CBV Institute

PRACTICE INSPECTION PROGRAM

SUMMARY REPORT

2022

April 30, 2023

We are pleased to share this report with Members and Students. This report provides a summary of findings of the 2022 practice inspections (the fourth year of practice inspections for CBV Institute), which covered work products issued during the four-year period of January 1, 2018 to December 31, 2021. CBV Institute's Practice Inspection Program strives to enhance the quality of professional services by upholding the standard of professional practice expected of all CBVs.

BACKGROUND

CBVs take immense pride in their designation and profession. The CBV profession is self-regulated, with cornerstones of professional excellence and the protection of the public interest. Adherence to professional standards is of utmost importance. Practice inspection is one of the important ways in which the Institute delivers on its commitment to excellence in practice. The purpose of this Summary Report is to share key practice inspection findings with practitioners in a transparent manner, and to fulfill the CBV Institute's obligation to ensure that its high standards of practice are being upheld.

Objectives of the Program

The objectives of the Practice Inspection Program (the "Program") are to ensure ongoing compliance with the CBV Institute's professional standards (Practice Standards and Code of Ethics); to protect the public interest; and to enhance the confidence the public and regulatory bodies have in the CBV Institute, its Members and Students, and the business valuation profession in general. The Program is governed by the CBV Institute's Mandatory Practice Inspection Policy (the "Policy")[1].

The findings in this Report are based on a random selection of work products. There were only a limited number of individuals inspected, and of those inspected, only a limited number of their reports were inspected. This Report is only intended to provide a summary of selected findings of the Practice Inspection Program for the period reviewed.

This Report has three main purposes:

1. To offer transparency as to the activities of the Practice Inspection Committee and the results of the Program;
2. To report on areas where adherence to professional standards may be improved to facilitate future compliance; and
3. To inform the CBV Institute and its Board of Directors of areas of possible updates and improvements to be considered relating to the Practice Standards and Practice Bulletins.

This Report and comments contained in this Report are not a Practice Standard or Practice Bulletin. This Report does not, and is not intended to, establish new or different standards of care in the professional practice of Members or Students, and does not amend or otherwise revise the Practice Standards or Practice Bulletins. Members and Students are advised to review and conform to Practice Standards and Practice Bulletins applicable to their professional practice.

1 Mandatory Practice Inspection Policy **available here**.

2022 Declarations

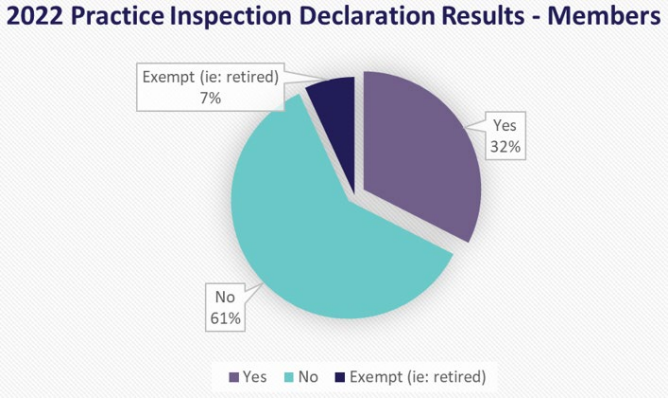
The Program commenced in 2019. In this fourth year of the Program, CBV Institute conducted practice inspections of work products completed by Members and Students during the period of January 1, 2018 to December 31, 2021 (the "Inspection Period").

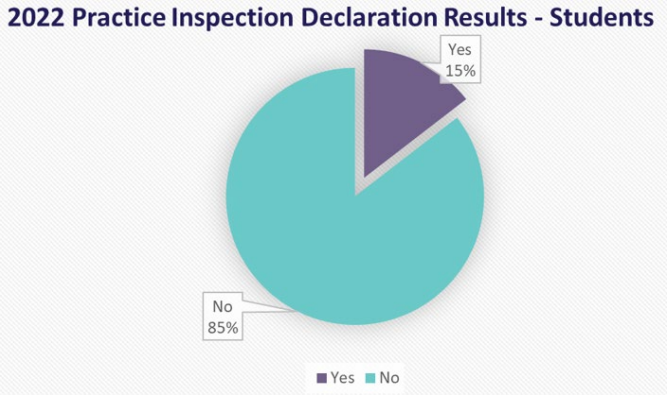
In general, the operational timing of the Program is as follows:

- March 1: practice inspection declarations are due from Members and Students wherein they declare whether or not they have completed work product that is covered by the Program;
- March-April: CBV Institute issues Notices of Proposed Suspension of Membership to Members who have failed to submit practice inspection declarations;
- May – December: practitioners are randomly selected and notified. Engagements are also randomly selected and practice inspections are conducted;
- January – April: results of the year's inspections are summarized and reported.

This year of the Program represents the completion of the first full four-year cycle of inspections. As initially contemplated, the first four-year cycle of inspections focused on successfully setting up and optimizing the operation of the Program, ensuring a robust, streamlined and appropriate process. During this period, we gradually expanded the Program, adding practice inspectors and refining the Practice Inspection Policy, process and related procedures. We are pleased to share that the Program is now running at full scale. Going forward we anticipate being in a position to expand the Program and increase the sample size of practitioners inspected, in order to achieve greater coverage and obtain more meaningful trends and more coverage of practitioners, while continuing to provide valuable feedback on individual inspections. We will continue to conduct all practice inspections virtually, unless there is a reason to inspect in person.

Below is a summary of the results of practice inspection declarations made by CBV Institute Members and Students in 2022, from which the year's inspections were sampled.



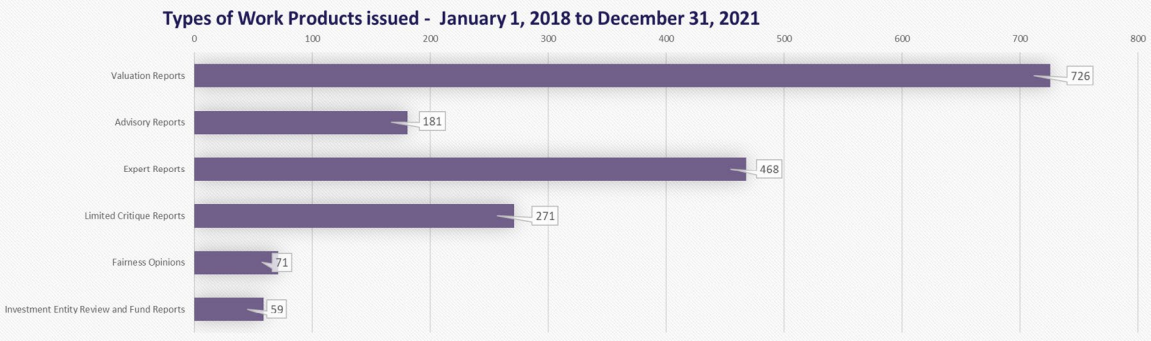


The annual practice inspection declaration asks all Members and Students whether they have signed or otherwise taken responsibility for work product(s) which are subject to CBV Institute Practice Standards during the relevant period. A "Yes" response means that the individual signed or otherwise took responsibility for a work product which is subject to the Practice Standards during the four-year inspection period of January 1, 2018 to December 31, 2021, and is therefore eligible for inspection. Only practitioners who sign the final issued work product, and not their staff or other engagement team members, are subject to practice inspection. "No" responses would include those individuals who may regularly undertake a variety of business valuation, damage quantification or other work that is subject to the Practice Standards, but who are not the ones who ultimately sign or sign-off on issued work products, generally because a more senior

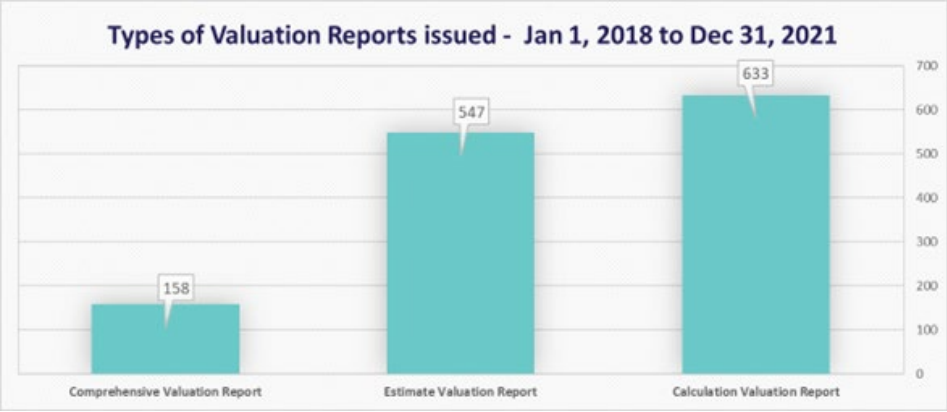
person in their organization signs or takes responsibility. Practitioners who declare “No” are not included in the pool from which selection for inspection is made.

Approximately 32% of Members (790 individuals) and 15%[2] of Students (80 individuals) declared that they signed or took responsibility for work products subject to the Practice Standards during the Inspection Period and were therefore eligible for inspection. On a blended basis, approximately 30% of all Members and Students issued work products subject to practice inspection during the years 2018 to 2021. These results are consistent with prior years.

Of those individuals who responded “Yes” to the practice inspection declaration, the breakdown by individuals who indicated they issued a certain type of work product at least once during the Inspection Period has been presented below:



Of those individuals above who issued valuation reports, the breakdown by type of report issued during the Inspection Period is presented below[3]. Note that this data represents the number of individuals who issued a particular report type, not the number of reports issued. For example, 633 practitioners indicated that they issued Calculation Valuation Reports at least once during the four-year inspection period. Calculation reports therefore continue to be a popular type of valuation report that is issued in practice.



WORK PRODUCT SUBJECT TO INSPECTION

When do the Practice Standards apply?

The Program inspects work products which are subject to the Institute’s Practice Standards, including reporting standards.

2 This percentage is calculated as the number of Students who responded Yes to the practice inspection declaration in 2022 divided by the total number of Students who were actively enrolled in a course (not terminated), as at December 31, 2022.

3 Respondents are able to select more than one valuation report type from Comprehensive, Estimate, and Calculation.

Given the breadth of services which business valuation professionals provide, practitioners are often asked to assist, advise or consult on matters for which the applicability of the Practice Standards may not always be clear. During this round of practice inspections, several questions arose during the annual Mandatory Practice Inspection Declaration process about whether CBV Institute's Practice Standards apply in certain situations, and if so, which Practice Standards apply.

In general, the Practice Standards (including reporting standards) are applicable if an engagement:

4. Requires the application of professional judgment,
5. Results in a written work product where a conclusion is expressed, and
6. The communication is not strictly internal to the practitioner's own organization or firm.

Practitioners are advised to consult with CBV Institute staff to discuss the applicability of the Practice Standards to a specific engagement. Guidance can also be found in Practice Bulletin No. 5 *Guidance as to when Communications are not Valuation, Advisory, Expert or Limited Critique Reports.*

Client Consent for Practice Inspections

Confidentiality of client information is of utmost importance to the CBV profession, and therefore the Program is carried out with highest attention to confidentiality. Before any file inspection can take place, clients must provide explicit consent to the practitioner before the Institute will proceed with the practice inspection.

To comply with their obligations, practitioners who sign or otherwise take responsibility for work products must advise clients in advance, and in writing, that their work product may be subject to practice inspection. Practitioners should obtain express client consent that the practitioner may disclose the work product and related file information to the Institute for the purpose of complying with their professional obligations. This consent should be obtained at the engagement acceptance stage, ideally as part of the engagement letter.

Sample consent language that should be used in engagement letters is shown below:

As part of our professional obligations to you, we will hold all your information and documents in strict confidence. We will not disclose your information and documents to anyone else unless we have your express consent, or a Court orders us to do so. I am a member (or Registered Student) of the Canadian Institute of Chartered Business Valuators ("the Institute"). The Institute has a Mandatory Practice Inspection Program. The objectives of this program, and the way in which Practice Inspections are conducted, are set out in the attached policy. In general terms, a Practice Inspection involves the review of Work Product and engagement-related working files to ensure compliance with professional standards. In the event that I am selected by the Institute for a Practice Inspection, I may be requested to disclose Work Product generated as a result of this engagement and supporting client documents to the Institute for the limited purpose of a Practice Inspection or related conduct and discipline process. By signing this engagement letter, you are providing your consent to our disclosure of Work Product and supporting client documents related to this engagement to the Institute for that purpose.

The Institute expects that practitioners have reviewed and updated their standard engagement letter terms and conditions to adequately reflect notification and consent for practice inspections.

A note about the Program's technology

The Program was fully virtual as of 2022 – that means, all practitioners provided engagement and file information electronically, all inspectors completed the inspections electronically, and the Practice Inspection Committee meetings were all held virtually. Operationally, this provides the flexibility and responsiveness that allows the Institute to operate the program effectively and efficiently, while safeguarding practitioners' client data.

Successfully running the Program in a virtual manner relies on two factors – a well-established internal process, and leveraging the functionality of a leading secure cloud storage platform, Sync. Sync is a Canadian cloud storage provider, and their platform provides the privacy-protection features and encryption technology to protect the sensitive information related to practice inspection from unauthorized access. We will continue to leverage Sync's technology for practice inspections going forward.

FINDINGS OF INSPECTIONS

Practitioners were selected randomly for inspection. The practitioners selected during 2022 included sole practitioners, practitioners from smaller or local accounting firms, practitioners from mid-size professional services firms, and practitioners from national professional services and consulting firms. A sampling of Students was also included in inspections.

All of the 2022 inspections were conducted virtually, with documents being submitted electronically to CBV Institute using CBV Institute's secure cloud-based platform. Inspectors did not rely on or test the internal compliance/quality control processes of any firm in 2022. The ability to rely on internal compliance review is expected to become increasingly important in subsequent years of the Practice Inspection Program, as the Institute increases the number of work products inspected per practitioner. Reliance on internal firm compliance processes should reduce the number of work products to be inspected by the Institute for an individual practitioner.

Work products were selected for each practitioner to cover a representative sample of their practice. Such 2022 inspections included Calculation Valuation Reports, Estimate Valuation Reports, Limited Critique Reports and Expert Reports (primarily guideline income reports). **Overall, the 2022 inspection results were positive; however, there were areas where compliance with applicable professional standards can be improved.**

The sample size of practitioners selected for inspection continues to increase annually. The number of work products inspected per practitioner in 2022 was, on average, three (3) work products.

During the Committee's 2022 process, all inspections resulted in non-trivial findings. The findings ranged in severity from less significant documentation deficiencies or process issues to more significant scope of work and reporting deficiencies.

- For all inspections, the Practice Inspection Committee accepted the action(s) proposed by the practitioner to address the noted findings, and no further action was required.
- There were no inspections that required additional action by the practitioner in order to deem the inspection complete.
- There were no inspections where Practice Inspection Committee requested reinspection. (Note that a reinspection is requested when there are multiple findings or when the Practice Inspection Committee

deems that the severity of the findings is higher. The purpose of a reinspection is to reassess the practitioner's practices using more recent engagements.)

- No inspection findings were significant enough to warrant referral to CBV Institute's Conduct and Discipline Committee.

Due to the relatively limited sample size and the design of the Program, results of inspections do not indicate trends in the profession. Furthermore, as this fourth year of inspection findings were based on a limited sample size, these percentages are not necessarily representative of practice trends in the overall population of practitioners issuing reports.

In determining the appropriate outcome for an inspection, the Practice Inspection Committee gave consideration to comments and responses from the practitioner and whether the:

- Findings and deficiencies were trivial – in which case the inspection was closed;
- Findings and deficiencies were less significant – in which case the inspection was closed with comments and proposed actions by the practitioner (noting both deficiencies and areas for improvement);
- Deficiencies were more significant – in which case other actions may be required of the practitioner, such as remedial actions, evidence of implementation, re-inspections, or sanctions.

The key areas of findings from the 2022 practice inspections are discussed below.

When is a Work Product a "Valuation Report" subject to the Practice Standards?

Clients may approach their CBV for a variety of advice and financial analysis related to valuation matters. This could include providing market data, sensitivity analyses, what-if analyses or other calculations. These analyses may be presented to users in a variety of formats – as excel models, emails, schedules, memos, PowerPoint deck slides, or even verbally in a Zoom meeting. These work products and analyses may or may not meet the definition of a "valuation conclusion"[4].

There are many such "grey areas" that practitioners encounter in practice. Two such examples that were encountered in the 2022 inspections included a draft memo/analysis provided to the client as guidance for settlement discussions and illustrative calculations of value in accordance with a shareholders' agreement. These types of work products allowed the Institute to assess the applicability of the standards in very case-specific scenarios. Ultimately, it brought a better understanding of the unique circumstances that arise in practice when CBVs are asked to assist their clients and when the determination of what is a "valuation conclusion" is not necessarily clear cut.

The results of our inspections confirm that CBVs regularly encounter such grey areas. Whenever a clear determination cannot be made by a practitioner as to whether a particular practice standard applies, and if so, which one, CBV Institute staff should be consulted for a case-specific determination. The Institute continues to provide professional advisory services to Members and Students and advice on the applicability of the practice standards in unique or complex situations.

The potential dangers of Draft Reports

This year, inspectors noted two instances where draft reports were issued that ended up being relied upon by clients.

In one such situation, a valuation report was requested by the shareholders of a business for purposes of strategic, estate and succession planning. The Calculation Valuation Report was issued in Draft form. A final copy of the valuation was not issued, but the practitioner indicated that the client appeared to have relied on the findings and conclusion in the draft valuation report. For this reason, inspectors treated the Draft Calculation Valuation Report as a "final" work product and completed the inspection as if the draft was in fact a final work product, fully subject to the Practice Standards.

Draft work products are by their very nature incomplete work products, and as such as not subject to the standards, so long as they are intended to be used for a purpose for which the Practice Standards are not intended to apply. It is essential that practitioners communicate clearly (and in writing) with their clients when issuing draft reports the valid conditions outlined in Practice Standard No. 110 under which a draft valuation is permitted to be distributed: that the draft work product be issued strictly for the purpose of obtaining comment, instruction, confirmation or other information required to complete the report.

A work product labelled "Draft" but which does not meet the four (4) conditions for a legitimate draft (in other words, is used for a purpose other than to obtain comments and corrections of facts from the client) may actually be used as, in effect, a final work product. To avoid this unintended outcome and reliance, a variety of report disclosure changes are currently being proposed to Practice Standard No. 110 to clarify the precise language that should be used and displayed on every draft report itself. The purpose of these changes is to prevent inadvertent or inappropriate reliance by clients on drafts.

4 Refer to the **2021 PI Annual Report**, which addresses two types of work products, namely schedules and consulting/ transaction advisory work.

In the **June 29, 2022 Re-exposure Draft**, it was proposed that draft (or preliminary) work products should be required to explicitly disclose the four conditions for a legitimate draft on the work product itself, as follows:

i. the work product is in draft form and is subject to comments regarding the accuracy and completeness of certain information, subsequent analysis, and amendment and correction, and that such subsequent analysis, amendment or correction could have a significant effect on any conclusions contained in the draft report;

ii. the work product is not complete, and the intended purpose of the draft is solely to obtain comment, instruction, confirmation or other information required to complete the Valuation Report;

iii. the draft work product is not suitable and should not be relied upon for any other purpose than as described above and it should not be distributed to a third party who may in turn rely on such work product;

iv. the Valuator expects that once comments have been obtained, and once subsequent analysis has been performed and the draft work product has been amended, that a Valuation Report will be completed and issued in due course

Unintended reliance by a client on draft work products sometimes cannot be helped. However, the valuator must do their part. Whether or not a client chooses to misuse a draft is often out of the control of the valuation professional, although certain disclosures and disclaimers should be provided by the valuator. Unintended reliance on drafts is a serious issue, and one which practitioners have a duty to mitigate. In other words, Members and Students cannot knowingly issue a draft work product if they know that their client, or another party, may rely on the work product for a purpose other than to obtain comment, instruction, confirmation or other information required to complete the final report.

What should practitioners do if they find out their draft report is being used for a purpose other than as contemplated? For instance, if a draft work product is being used for negotiation or settlement discussions. What is the CBV's responsibility if they become aware of misuse of a draft work product? Since CBVs cannot ascertain or control other, non-intended uses of draft work products, this is often a challenging matter. Some guidance is available in Practice Bulletin No. 7, which states that when draft reports are distributed, reasonable steps should be undertaken to prevent reliance on them or use for any purpose other than to obtain comments in respect of errors, omissions, misinterpretations, or other factors. Such "reasonable steps" might include appropriate warnings, such as informing the party that engaged the CBV (in writing) that it is not appropriate to rely on the draft report. Practitioners should also consider including in their engagement letter, in correspondence circulated with draft reports, and in the draft report itself, appropriate warnings that the draft report is in draft form and is subject to:

i. comments regarding the accuracy and completeness of certain information,

ii. subsequent analysis, and (iii) amendment and correction, and that such subsequent analysis, amendment or correction could have a material effect on any conclusions contained in the draft report.

It is also appropriate to prominently state that the draft report is not complete and that the intended purpose of the draft report is to obtain comments in respect of errors, omissions, misinterpretations or other factors, that such matters could have a material effect on the conclusions contained in the draft report, that the draft report is not suitable for any other purpose and may not be relied upon, and that it may not be disclosed to third parties. There is an implied obligation on practitioners to make efforts to ensure that no reliance is placed on draft reports, and to keep documentation of these efforts.

Practitioners should exercise care when distributing draft reports, particularly draft reports that may be seen to contain a conclusion but are substantially incomplete due to missing information and consider:

- not issuing a report-like communication – rather providing a status update on the missing information via email, being careful to avoid any value indication whatsoever.
- including appropriate warnings in the written communication (email) accompanying the draft report distributed to the client.
- ensuring that the report does not appear to a reader to have been prepared in compliance with Standard No. 110 (as indicated in Practice Bulletin No. 5).

It is a matter of the facts and circumstances of the specific situation whether a valuation conclusion has been expressed.

Illustrative Calculations of Value

For one valuation engagement we inspected, in conjunction with the issuance of a valuation report, the practitioner was asked by the client to also prepare a second (and separate) work product - a calculation of the FMV of the Company pursuant to a specified formula in the shareholders' agreement. This report was issued as a standalone report, dated the same day as the practitioner's valuation report and titled "Illustrative Calculation of Fair Market Value Pursuant to Company Shareholders' Agreement." This second report stated that "it has been prepared for illustrative purposes only" and that it "does not constitute a formal valuation in conformity with The Practice Standards of the Canadian Institute of Chartered Business Valuators ("CICBV"), and that it does not "represent our conclusion of the FMV of Company nor its subsidiaries or affiliate companies." We note that the valuation formula for FMV specified in the shareholders' agreement in this situation was prescribed as follows:

Five (5) times EBITDA for the most recently completed fiscal year based on definition of EBITDA set out in the Shareholders' Agreement
Less:
- Outstanding bank and other long-term debt; and
- Advances owing to other related companies

Plus:
- Advances owing from other related companies
- Working capital in excess of a current ratio of 1.5 to 1.25, based on definition of current ratio set out in the Shareholders' Agreement; and
- FMV of any real property investment assets, excluding from working capital

Illustrative calculations can be a potentially risky area, particularly when practitioners determine that such reports need not follow Practice Standard No. 110.

In this particular situation, the illustrative calculation report was not considered to be a valuation report subject to CBV standards for two reasons:

- the calculation was based on information provided by the client without requiring the valuator's professional judgment,
- a formal valuation conclusion with respect to the FMV of the same assets was issued via the practitioner's Calculation Valuation Report dated the same day.

Given the specific facts and circumstances of this engagement, inspectors did not raise any concerns with the use of "illustrative calculation" report. However, in general, caution should be exercised in providing illustrative calculations of FMV that do not comply with applicable disclosure standards and that may be seen to constitute a "valuation conclusion". Furthermore, in situations where the practitioner may be asked to calculate FMV based on a different type of formula in a shareholder's agreement (say, 5x "maintainable earnings"), where judgment would apply, this would constitute a valuation conclusion requiring a valuation report. Assessments will necessarily continue to be made on a case-by-case basis. The purpose of the reporting standards is to ensure a quality product, and that valuators are explaining how they have applied judgment to specific valuation inputs in arriving at their opinion.

Is it ever appropriate for a CBV to state in a report that the report was not prepared in accordance with CBV Institute standards? If the report contains a conclusion to which any of the practice standards would apply, and taking into consideration the written client communication accompanying the work product, then it would be inappropriate to "opt out" of the practice standards. In other words, it would be inappropriate for a Member or Student to "opt out" of the standards by making a statement of non-compliance with the standards, if the standards are intended to apply in that particular circumstance. That said, there may be some situations where existing practice standards do not apply to that type of work product. In that situation, it is appropriate for the Member or Student to do the work, and to include a disclaimer or caveat on the work product itself explaining that the CBV Institute practice standards do not apply, such as "This communication does not express a conclusion and is not a report as defined by the Practice Standards of The Canadian Institute of Chartered Business Valuators." Care should be exercised to ensure that the communication is not likely to appear to a reader to be a report that has been prepared in compliance with the practice standards. Given the severity and potential risk associated with a determination that the practice standards do not apply, practitioners should carefully consider and are advised to consult with Institute staff whenever such a statement is made in a report.

Independence and Conflict of Interest for Smaller Firms

Inspectors continue to have findings for smaller valuation and professional services firms around independence and conflict of interest. Several smaller firms did not have a formal and documented independence and conflict check process in place prior to accepting an engagement, although inspectors noted more informal processes such as maintaining client lists. While the Institute does not publish a checklist related to independence and conflict of interest, practitioners are expected to be in compliance with Code of Ethics requirements and to be able to demonstrate that compliance through an appropriate process. Regardless of the size of their practice, practitioners must give thought to and document their client acceptance and conflict of interest process. This documentation is requested in every engagement file selected for inspection.

The Code of Ethics requires that "a Member providing independent professional services shall, in respect of the particular engagement, be and remain free of any influence, interest or relationship which, in respect of the engagement, impairs the professional judgement or objectivity of the Member or which, in the view of a reasonable observer, would impair the professional judgement or objectivity of the Member." Such influences, interests or relationships, which are all common threats to independence, can include:

- Direct or indirect financial interests or contingent or referral fees,
- Loans to a client (which may require consideration of large outstanding fee balances),
- Close business relationships with a client,
- Family and personal relationships with a client,
- Making management decisions or performing management functions for a client,

- Providing professional services to a new client whose interests may conflict with the interests of a former or existing client (such as for example being hired by one spouse in a matrimonial dispute after having been retained and providing services on a joint retainer basis to both spouses).

The above is not a complete list of relevant considerations. Practitioners are encouraged to implement a formal conflict check process for all engagement team members, and to document this process. Inspectors will continue to review such processes as part of inspections. Practitioners can refer to section 400 of the Code of Ethics and should consult with Institute staff regarding their specific circumstance.

Extent of Corroboration – Practice Standard No. 120

The degree of independent corroboration performed by the valuator is one of the fundamental areas that sets apart a Calculation Valuation from an Estimate Valuation and from a Comprehensive Valuation. The degree of independent corroboration thereby also contributes to the reliability of a valuation conclusion. In practice, there is a wide range of what valuators can and do corroborate in a valuation engagement.

The application of professional judgment is a key aspect of business valuation practice, and the standards include numerous references to areas where valuators must rely on their professional judgment, including and especially in determining the scope of work and scope of review that is appropriate for each engagement. This is particularly important when it comes to the degree of corroboration that is expected on a particular valuation.

One area which inspectors continue to come across is reliance, without independent corroboration, on certain key inputs to the valuation, particularly when those key inputs are within the valuator's area of expertise, knowledge or competence. Reliance on management representations with a lower degree of independent corroboration by the valuator is more common for Calculation-level valuations, but even in these types of valuations, inspectors noted that inputs that could easily have been corroborated, were not. Failure to corroborate certain key inputs detracts from the credibility of the work product and may pose the risk that the conclusion is not properly supported, as required by the standards.

Certain inputs to a business valuation are (by necessity) obtained from management, as they represent "facts" about the business, whereas other inputs are derived by the valuator. A few examples of inputs which are (or should be) within the valuator's area of expertise include:

- whether or not there is a market for the particular business (industry knowledge),
- whether the business is a going concern (company specific analysis),
- the reliability and inherent risk of cash flow forecasts supplied by management (when viewed in comparison to historical financial performance and industry analysis),
- the selection of normalized earnings or cash flow levels.

But what exactly is corroboration? How much corroboration is expected of practitioners? What's the minimum level of corroboration? And how does this differ at the Calculation, Estimate and Comprehensive levels? The standards are not explicit in this regard, making this an area where inconsistency in practice can result.

Corroboration refers to the practitioner's scope of work which seeks to assess whether significant inputs or assumptions provided by management, the business owners and/or others can be relied upon, such as by confirming the reasonableness of the information with another source (whether internal or external). Along with review, inquiry and analysis, corroboration is one of the key tools that a valuator uses when

applying professional skepticism in order to render a credible and properly supported valuation conclusion[5]. Practitioners must be able to support and explain to inspectors why a particular valuation relied heavily on client representations, without the practitioner demonstrating the application of their own independent inquiry, analysis and/or corroboration, particularly for components of the valuation that could materially impact the concluded value.

Type of Valuation Report	Extent of Review and Analysis	Extent of Corroboration
Comprehensive	Comprehensive review and analysis of business and industry and all other relevant information and factors.	Corroboration of significant relevant information and factors.
Estimate	Limited review and analysis of relevant information.	Limited corroboration of significant relevant information.
Calculation	Minimal review and analysis of relevant information.	Little or no corroboration of significant relevant information.

Guidance from Practice Bulletin No. 3

The Institute has raised concerns about the existing Calculation Report standards, where the use of the words “minimal review and analysis” and “little or no corroboration” is at odds with the fundamental requirement to provide a valuation conclusion that is credible and properly supported. Members have also expressed concern that such minimal work can result in users’ needs not being fulfilled or valuations issued which do not appear sufficiently credible. Practice inspection findings confirm these concerns over the depth of the scope of work. Revisions to the standards to raise the bar on the required scope of work for Calculation Reports is underway and expected to be finalized later this year.

For example, a valuation conclusion for a matrimonial dispute was based on the Adjusted Net Asset Value Method, where over 50% of the concluded value concluded related to FMV of automotive equipment. The valuator made the assumption that the FMV of the equipment was equal to a management estimate, however this estimate was as at a different date than the valuation date. The Practice Inspection Committee concluded that the scope of work and evidence gathered was not inappropriate, but noted that given the significance of this asset to the overall value conclusion, it would have been a “best practice” to seek further corroboration for the values used for the automotive equipment, even in a Calculation Valuation Report.

When assessing the sufficiency of the scope of work for a particular level of valuation report, inspectors gave consideration to whether the area represents a “key input” to the value conclusion, based on the purpose and intended use of the report. In assessing this, inspectors generally focus on the types of key valuation components and assumptions listed within the standards[6], such as:

- normalizing adjustments;
- capitalization rates;
- income tax issues;
- redundancies;
- minority and other discounts.

The above is not a complete list. Inspectors generally consider the specific valuation engagement, its intended users and the purpose for which the valuation is issued, along with:

5 This definition of “corroboration” is presently proposed to be included in the new (proposed, draft) Practice Standard No. 100.
6 Refer to par 4.1(c) of Practice Standard No. 120.

- Is the input relevant?
- Is the input significant? In other words, whether the particular valuation input is likely to have a significant impact on the conclusion expressed.

Inspectors also consider Practice Bulletin No. 3 *Guidance on Types of Valuation Reports*.

The Practice Inspection Committee's role is not to question professional judgment. However, where a practitioner is using professional judgment, the expectation is to document the rationale and data sources considered (via additional documentation and support in the engagement file) and to highlight areas of significant judgment so the reader can understand. Files with deficiencies in this area were those where there was little or no explanation of how the practitioner applied their professional judgment. The Practice Inspection Committee believes it is important to give insight into what factors were considered by the practitioner, and how they were considered. This documentation should not be boilerplate. Practitioners should explain areas of significant judgment within the valuation report itself, making the work product clearer and more understandable to a user. File memos can also serve to document the practitioner's thought process in areas of significant professional judgment.

Suitability Discussions – What type of Report to issue?

CBV Institute's valuation standards permit three types (or levels) of valuation conclusions and valuation reports. It is understood that prior to determining the scope of work and signing an engagement letter, a discussion takes place between the valuator and their client as to the information that is available, the purposes of the valuation, the intended users, and therefore the level of reliability of the resulting valuation conclusion that is most appropriate.

As part of any practice inspection, inspectors will ask: What suitability discussions take place regarding the type of report to be issued? Are these discussions and conclusions documented? Why was a Calculation/ Estimate/Comprehensive report determined to be appropriate in this instance? What was the specific intended use of the report?

Practice Standard 110 indicates that "the Valuator and the client should consider the purpose for which the Valuation Report is being prepared, the availability of information on which to base a conclusion, and the client's need for assurance. The Valuator should also consider whether the type of Valuation Report will be credible for the purpose intended."

In several practice inspections the inspectors found that suitability discussion documentation was lacking, especially in situations where there was no engagement letter. In most instances there was no discussion or documentation of the impact of availability of information and the impact a lack of available information might have on the credibility of the valuation conclusion.

In one inspection involving a valuation for a division of assets in a matrimonial dispute, the practitioner issued an Estimate Valuation Report even though there was a significant lack of available and accurate information on which to base a conclusion. This included a lack of basic financial information and accounting records, including the fact that the company had no formal accounting system, did not maintain a general ledger or prepare internal financial statements. Further there were no written agreements with respect to the professional services provided. The Valuation Report did contain a section outlining the limitations on the scope of review and indicated the practitioner was not able to determine the impact of the limitations on the valuation conclusion. The practitioner indicated that an Estimate Valuation Report was agreed upon as the other party involved in the dispute had retained another valuator who had prepared an Estimate Valuation Report. There was therefore an expectation that the two valuators' reports be at the same level,

rather than one CBV issuing an Estimate and the other CBV issuing a Calculation. Given the limitations in scope present in this file, it was difficult for the inspectors to determine whether the valuation conclusion was credible for the purpose intended, or whether it was appropriately labelled as an Estimate. In the view of the Institute, given the low quality of the financial information that was obtainable, both reports probably should have been issued as Calculations.

With the differences between an Estimate and a Calculation being subject to professional judgment, there is diversity in practice between what information is considered "sufficient." A lack of fundamental historical financial information impacts the credibility of the valuation conclusion at any level. Although legal counsel may request an "estimate" level report, the responsibility remains on the valuator to adequately label their final work product. A report which has substantial scope limitations related to the credibility or availability of the business' financial records should be carefully considered and the limitations should be consistently reflected in the type of report issued. While a client or their counsel may want and need assurance at an estimate level, such level of "comfort" may not be possible given the lack of or non-existent underlying financial information.

Practitioners should review the Practice Standard with respect to these issues. In particular, Practice Standard No. 110, paragraph 7 and Practice Standard No. 120 paragraphs 3 D, 4.1 and 4.1 A (III). Further guidance is outlined in Practice Bulletin No. 3 (paragraph 17) and when in doubt, practitioners should consult with appropriate personnel at the Institute.

When Scope Limitations are Significant

The practice standards require a valuator to assess when access to essential information is denied by the client or some other party, or is otherwise unavailable to them, and in those cases, to qualify the valuation conclusion expressed and to clearly set out the scope of work limitation in the valuation report. But what should valuators do when the scope limitations appear to be significant, such as for example missing key financial information, unreliable financial records of the business, or insufficient or contradictory information to ascertain who the rightful owner of particular assets is, particularly in a dispute situation. In all of these examples, the impact is likely to be material to the valuation conclusion.

Such fundamental scope limitations can prevent the valuator from being able to render a credible (and appropriate supported) conclusion, no matter how deep their scope of work may be.

At what point is the scope limitation so significant that a valuator should simply not provide a conclusion? And what should a valuator do if their client, or their legal advisors, insist on the provision of "a number, however rough." These types of situations can be complicated and involve substantial professional judgment.

For this reason, the Institute is proposing to revise Practice Standard No. 110 to include language addressing situations where the scope limitation is so significant that it may restrict the ability of the valuator to form a credible valuation conclusion. In these situations, and depending on the nature of the scope limitation, the valuator should either a) issue the report and include a significant and prominent scope limitation (also known as "qualified" conclusion or disclaimer), explaining what the possible impact of the limitation could be on the conclusion expressed, or b) do not issue a conclusion or report (also known as a denial of a conclusion).

Similarly for expert reports, Practice Standard No. 320 states that "when access to essential information is denied by the client or some other party or is otherwise unavailable to the Expert, any conclusion expressed by the Expert in the Expert Report shall be qualified and the limitation(s) on the scope of work clearly set out in the Expert Report."

Inspectors found instances of reports disclosing that certain documents requested that may have been relevant to the preparation of the report were not made available to the valuator, without noting any scope limitations or qualifications. In these instances, inspectors would expect the conclusion expressed to be qualified and would expect that the limitations on the scope of work would be clearly set out in the report.

In another instance, the practitioner had limited financial information available (i.e., no balance sheet, no listing of assets, no financial information by operating entity), and an inability to communicate with management. Despite this, an Estimate Valuation Report was issued. The Practice Inspection Committee's view was that with such limitations in the possible scope of work, the conclusion should have been issued as a Calculation Valuation Report with a scope limitation.

Special Purchaser Considerations

Practice Standard No. 110 requires a valuation report to indicate the extent to which special purchasers were considered and why. It is recommended that the discussion include the steps taken to investigate the existence of special purchasers, the problems of quantifying the amount of net economic value-added, and the degree to which special purchasers have influenced the conclusion. Practice Standard No. 120 indicates the valuator shall consider key valuation components and assumptions, which might include special purchasers.

Inspectors have found varying practices in meeting the requirements of the standards with respect to special purchasers. Examples include:

- statement that the practitioner has not identified any special purchasers and the conclusion does not include any consideration of any impact. In this case it was not clear and there was no documentation as to what investigation took place to make this determination;
- statement that there were no special purchasers identified, without any investigation, even though it appeared to the inspector there may exist special purchasers given the type of business and the market it operated in;
- statement assuming there were no special interest purchasers without any comment if they were considered. or any file documentation to further support.

In one example, the valuation report made an assumption that there were no special purchasers in the marketplace. The valuation determined the FMV of the en-bloc equity of a dental practice, for purposes of a transaction. Given recent trends towards consolidation and roll-ups of dental practices in certain parts of Canada, inspectors believed there would likely be a market that should have been investigated or considered. Practice Standard No. 120 states that special purchasers are a key valuation component, and Practice Standard No. 110 recommends that the valuator take steps to investigate the existence of special purchasers.

In the **June 29, 2022 Re-exposure Draft**, it was proposed "The Valuation Report should indicate whether acquirers who might enjoy post-acquisition economies of scale, synergies, or strategic advantages were considered in arriving at the Valuation Conclusion and the reasons why or why not. (Explanatory comment: the intent is to disclose what steps the Valuator took to investigate the existence of strategic acquirers (or special interest purchasers), the challenges of quantifying the amount of any premium on account of strategic acquirers, and the degree to which strategic acquirers have influenced the Valuation Conclusion)."

RELATED GUIDANCE AND UPDATES

Reinspections

In accordance with the Policy, the cost of the Practice Inspection Program is an Institute expense, except for costs associated with any reinspection or intensification of a Practice Inspection ordered by the Practice Inspection Committee in response to deficiencies. Such costs are to be paid in full by the practitioner so affected. Over the last several years, the Institute has applied a grace period on reinspection costs, bearing all of the costs of reinspections thus far. Starting on January 1, 2023, the costs of any reinspection requested by the Practice Inspection Committee shall be borne directly by the practitioner. Costs associated with any such reinspection, including CBV Institute staff time, will be subject to reimbursement by the practitioner to CBV Institute (refer to the Practice Inspection Program's Frequently Asked Questions[7] for further details).

Revisions to the Practice Standards

On June 3, 2021, the Institute issued an **Exposure Draft** with proposed revisions to the 100-series Practice Standards for valuation conclusions and valuation reports. On June 29, 2022, the Institute issued a **Re-Exposure Draft** with further proposed revisions to the valuation practice standards, incorporating member feedback that was received in 2021. The Institute is continuing to work on revising Practice Standards No. 110, 120 and 130 to incorporate additional details in the areas where there was strong support for improvements and clarifications, including a number of topics discussed in this report. The standards are expected to be published in final form later this year.

CONCLUSION AND NEXT STEPS

We are pleased with the evolution and maturity of the Practice Inspection Program over the last four years. Feedback from practitioners indicates that inspector comments are continuing to be well received and appreciated, in a profession-wide effort to become more consistent in the level of services delivered.

CBV Institute is both a regulator and a standard-setter. The Program allows the Institute to take the learnings from inspections performed in its role as a regulator to leverage the quality of its professional standards as a standard-setter. As a result of inspections carried out over the past four years of the Program, the Institute has had the opportunity to identify and examine the specific areas of the practice standards, particularly the valuation standards, that require additional clarity and detail. As such, these areas have been referred to the Professional Practice and Standards Committee (PPSC) for further work and improvement. Going forward, the PPSC and the Practice Inspection Committee will be working more closely together.

The results of the last four years of inspections showcase the benefits of the Program to the profession, and the unique opportunities it provides practitioners to maintain or improve their processes, their work and ultimately their reports. We will continue to share the results of practice inspections, our observations, and suggestions for improvement, for the benefit of the CBV profession and those who rely on it.

CBV Institute remains committed to protecting the public interest and helping its Members and Students maintain a leading reputation in the marketplace by ensuring ongoing observance of Professional Standards to enhance the confidence that the public has in the business valuation profession generally.

7 https://cbvinstitute.com/members-students/standards-ethics/practice-inspection/faqs-practice-inspection-program/. Reinspection fees will be based on hours expended and a fixed hourly rate. An estimate of the expected costs of a reinspection and the basis for such will be provided in advance.

On behalf of the Practice Inspection Committee, we wish to thank Institute staff for their efforts, and the inspected practitioners for their cooperation throughout this process.

ON BEHALF OF THE PRACTICE INSPECTION COMMITTEE,

Michael Cockayne

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