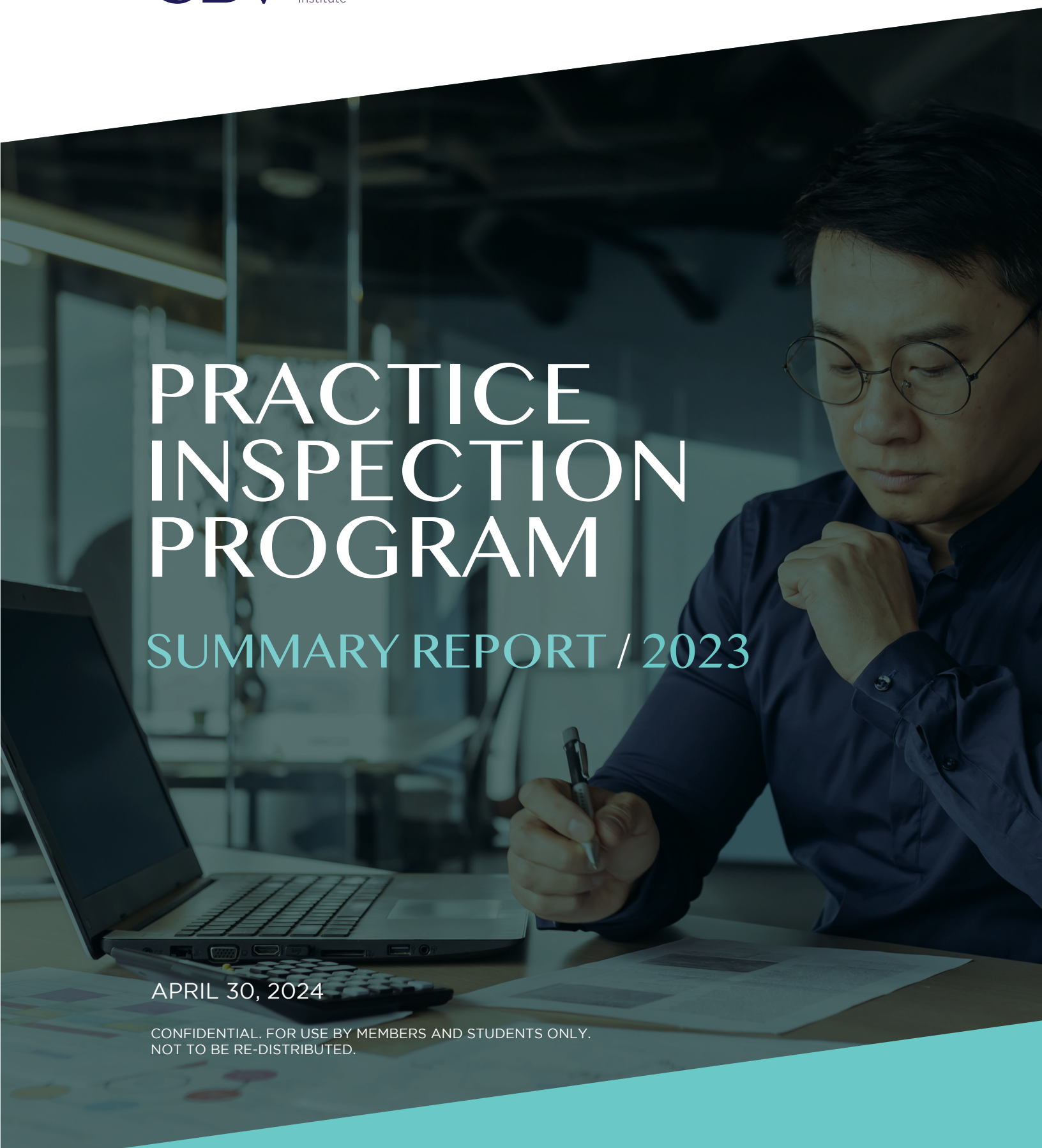
Chartered Business Valuators Institute



PRACTICE INSPECTION PROGRAM

SUMMARY REPORT / 2023

APRIL 30, 2024

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We are pleased to share this practice inspection program summary report ("Report") with Members and Students. This Report provides a summary of findings of the 2023 practice inspections, which covered work products issued during the four-year period from January 1, 2019 to December 31, 2022. 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 protecting the public interest. Adherence to professional standards is of utmost importance to both the profession as a whole and to the individual practitioners who comprise our profession. Practice inspection is one of the important ways in which the CBV Institute delivers on its commitment to excellence in professional practice.

Objectives of the Program

The objectives of the Practice Inspection Program (the "Program") are to ensure ongoing compliance with CBV Institute's (the "Institute") Practice Standards and Code of Ethics ("Professional Standards"); to protect the public interest; and to enhance the confidence the public and regulatory bodies have in the Institute, its Members and Students, and the business valuation profession in general. The Program is governed by the Institute's Mandatory Practice Inspection Policy (the "Policy")[1]. The Program inspects work products which are subject to the Institute's Practice Standards. The Program commenced in 2019 and is overseen by the Institute's Practice Inspection Committee (the "PIC"), a committee of the CBV Institute Board of Directors. The PIC's role includes reviewing inspection findings and determining the appropriate remedial actions.

The Program's inspection of selected work products informs this Report. These inspections reflect a small cross-section of work product from a limited number of randomly selected individuals. This Report only provides a summary of selected findings of the Program for the period reviewed.

This Report has three main purposes:

1. To offer transparency as to the activities of the PIC 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 the 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.

2023 Declarations

In this fifth year of the Program, the Institute conducted practice inspections of work products completed by Members and Students during the period of January 1, 2019 to December 31, 2022 (the "Inspection Period").

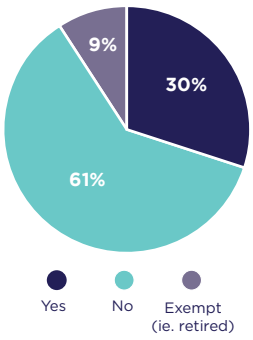
In general, the operational timing of the Program is as follows:

- March 1: practice inspection declarations are due from Members and Students wherein they declare whether they have completed work product that is covered by the Program.
- March - April: the Institute issues Notices of Proposed Suspension of Membership to Members who have failed to submit practice inspection declarations.
- May – December: practitioners are randomly selected for inspection and notified. Engagements to review are also randomly selected and practice inspections are conducted.
- January – March: results of the year's inspections are concluded as necessary and are summarized and published for the benefit of Members and Students.

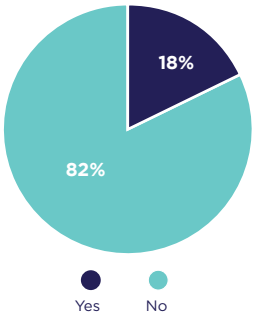
Below is a summary of the results of practice inspection declarations made by Members and Students in 2023, from which the year's inspections were sampled.

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 the 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, 2019 to December 31, 2022, 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 professional in their organization signs or takes such responsibility. Practitioners who declare "No" are not included in the pool from which selection for inspection is made.

2023 PRACTICE INSPECTION DECLARATION RESULTS - MEMBERS



2023 PRACTICE INSPECTION DECLARATION RESULTS - STUDENTS



Approximately 30% of Members (784 individuals) and 18%[2] of Students (86 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 28% of all Members and Students issued work products subject to practice inspection during the years 2019 to 2022. These results are consistent with prior years.

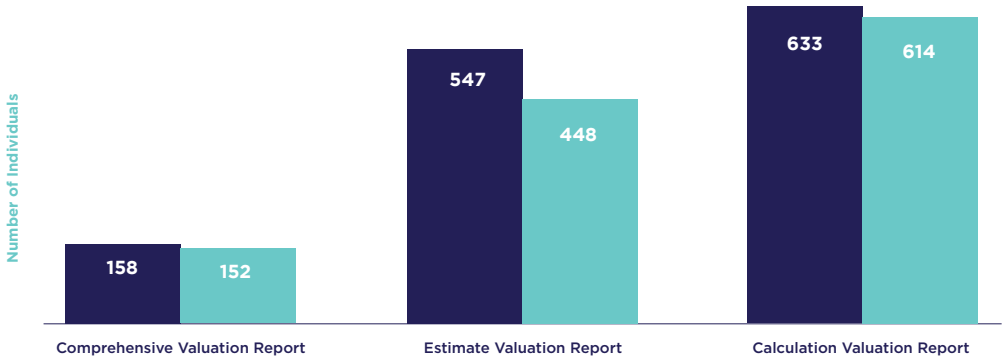
Of those individuals who responded "Yes" to the practice inspection declaration, the breakdown by individuals who indicated they issued a certain type of work product at least once during the Inspection Period is presented below. These results are also consistent with prior years.

INDIVIDUALS AND TYPES OF WORK PRODUCTS ISSUED - JANUARY 1, 2019 TO DECEMBER 31, 2022

Individuals may issue more than one type of report during the Inspection Period.

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, 614 practitioners indicated that they issued Calculation Valuation Reports at least once during the four-year Inspection Period. Calculation Valuation Reports continue to be the most popular type of valuation report that is issued in practice as 71%[4] of practitioners prepared these types of reports (73% in the prior year) at least once during the Inspection Period. The proportion of practitioners preparing Estimate Valuation Reports dropped from 63% in last year's declaration to 51% in the current year. The proportion of practitioners preparing Comprehensive Valuation Reports remained relatively steady at 17% (18% in the prior year).

INDIVIDUALS AND TYPES OF VALUATION REPORTS ISSUED - JANUARY 1, 2019 TO DECEMBER 31, 2022



FINDINGS OF INSPECTIONS

Practitioners were selected randomly for inspection as were work products of those practitioners. The practitioners selected during 2023 included sole practitioners, practitioners from smaller or local accounting firms, practitioners from mid-size professional services firms, and practitioners from national and international professional services and consulting firms. A sampling of Students was also included in inspections. Practitioners were asked to seek express client consent prior to the start of an inspection. Refer to **Appendix A** for important reminders about client consent for practice inspections.

Inspectors reviewed the internal compliance/quality control processes of some firms in 2023, and some key takeaways from this review are discussed under the section titled "Firm Quality Control Processes."

The sample size of practitioners selected for inspection is assessed annually at the start of the year. Work products were selected for each practitioner to cover a representative sample of their practice. The number of work products inspected per practitioner can vary from one to four work products. In 2023, the average number of work products inspected was two work products per practitioner. In 2023 the work products inspected consisted of Calculation Valuation Reports, Estimate Valuation Reports, and Expert Reports.

A practice inspection can conclude in one of the following ways:

- If the findings are trivial or minor in nature, the inspection will be closed.
- If there are non-trivial findings, then the PIC may:
    - require further written submissions from the practitioner on the intended course of corrective action to address any findings.
    - require the practitioner to take certain remedial action to address the findings.
    - order a further inspection within a reasonable period. A reinspection is requested when there are multiple non-trivial findings or when the PIC 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.
- If the findings are such that remedial action or reinspection is not judged as sufficient or where there is a continuing history of deficiencies, a complaint may be referred to the Conduct and Discipline Committee for its separate and independent consideration.

Overall, the 2023 inspection results indicated some areas where compliance with Practice Standards can be improved, as well as areas where Practice Standards need revision to be more specific.

Findings ranged in severity from less significant documentation deficiencies or process issues to more significant scope of work and reporting deficiencies. No inspection findings were significant enough to warrant referral to the Conduct and Discipline Committee.

The key areas of findings from the 2023 practice inspections are presented and discussed below.

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Feedback from practitioners who underwent practice inspection in 2023 was positive and indicated that the Institute's practice inspection program is tough but fair, and well designed. Practitioners appreciated the attention to detail and care that is taken to safeguard confidentiality. Practitioners also indicated that appropriate time was provided to assemble and provide documentation and to discuss inspection findings. Finally, they understood that the focus of the Program is on the quality of work and on promoting best practices, and that the process is first and foremost educational in nature. Most practitioners regard the inspection process as a collegial way to learn and improve.

Engagement Management Issues

CONFLICT AND INDEPENDENCE VERIFICATION PROCESSES

There were no instances of conflicts of interest noted in any of the inspections. In most cases, practitioners and their firms have some conflict and independence verification processes in place, however inspectors noted that these processes were not always robust. Inspectors noted instances of conflict check processes that were at times not sufficiently thorough, not fully documented or not consistently applied. This is a significant concern for engagements which require independence and objectivity under the Practice Standards.[5]

For several of the 2023 inspections, practitioners were not able to provide inspectors with any documentation of their conflict and independence verification processes for the selected engagements.

Inspectors also observed that for some firms, the conflict check process did not apply to all new engagements – but rather only to certain types of engagements and situations, such as when the engagement was considered adversarial or when the engagement was being conducted on behalf of multiple parties. In other cases, while a firm policy existed for all engagements, the policy was not applied consistently to all offices of the firm. For these practitioners, the PIC required that the conflict check process be improved and stressed the importance of a fulsome conflict check process to be conducted consistently on all engagements where independence is required under the Practice Standards.

A robust client acceptance process, one that is thorough, applied consistently and well documented, ensures that the practitioner is appropriately independent, and that acceptance of the engagement does not create a conflict of interest. The absence of actual and perceived conflict of interest in engagements, where independence is required, is necessary to maintaining the integrity and reputation of the Institute and its Members and Students.

FEE QUOTATIONS

One finding of inspections was in relation to an unusually low fixed fee quoted to a client for an Estimate Valuation Report. The practitioner based the quoted fee on the client's ability to pay. While fees are generally a commercial matter and not addressed by professional standards, and thereby not part of practice inspections, inspectors flagged this as an observation as it had potential implications for the scope and sufficiency of work under the Practice Standards.

When quoting fixed fees to clients, the quantum of the fee should be considered thoughtfully. Fee arrangements should be such that they do not jeopardize the scope and quality of work, nor create an actual or perceived conflict of interest. For example, committing to performing an engagement at too low of a fixed fee raises the risk that the practitioner will feel increased pressure to limit their analysis, investigation and corroboration to the bare minimum as the fees may not be sufficient to do the appropriate level of analysis and work required of the report.

When quoting fixed fees, it is prudent to reflect the amount of work required by the Practice Standards to complete a credible and properly supported work product. This also underscores the importance that practitioners obtain adequate information from their clients upfront to properly assess the scope of the engagement and ensure that the fee quoted allows for sufficient work to be done to meet the intended use of the work product.

Fee structures may also be an important consideration for independence and conflict of interest (in fact and in appearance) under the Code of Ethics. For example, greatly discounting fees, or doing work "pro bono" may, in some instances, also pose the risk of a perceived conflict of interest or lack of independence.

SUITABILITY OF THE VALUATION REPORT FOR THE CIRCUMSTANCES

The Institute's valuation Practice Standards entail three types of valuation reports commensurate with the level of assurance provided. Practice Standard No. 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."

It is therefore understood that prior to determining the scope of work and signing an engagement letter, a discussion takes place between the practitioner and their client as to the information that is available, the purpose of the valuation, the intended users, and the ensuing appropriate level of assurance required from the resulting valuation conclusion.

As part of any practice inspection, inspectors will ask:

- What suitability discussions took place regarding the type of report to be issued?
- Were these discussions and conclusions documented?
- Why was a Calculation/Estimate/Comprehensive report determined to be appropriate in the circumstances?
- What was the specific intended use of the report?

In several files the inspectors found that suitability discussion documentation was lacking, especially in situations where there was no engagement letter. In some instances there was no discussion or documentation of the impact that the availability of information (or lack thereof) might have on the credibility of the valuation conclusion and the level of assurance required.

In two inspections of Estimate Valuation Reports, significant assumptions were made where no corroborating evidence could be obtained. Practitioners should consider the scope of work required by the level of assurance they are providing. In cases where a deeper scope of work is not possible, the level of assurance and report type should be selected accordingly.

DRAFT REPORTS – EXERCISE CAUTION

Inspectors continue to encounter instances of unfinalized draft reports and have concerns when draft reports are issued with the knowledge of reliance, leading to the risk of a misuse of a draft report.

One work product inspected was a valuation report in the context of the settlement of a dispute. The work product was labelled as a "draft for discussion purposes" and was distributed for purposes of settlement discussions by the parties. The report was also labelled "for guidance purposes only". There was intended reliance that was known to the practitioner, as evidenced by email correspondence, and therefore the report did not qualify as a draft report per Practice Standard No. 110. The practitioner's view was that the report did not contain a valuation conclusion because it was based on incomplete work, however the inspectors thought it did based on the totality of the report (which arrived at a value indication) and the intended use. It is a matter of the facts and circumstances of the specific situation whether a valuation conclusion has been expressed.

The Institute remains concerned about the practice of attempting to settle disputes using draft conclusions and draft reports, as these are incomplete work products. There are situations where the practitioner simply cannot obtain any more information required to finalize their conclusion. Where the report is unfinalized due to missing information, the materiality and pervasiveness of the missing information must be assessed – for example, is the practitioner missing one item only (such as fair market value of management compensation) or is the practitioner missing entire sets of financial statements, information about an entire division of the company, tax filings, or other information which may impact the valuation conclusion.

There are also many different stages of a draft report, ranging from preliminary schedules to a more substantially complete draft report which requires only confirmation from the client prior to being finalized, to anything in between. What should practitioners do in these situations, particularly if the parties are pressuring the CBV to provide "a number"? Some of the PIC's recommendations relating to drafts include:

- To the extent possible, issue substantially complete drafts.
- Clearly communicate to the client (and their legal representatives) a list of the outstanding information that is needed to finalize the draft report.
- If substantial information is still outstanding or missing, consider whether a draft report should be issued at all given the stage of the file. Practitioners may want to avoid issuing a report-like communication (and avoid communication formats that may mistakenly appear to a reader to have been prepared in compliance with Practice Standard No. 110), and may want to instead consider providing a status update on the missing information via email, being careful to avoid any value indication whatsoever.
- Consider whether the draft report can be issued with substantial scope limitations noted.

When issuing draft work products to clients, practitioners must clearly communicate clearly (in writing) with their clients, the conditions in Practice Standard No. 110 under which a draft valuation is permitted to be distributed: 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 (i.e., is used for a purpose other than to obtain comments and corrections of facts from the client) may actually be relied upon by some clients. 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. The purpose of these changes is to prevent inadvertent or inappropriate reliance by clients on drafts.

While these standard revisions are being finalized, the PIC recommends the following best practice disclosures on draft or preliminary work products on the work product itself, as follows:

1. *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;*
2. *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;*
3. *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; and*
4. *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 is sometimes difficult to avoid. However, the valuator must take care to avoid or protect against unintended reliance on draft reports by communicating restrictions of the draft appropriately. Whether or not a client chooses to misuse a draft is often out of the control of the valuation professional. 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 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 practitioners 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 practitioner (in writing) that it is not appropriate to rely on the draft report.

Firm Quality Control Processes – A best practice to implement

Based on the quality control processes of firms reviewed in 2023, inspectors noted that larger firms tended to have more robust internal quality control processes in place (herein after referred to as “QC”). However, given the nature of the findings reflected in this Report, the PIC recommends a broader implementation and strengthening of such practices across the board for all practitioners and their firms.

In one inspection, an Estimate Valuation Report was issued with an apparent lack of information and insufficient supporting documentation. The report had in fact been done as a Calculation Valuation Report (pursuant to a revised engagement letter), yet the report issued to the client was labelled as an Estimate Valuation Report, a fact which the internal QC process did not catch. In another inspection, significant mathematical errors were noted which resulted in a material impact to the valuation conclusion. A robust internal QC process would normally identify these types of issues prior the issuance of the reports.

Refer to **Appendix B** for additional details and recommendations for QC processes.

The Institute expects to continue to examine quality control processes in future practice inspections.

Insufficient Analysis or Support for Key Valuation Inputs

Determining the appropriate scope of work (consisting of review, analysis and corroboration) for each of the three types of Valuation Reports, is subject to professional judgment that takes into account all of the relevant facts and circumstances including the engagement agreed to between the client and the Valuator. Practice Bulletin No. 3 provides some examples of the continuum of scope of work, and notes that the following categories are generally expected to be considered:

- Economic environment;
- Industry in which the business operates;
- Company-specific non-financial information (e.g., ownership, business background, management, and significant agreements);
- Company-specific financial information (e.g., historical and future-orientated financial statements); and
- Valuation context and assessments (e.g., performing valuation calculations using various valuation techniques and methodologies).

Practice Bulletin No. 3 also highlights other key considerations in addition to the above, such as the purpose for which the valuation report is being prepared, the availability of information on which to a base a conclusion, and the client's need for assurance given their intended use and reliance.

In several inspections, in the context of the type of Valuation Report issued, there was insufficient analysis and support for key elements of the valuation. Some examples are noted below.

Pertaining to Estimate Valuation Reports:

- "Rules of Thumb" were used as a valuation method with very limited or no explanation or justification concerning acceptance or use by market participants. There was very little support in the report for the rules of thumb used and reliance on the rules of thumb in arriving at the value conclusion was therefore not sufficiently justified and explained. Depending on the circumstances of the engagement, using rules of thumb as a primary (and sole) valuation methodology for an Estimate-level valuation may not be sufficient to meet the requirements under the standards. While Practice Standards Nos. 110, 120 and 130 do not explicitly address the use of rules of thumb, relevant guidance on this topic can be found within the International Valuation Standards. For example, IVS states that: *"Anecdotal or "rule of thumb" valuation benchmarks are sometimes considered to be a market approach. However, indications of value derived from the use of such rules should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them*[6]*."*
- The valuator concluded that a discount for a minority interest position was not necessary without any analysis as to why this was appropriate based on the circumstances, resulting in a value conclusion that was not sufficiently supported. Sufficient analysis and support for the level of (or lack of) discount for a minority interest position should be provided.
- The valuator derived a weighted average cost of capital (WACC) without any analysis or assessment of the cost of debt used nor any analysis or assessment of the debt-to-equity proportions used. The components of cost of capital used to derive an appropriate discount rate need to be adequately supported.

- With respect to the WACC rate and the discount for a minority interest, the valuator derived these key inputs from another valuator's report (who was engaged by the opposing side to value the same business) without any of their own additional analysis. The report was used in the context of a dispute and the valuator's role was to arrive at their own independent value conclusion. Even though the inspected valuator may have concluded (agreed with) the WACC and minority discount of the other valuator, the inspected valuator should nonetheless have disclosed their analysis and rationale.
- The valuator applied a discount rate based on an assumption, without any analysis or support. The discount rate used is a key element of the value conclusion and needs to be a key valuation decision made by the valuator. Its determination must be clearly set out in the report such that a user understands its basis.
- A report that placed significant reliance on management's financial projections to conclude on value contained very limited or no assessment of these projections. For an Estimate Valuation Report, where financial projections are material inputs to the valuation conclusion, assessment of these financial projections is required. While the projections are management's representation, it is incumbent on the valuator to undertake procedures to assess the reasonability and risk inherent in the information relied upon, particularly when the projections are fundamental to the conclusion.
- A report assumed a substantial amount in respect of excess working capital that was based solely on estimates provided by management. No further analysis or evaluation was carried out by the valuator. Where an assumption is material to the valuation conclusion, some analysis, corroboration, or evaluation as to the reasonability of the assumption should be undertaken.
- A valuator concluded a substantial value for the business' land and buildings in a valuation report prepared for dispute purposes. The amount was based on amounts provided by management without further support being obtained. While it may not be necessary or practical in every circumstance to have a real property appraisal to support the value, given the material impact on the valuation conclusion, the intended use of the report, and the level of assurance inherent to this Estimate Valuation Report, it would have been appropriate for the valuator to have attempted to corroborate the value in some other manner.

Pertaining to Calculation Valuation Reports:

- A report assumed an amount for sustaining capital expenditures (capex) that was based on an average of historical capex. However, the average included periods when revenues were substantially lower than projected for the selected maintainable cash flow levels. Further analysis and inquiry would have been appropriate to ensure that the assumed level of capex was consistent with the selected maintainable cash flows.
- A report did not consider the impact of projected revenues, that were substantially increased from current levels, on the additional investment in working capital that might be required in future periods.
- A report arrived at a value conclusion that was based on projected revenues that were substantially increased from prior periods. The projected increase in revenues could not be substantiated by management as projected revenues were based on matters management had little knowledge of, involving a new source of business. On this basis, the value conclusion was largely hypothetical, and the situation was not sufficiently communicated in the report.

Other Scope of Work Issues

LACK OF INFORMATION CONCERNING THE BUSINESS IN ESTIMATE VALUATION REPORTS

In two inspections, Estimate Valuation Reports were found to be lacking sufficient details concerning the business valued and the market, such as information concerning the operations of the business; competitors; demand and supply conditions; market size; etc.

While some reports for some intended uses (like valuations for management's internal use only) may not require great detail about the business itself (as management already knows the business), other reports for other intended uses (such as disputes, taxation, etc) are likely to have intended users who are not similarly knowledgeable about the business and require this important context to properly understand the valuation report.

The concern of the PIC is that the report disclosure should be understandable and appropriate for (all) the intended users, enabling them to follow the valuator's selection of the valuation basis and valuation approach adopted. It should be evident to a report user that the valuator had an appropriate understanding of, or considered, the various risk factors affecting the business' ability to generate the projected cash flows or what those risk factors were.

INAPPROPRIATE RELIANCE ON CLIENT INSTRUCTIONS

There are many inputs to a valuation conclusion – such as facts about the business, tax rates and tax status, normalized expenses, redundancies, ownership percentages, etc. Some inputs may be more significant (or material) than others with respect to their impact on the final valuation conclusion expressed. Inspectors focus on the key valuation inputs. Inputs provided by the client should generally not be (blindly) relied upon if they pertain to areas that are fundamental parts of a valuator's professional judgment and expertise. Where reliance on client instructions cannot be avoided (e.g., instructions from legal counsel), clear and specific disclosure regarding the instructions should be included in the report, to ensure transparency. As a best practice, the disclosure may include the reason for the instruction and the impact on the valuation conclusion.

In one inspection where an independent Estimate Valuation Report was issued, the valuator relied upon instructions given by their client as to the valuation approach to use. The determination of the appropriate valuation approach to be used is a fundamental aspect of the valuation and needs to be a determination of the valuator, considering the facts and the valuator's professional judgment. An integral part of the value conclusion relates to the appropriateness of the approach employed and the Valuation Report must address this matter regardless of instructions or prior discussions with the client.

In another inspection where an Estimate Valuation Report was issued, the engagement letter included direction from the client that no adjustment was to be made for either lack of liquidity or minority interest. The valuation was to be used in connection with repurchasing shares related to a change in employment. An unexecuted shareholders agreement contemplated these stipulations. However, both the definition of value used and the value conclusion were silent with respect to these factors, leaving the report user uninformed as to whether the valuator had given any consideration to these factors, and the reasons for disregarding them.

DEFICIENT FINANCIAL INFORMATION

In one work product inspected, a valuator based a conclusion on the significant assumption that the financial information was correct when they had significant concerns that it was not reliable.

What should a valuator do if they are faced with deficient financial information? If the financial information is thought to be unreliable and a credible conclusion cannot be expressed, what are the options? Guidance is available on some of these issues in Practice Bulletin No. 6. "In all cases it is a matter of professional judgment, taking into account the importance of the information to the conclusion arrived at in the context of the type of report to be issued, as to the nature and extent of the procedures that the Valuator/Expert undertakes to determine the veracity of information relied upon."

Issuing a report with a low level of assurance (e.g., Calculation Valuation Report) does not justify the use of deficient or unreliable information. While the reduced scope of work inherent in a report with a low level of assurance (i.e. less enquiry, analysis, and corroboration) may result in deficient financial information going undetected, when the deficiency is known or suspected, one cannot proceed without addressing the issue regardless of the type of report being issued.

If the suspect information is significant, does stating a scope limitation enable the valuator to proceed with its use to arrive at a qualified conclusion that is subject to a limitation? Practice Standard No. 120 states "When access to essential information is denied by the client or some other party, or is otherwise unavailable to the Valuator, any conclusion expressed by the Valuator in respect of such valuation shall be qualified and the limitation(s) on the scope of work clearly set out in the Valuation Report." Scope limitations are intended to deal with information that is not made available to the valuator, not information the valuator has that is thought to be inaccurate or deficient.

In situations like this, the valuator should refrain from drawing a conclusion based on significant information that is deemed inaccurate or insufficient, especially when they know it may lead to misleading outcomes.

INDICATIONS OF VALUE FROM MULTIPLE METHODOLOGIES

In one Estimate Valuation Report inspected, six different methodologies were employed having a wide range of resulting values. The report had limited or no disclosure as to the strengths and limitations of each methodology or the rationale as to how the results of the various methodologies contributed to the valuation conclusion (which was expressed within a range). Practice Standard No. 110 requires that "the valuation report shall provide sufficient information to allow the reader to understand how the Valuator arrived at the conclusion expressed."

REPRESENTATION LETTERS

There are situations when a report is issued in draft form, but, for a variety of reasons, is never issued in final form. One consequence of failing to issue a final report can be the failure to obtain a management representation letter. A representation letter should be sought after a draft report is issued, for confirmation of key representations made by management such as the cash flow forecasts.

It is best practice to have management review the underlying assumptions used in the valuator's analysis and confirm their agreement with a representation letter. The follow-up that is required in obtaining a representation letter can also be an effective tool to mitigate the risk that may arise if no final report is issued and inappropriate reliance is placed on the draft report.

Where management representation letters cannot be obtained, as may be the case in dispute matters, documentation should be kept on file as to why such representations had not been obtained, as required by Practice Standard No. 130.

LACK OF ACCESS TO MANAGEMENT AND SCOPE LIMITATIONS

Occasionally a valuator is not given access to management of the business being valued, and thus has no ability to ask questions or gather additional relevant information. This raises the question as to whether the conclusion is impacted by this limitation or indeed whether the valuator can even conclude on value, depending on the extent of information that is required from management. The valuator needs to assess the importance of speaking to management in their ability to express a conclusion and whether the potential impact is such that the lack of access to management is a limitation on the scope of their work that is significant enough to cause the valuator to qualify their conclusion.

Report Disclosure Issues

Report disclosure issues are generally the easiest for inspectors to uncover. Most of the observed disclosure deficiencies were noted in valuation reports (rather than in expert reports, etc). Some examples of the type of report disclosure issues noted by inspectors in 2023 included:

- The description of the business is superficial and too brief (two sentences). The report should provide a more detailed description of the business activities, a brief history, a discussion of the factors influencing value and the various earnings and cash flow risk factors present.
- Incorrect or inappropriate use of valuation terminology in reports, such as reference to three generally accepted bases of value (should be "approaches"), referring to the asset approach as a methodology, referring to adjusted book value as an approach rather than a method, etc. Practitioners are encouraged to review the updated International Valuation Glossary – Business Valuation contained in Practice Bulletin No. 2.
- Scope of Review items that are too generic and vague. For example, the listing of documents reviewed by a practitioner, included a line item "such other corporate, industry and financial market information and analyses as we considered necessary or appropriate in the circumstances," without listing any specific information. The Scope of Review items should be more specific to the documents reviewed for the engagement (par 12.1 of PS 110 requires the "specific information" to be identified).
- In a Calculation Valuation Report the information that was available for review regarding some business entities was missing important information, such as the financial statements of subsidiary entities as of the valuation date and the report did not reference this scope limitation or qualify the conclusion, resulting in the user not being aware of the inherent limitations of the conclusion.
- In a valuation for family law dispute purposes the valuator did not have discussions with management concerning the business being valued, resulting in a significant limitation to the conclusions provided. In such circumstances Practice Standard 120 requires that the conclusion be qualified and the limitation to the scope of work shall be clearly set out to inform users of such.

Spotlight on Students

Inspections of individuals who issue and sign work products while holding "Registered Student" status in the CBV Institute Program of Studies continues to result in relatively more findings as compared to inspections of Members. Students are reminded that they have the same responsibilities under the Code of Ethics and Practice Standards as Members. They are not prohibited from signing reports, however, there are some critical things to keep in mind regarding competence, experience, quality control, peer review, and other valuation process considerations.

Students are reminded that they **must**:

1. Objectively assess their competency for the specific engagement prior to accepting an engagement.
2. Perform quality control checks prior to issuing and signing a work product.

Given the (limited) experience level inherent with being a Student, Students are **strongly encouraged** to obtain an independent review (or "second partner review") by another Member prior to issuing any work product.

RELATED GUIDANCE AND UPDATES

REVISIONS TO THE PRACTICE STANDARDS

Following exposure drafts issued in 2021 and 2022, the Institute is continuing to work on revising Practice Standards No. 110, 120 and 130, including for some of the topic areas noted 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 five 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.

The 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 five 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 five 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.

The 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. 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,

Robert S. White, CPA, CA, CBV
Chair, Practice Inspection Committee
CBV Institute

Catalina Miranda, CPA, CA, CBV
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APPENDIX A

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 they 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.

APPENDIX B

FIRM QUALITY CONTROL PROCESSES

QC includes those processes and procedures designed to ensure the accuracy of the qualitative and quantitative aspects of the work product and adherence to Practice Standards. These procedures may involve verifying the mathematical, logical, or factual accuracy of the work product itself, and/or the underlying source information used in the work product. Such a review should also consist of an independent, critical review of the conclusions in the work product and assess whether:

a) the work complies with professional standards, including the Practice Standards, and

b) there is sufficient support for key inputs, particularly those requiring professional judgment.

As many of the Institute's scope of work standards (Practice Standards 120, 320, 420, etc.) call for "sufficient evidence" to be gathered. This necessarily means that the amount of work and due diligence underpinning a work product is subject to judgment under the Practice Standards. For example, Practice Standard No. 120 states that "Sufficient evidence shall be gathered by such means as inspection, inquiry, computation and analysis to ensure that the Valuation Report and the conclusion contained therein are properly supported."

This application of professional judgment is intentional, as what is considered "sufficient" is case-specific and will depend on the purpose and intended use of the valuation, the intended users, as well as the information available in the circumstances. Inspectors regularly challenge practitioners on the sufficiency of the support gathered for key inputs to the valuation. An internal QC process would greatly assist to ensure some of this review and challenge is happening before work products are issued.

A key component of an effective QC process is a "sanity check;" an independent review[7] of the amount of work undertaken to ensure that all significant areas of the valuation have been properly supported and make sense. A robust QC process often acts as a second pair of eyes on key judgments, inputs and assumptions, to assess the sufficiency of the work performed.

Inspectors observed the following best practices of a robust QC process:

- Is undertaken on every engagement to which the Practice Standards apply, on an on-going and continuous basis
- Ensures appropriate client acceptance issues are addressed and documented (e.g. conflict and independence verification, reasonability of fee quotes, suitability of valuation report)
- Includes independent review, oversight and sign-off on work products by an authorized reviewer (i.e., another CBV) of the firm who is not part of the engagement team (this is often known as a "second partner review")
- Requires verification of calculations to ensure mathematical and technical accuracy
- Applies professional skepticism

- Focusses on pivotal, conceptually intricate, or challenging issues, or those aspects of the work that are subject to professional judgment or error
- Is performed before a work product is issued externally to a user
- Is required to be documented in every engagement file as evidence of the QC process
- Is reflected in time entries as further evidence of when the process took place and by whom.

Inspectors noted that the better QC processes applied not only to completed (final) work products and reports, but also more broadly to any draft or interim deliverables that are substantially complete and have been distributed to a client (or that contained results, conclusions, recommendations, or information that may be used by the client).

Having an internal QC process is not a mandatory requirement but is a best practice that all practitioners should consider.

For instance, the importance of QC processes in valuation is highlighted in the latest edition of the International Valuation Standards (IVS issued in 2024 and effective January 31, 2025). IVS requires that "there must be valuation process quality controls around the valuation process" and that "the controls should assess the judgments made during the valuation, including their reasonableness and freedom from bias." While the Institute's Practice Standards do not presently require internal controls to be in place for every valuation engagement, this is a best practice.

Regarding sole practitioners or those who are the only CBVs at their firms, the PIC recognizes that it may not always be possible to implement a "second partner review", but recommends that these practitioners, at a minimum, perform a self-review using the Institute's Practice Inspection checklists, available here: https://cbvinstitute.com/members-students/standards-ethics/practice-inspection/.

REFERENCES

1. Mandatory Practice Inspection Policy available here.
2. This percentage is calculated as the number of Students who responded Yes to the practice inspection declaration in 2023 divided by the total number of Students who were actively enrolled in a course (not terminated), as at December 31, 2023.
3. Respondents can select more than one valuation report type from Comprehensive, Estimate, and Calculation.
4. This percentage is calculated as the number of practitioners who indicated they issued Calculation Valuation Reports (614 individuals in 2023), divided by the number of practitioners who indicated "Yes" on their 2023 practice inspection declaration (870 individuals in 2023, made up of 784 Members and 86 Students).
5. For example, Practice Standard No. 110 requires the valuator (or their firm) to be acting independently and objectively, and to make a positive statement in their Valuation Report to this effect.
6. IVS effective January 31, 2025, IVS 103 Valuation Approaches, Appendix, par A10.16.
7. The term "independent review" refers to a peer review by a practitioner who was not directly part of the engagement team.