management depth/capabilities/succession issues
- _____ Pass Fail **Pass/Fail**—Capital structure (e.g., class of common stock, common and preferred stock, etc.). If more than one ownership class, the characteristics of each should be described.
- _____ Pass Fail **Pass/Fail**—Distribution of ownership (and important relationships)
- _____ Past transactions in the ownership of the company (or lack thereof)

ECONOMIC AND INDUSTRY OUTLOOK

- _____ Economic outlook—National and/or local
- _____ Industry outlook—Are the factors stated relevant to the value of this company (versus boilerplate)?
- _____ Are specific applications to subject company stated?

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SOURCES OF INFORMATION

| | | | |
|-------|------|------|---|
| _____ | Pass | Fail | <p><u>Pass/Fail</u>—Sources of information—List the sources of information used to prepare the report.</p> <p>Site visits—Describe the nature of the site visit.</p> <p>Management interviews—Describe the nature of the management interview</p> |
| _____ | | | <p><i>Economic and Industry Data</i></p> <p>Economic general sources used.</p> <p>Industry economic sources used.</p> <p>Industry ratio sources used.</p> |
| _____ | | | <p><i>Company Financial Statements</i></p> |
| _____ | Pass | Fail | <p><u>Pass/Fail</u>—Income statement—Company’s historical income statements presented in report or in exhibits with sufficient detail and history to review for possible adjustments. (If missing, an explanation of its absence should be included.)</p> |
| _____ | Pass | Fail | <p><u>Pass/Fail</u>—Balance sheet—Company’s historical balance sheets presented in report or in exhibits with sufficient detail and history to review for possible adjustments. (If missing, an explanation of its absence should be included.)</p> <p>Cash flow statement—Company’s historical cash flow statements presented in report or in exhibits with adequate detail. (If missing, an explanation of its absence should be included.)</p> <p>Comparative ratio analysis—Company’s statements of historical ratios presented in report or in exhibits with adequate detail. (If missing, an explanation of its absence should be included.)</p> <p>Periods for which statements were received</p> |
| _____ | | | |

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Status of statements (e.g., audited, reviewed, externally compiled, internally compiled)

Income Approach Data

Source(s) of cost of capital (equity and debt if WACC is being utilized) data (publications, online services, dates of publication, etc.)

Source and/or basis for long-term cash flow or earnings growth assumption for derivation of capitalization rate using Gordon Growth Model for time zero cap rate or for Horizon value cap rate calculation

If report applied a debt-free income approach, then it must adequately justify the debt/equity weighting for WACC calculation. If an industry norm or company optimal D/E weighting is used, then the report must present a reasoned basis for weighting.

Sources of earnings or cash flow growth projections for subject company (who made them, when, what for, what adjustments did the appraiser make to projections, etc.)

Market Approach Data

Specify the sources for guideline or transaction comparative company data.

State whether or not the report applied a debt-free income.

Specify the sources of earnings growth estimates for market comparative companies (who made them, when, what for, etc.).

Asset Approach Data

Sources of data for asset (or liabilities) values relied on

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Source of data/assumptions provided if contingent liabilities are identified and capitalized.

FINANCIAL STATEMENT ANALYSIS

Financial Statement Adjustments

Is there adequate explanation of what adjustments were made to the company's financial statements or an explanation of why none were necessary?

Are the financial adjustments reasonable relative to the level of value (control vs. minority interest)? If there appears to be a conflict with premise of value, then is the reason or rationale for the adjustment(s) adequately presented in the report?

Are the magnitudes of the adjustments adequately supported?

If the market approach was used where guideline company financial statements were available (usually public companies), is there an adequate explanation of what adjustments were made to the guideline company statements or an explanation of why none were necessary?

COMPARATIVE FINANCIAL STATEMENT ANALYSIS

Are the company's financial ratios, income statement, balance sheet, etc. compared with themselves over time to identify trends?

Are the company's financial ratios compared with those of peers in the same industry or with selected ratios of guideline companies?

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- _____ Have the accounting policies and definitions (LIFO/FIFO, depreciation, amortization, etc.) of ratios computed been put on a comparable basis between the subject company and the guideline companies and/or industry averages used for comparison?
- _____ Have other financial statement adjustments been made and justified to “normalize” the company’s historical financial performance?
- _____ Are the strengths and weaknesses resulting from the financial analysis pointed out?
- _____ Are the valuation parameters (e.g., discount or capitalization rates in the income approach, multiples in the market approach) reasonable in light of the financial statement analysis strengths and weaknesses?

VALUATION METHODOLOGY

Income Approach—Historical

- _____ Are the income variables clearly defined and their selection supported (e.g., net cash flow to equity, net cash flow to invested capital, net income, pretax income, etc.)?
- _____ Is the basis for the income variable’s time frame adequately disclosed (why average of years, weighted average, or L.T.M.)?
- _____ Are the estimates of earnings or cash flows to be capitalized adequately supported as being representative of future earning power?
- _____ Is the capitalization rate adequately supported, and is it the appropriate rate for the definition of the income variable being capitalized?

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_____ Is the level of adjusted income consistent with the stated level of value being derived (e.g., control level adjustments being made to derive the value of a controlling interest)? If not, is the issue adequately discussed in the report?

Income Approach—Future

_____ Are the company’s projected income statements presented with adequate detail (nominal, common sized, trend analysis) and in a form comparable to historical income statements?

_____ Are the company’s projected balance sheets presented with adequate detail (nominal, common sized, trend analysis) and in a form comparable to historical balance sheets?

_____ Are the company’s projected cash flow statements presented with adequate detail and in a form comparable to historical cash flow statements?

_____ Are the company’s projected financial ratios (day’s receivable, day’s inventory, day’s payable, etc.) in a form comparable to historical ratios? If the future ratios are assumed to be significantly different from historical ratios, then are the variances explained or justified?

_____ Pass Fail **Pass/Fail**—If projections of balance sheets or income statements were utilized in the valuation, key assumptions underlying the projections must be identified and discussed.

Market Approach

_____ Are the criteria for selection of guideline public companies or merger and acquisition transactions clearly spelled out?

_____ Is the population from which the companies have been drawn clearly specified?

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- _____ Is it clear that all qualified companies from the specified population have been considered?
- _____ Does the report clearly specify what market multiples are used and why they are appropriate?
- _____ In selecting each multiple to be applied to the subject company out of the range of observed multiples for that company, does the report justify the level of the multiple chosen?
- _____ Does the report provide an adequate explanation of the weight ultimately accorded to each of the methods used?
- _____ If market transaction is applied, does the report identify the level or amount of detail limitation of available information?

Asset Based Approach

- _____ Are all the tangible assets and liabilities adjusted that should be adjusted?
- _____ Are intangible assets appropriately adjusted?
- _____ Are all off-balance-sheet assets and liabilities, actual or contingent, recognized and taken into consideration (or is there a statement that there are no off-balance-sheet assets or liabilities)?
- _____ Is the support for the amounts of the adjustments convincing?

Excess Earnings Method

- _____ Are all tangible assets satisfactorily adjusted to current values?
- _____ Is there a satisfactory explanation of the estimate of the market's required rate of return on the company's operating tangible assets?

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- _____ Is the level of income being capitalized clearly defined?
- _____ Is the estimate of earning power being capitalized reasonably supported as a representation of ongoing earning power?
- _____ Has an appropriate amount of reasonable owner's compensation been deducted as an expense in arriving at the amount of earning power to be capitalized?
- _____ Is the capitalization rate applied to excess earnings adequately supported?
- _____ Is there some type of "sanity check" (check for reasonableness) on the result (e.g., is the overall capitalization rate reasonable, or is the number of years that would be required for the business or practice's earnings to pay the alleged value reasonable)?

OVERALL VALUATION METHODOLOGY

- _____ Are the various approaches to value explained?
- _____ Are reasons given for using and not using various approaches to value?
- _____ Are the approaches adequate considering the entity and/or interest appraised and for the stated purpose of the report?

ARE THE DATA USED APPROPRIATE FOR THE VALUATION DATE?

Cost of Capital Data—If the build-up or CAPM procedure is used:

- _____ Is the risk-free rate as of the effective valuation date?
- _____ Are other components, such as equity risk premium, current as of the year of valuation?

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_____ Is the equity risk premium appropriate for the method used (large stock equity premium or total return on small company stocks)?

_____ Is the net adjustment for company- and industry-specific factors adequately explained?

_____ Is the size premium appropriately selected and explained?

Market Approach Data—If the guideline public company method is used:

_____ Are the market prices for the guideline companies the prices as of the effective valuation date?

_____ Are the fundamental data for the guideline companies for the same time periods as the fundamental data for the subject company (e.g., P/3-year average earnings applied to 3-year average earnings)?

Market Approach—If the guideline transaction (merger and acquisition) method is used:

_____ Are the transactions close enough to the valuation date to be relevant?

_____ If the transactions are somewhat removed from the valuation date, is this addressed or discussed?

_____ If the transactions are from a private database, are the limitations of the quality and applicability of the data discussed (e.g., difference in location, lack of information regarding the terms of each transaction, lack of knowledge of financial history/condition of selling company, lack of detailed information other than general SIC code regarding the acquired company)?

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Asset Data

Are asset appraisals in reasonable proximity to the valuation date?

If asset appraisals are somewhat removed in time from the valuation date, are adjustments for differences in market conditions addressed?

DISCOUNTS AND PREMIUMS

Discount for Lack of Marketability

Has the discount been applied only to methods that produce actively traded values?

If applied to a control value, does the report disclose that marketability discounts are based on minority stock studies?

Are the sources of marketability discount data disclosed?

Does the report disclose the reasons the discount was selected (e.g., why the average discount of 35% is appropriate)?

Discount for Lack of Control

Has the discount been applied only to valuation methods that produce a control value?

If control premiums studies or transactions are used as a basis for a minority discount, does the report explain that the minority interest discount is the inverse of the premium and, if applicable, is the computation presented in the report?

Have the sources of control premium data been disclosed?

Does the report disclose the reasons the discount was selected?

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Control Premiums

Has the premium been applied only to valuation methods that produce minority values?

Does the report disclose the reasons the premium was selected?

Have the sources of control premium data been disclosed?

With a report that makes significant adjustments to adjust the company's earning power to a control level, is there a discussion of the potential impact on the applicable control premium?

Other Discounts

Have any other discounts been clearly disclosed?

Has the basis for determining the discount been appropriately disclosed?

Have appropriate sources of supporting data been adequately disclosed?

VALUATION SYNTHESIS AND CONCLUSION

Pass Fail

Pass/Fail—Are the valuation methods all on one consistent level of value (e.g., all on a minority interest basis or all on a controlling interest basis)?

Is the relative degree of weight accorded to each approach satisfactorily explained?

Considering the level of value produced by each method, are proper discounts or premiums applied, if applicable?

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| _____ | | | If there are nonoperating or excess assets, have they been treated appropriately in light of the definition of value sought and the ownership characteristics? Also, was the income/expense from these non-operating assets removed from the company's adjusted earning power? |
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APPRAISER'S QUALIFICATIONS

Experience and Professional Involvement

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|-------|--|--|---|
| _____ | | | Length and type of experience |
| _____ | | | Professional involvement (e.g., teaching, speaking, writing, committee/officer, professional association involvement) |

APPRAISER'S CERTIFICATION

| | | | |
|-------|------|------|--|
| _____ | Pass | Fail | <u>Pass/Fail</u> —Signed statement of disinterestedness (or disclosure of interest) included. |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Conformance (or lack of conformance) to any professional standards (e.g., USPAP, ASA BV Standards, etc.) explained. |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Statement is included that compensation is not contingent on value reported or on any predetermined value. |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Statement included that no person other than those identified had any significant professional input. |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Statement included that, to the best of our knowledge, all statements are true and correct. |

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STATEMENT OF CONTINGENT AND LIMITING CONDITIONS

Pass

Fail

Pass/Fail—Statement included that the opinion of value is only for the stated effective valuation date and only for the stated valuation purpose.

Statement included listing reliance on data supplied by others without independent verification (the typical report will have a fairly lengthy list of assumptions and limiting conditions of which the reviewer should be aware).

Are the listed assumptions and limiting conditions appropriate for the engagement?

OVERALL EVALUATION

Is the report understandable to the reader?

If the report and listed data sources were handed to another competent appraiser, could all of the data provided be independently checked for accuracy and thoroughness?

Is there replicability? That is, could another competent appraiser follow the thought process leading to the conclusion (not necessarily agree with the conclusion, but be able to understand how it was formed)?

Did the appraiser clearly appraise the property that was identified to be appraised?

Is the appraisal methodology appropriate for the purpose of the appraisal, the relevant standard of value, the ownership characteristics (e.g., minority marketability, etc.) and any controlling case law precedent?

Is the report internally consistent (e.g., nothing in one place that seems to contradict something somewhere else)?

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| | | | |
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| _____ | | | Is the report comprehensive (e.g., does it do everything it promises to do; are all the topics included that seem necessary to support the conclusions reached)? |
| _____ | | | Are there any obvious omissions in the report? |
| _____ | | | Does the report logically lead to convincing support for the conclusion(s) reached? |
| _____ | | | Is the professional format acceptable (spelling, grammar, layout)? |
| _____ | Pass | Fail | <u>Pass/Fail</u> —Signature included. Also, if original report was signed by two or more individuals, then a signed statement from the other appraiser(s) is required stating that the report was primarily the work product of the Candidate. Only one person/Candidate can claim to be the primary preparer of a given report. |

Candidate's Name: _____

Name of the Report: _____

Date of the Report: _____

REPORT REVIEW SCORING

| | # Items Passed | # Items Failed |
|------------------------|---------------------------|---------------------------|
| PASS/FAIL SCORE | _____ | _____ |
| THIS REPORT HAS | PASSED | FAILED |

COMMENTS

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