PRACTICE BULLETIN NO. 5

GUIDANCE AS TO WHEN REPORTING STANDARDS ARE NOT INTENDED TO APPLY

Practice Standards Nos. 110, 210, 310, 410, 510, and 610 (together, the "Reporting Standards") set the minimum requirements for written communications issued by Members.

1. Members are often asked to assist, advise or consult in situations not contemplated by the Reporting Standards.

2. Members must carefully determine if the communication being issued is such that they must comply with the Reporting Standards. In making this determination, Members must consider the nature and substance of the communication, as well as the intended use/purpose and the intended user(s).

3. The purpose of this Practice Bulletin is to help Members determine the circumstances when the Reporting Standards are not intended to apply.

4. The following are situations where, given the nature and substance of the communication, Reporting Standards might not apply (each is described in more detail in the sections which follow):

   (i) An illustrative pricing analysis for a contemplated transaction in the context of a buy-side, sell-side or capital raising mandate (where the pricing analysis is clearly labelled as illustrative).

   (ii) Communications that do not include a conclusion (opinion) and are clearly noted as such.

   (iii) Communications that are intended solely for internal use within the Member's own organization.

5. This Practice Bulletin contains principles and general guidance but does not contain an exhaustive guide to all scenarios a Member might encounter in practice. Recognizing that there are many “grey areas,” Members are encouraged to carefully review the guidance contained in this Practice Bulletin, and to consult with CBV Institute staff to discuss the applicability of the Reporting Standards to a specific engagement, communication or work product.

6. Nothing in this Practice Bulletin should be construed to allow a Member to “opt out” of the Practice Standards due to time and fee constraints, significant scope limitations, or lack of access to key information. Failure to comply with applicable Practice Standards may result in a breach of the Code of Ethics.

Illustrative pricing analysis for a contemplated transaction in the context of a buy-side, sell-side or capital raising mandate

7. Members might be engaged to perform services commonly known as pricing analysis. These work products differ in several substantive ways from valuation conclusions as contemplated by the Reporting Standards.

8. An illustrative pricing analysis is generally done on behalf of a client or prospective client (intended user) to assist them in setting a range of price expectations in the context of a buy-side or sell-side transaction or a capital raising mandate (intended use/purpose). In these engagements, the final price will generally be determined through negotiation by arms’ length parties. Typically, the Member is taking an advisory role (i.e., advising a client and/or the client’s management team), and the Member may do so either as an independent or non-independent advisor, so long as the Member’s role in terms of independence is clearly documented with the client in the terms of the engagement.

9. Given the differences from a valuation conclusion, as well as the intended use/purpose and intended user(s) of an illustrative pricing analysis, communications created under the specific circumstances outlined in the paragraph above may not require a Valuation Report as defined by Practice Standard No. 110.

10. In determining whether a communication is an illustrative pricing analysis to which the Reporting Standards are not intended to apply, **all** of the following criteria **must** be met:

a) <u>Intended use/purpose:</u> There must be a clear and documented understanding with the client that the work product is illustrative pricing analysis work in the context of a contemplated transaction, and specifically for the purposes of a contemplated buy and/or sell-side M&A or capital raising mandate or otherwise to assist the client to form a preliminary understanding of the price they could transact at in the current market environment.

b) <u>Intended user:</u> The only intended user of the pricing analysis is the Member's client and/or the client's management team, and no other third parties (e.g., courts/ mediators/adjudicators/arbitrators, other triers of fact, investors, lenders, or non-client shareholders). The pricing analysis must be for management's informational purposes only, and only in the context of management's strategic planning for a contemplated transaction(s). This restriction on use should be documented in the terms of engagement and should also appear on the pricing analysis work product itself.

c) The Member includes appropriate disclaimers on their work product, such as:

> "*We highlight that while this illustrative pricing analysis has been prepared by a Chartered Business Valuator (CBV), it does not contain any valuation conclusions and is not a Valuation Report as defined by the Practice Standards of the Canadian Institute of Chartered Business Valuators (CBV Institute). Had a valuation been issued in accordance with the Practice Standards of the CBV Institute, the results of the analysis might have been different. Any amounts referenced in the pricing analysis are for illustrative purposes only."*
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> AND (as applicable)
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> *"This analysis has been prepared for use solely by Management of XYZ Company in contemplation of… (describe the buy/sell transaction as specifically as possible). Under no circumstances may this illustrative pricing analysis be provided to any third parties, or relied upon by any third parties, for any purpose. It is not intended for general circulation or publication, nor is it to be reproduced or used for any other purpose. We will not accept any responsibility or liability for losses incurred by any party as a result of the circulation, publication, reproduction or use of this illustrative pricing analysis."*

AND (as applicable)

"We did not perform all of the procedures necessary to render a valuation conclusion or opinion as to the value of the shares, assets, or any business interest of/in the Company. A valuation conclusion can differ significantly from pricing analyses prepared in contemplation of a transaction due to many factors that have not been considered in the scope of this engagement. This would have involved a higher scope of work, such as…"

d) The client has no expectation of receiving a Valuation Report. The Member should document this in the terms of engagement.

e) The communication does not appear confusingly similar to a Valuation Report. For example, avoid using terms such as "value" and "conclusion" in the illustrative pricing analysis. Also, preface all terms which could be confused as "value" or "conclusion" terms with the word "illustrative" (e.g., Illustrative Enterprise Value, Illustrative EBITDA, Illustrative Equity Value, Illustrative Multiples).

11. Even when all the above criteria for an illustrative pricing analysis are met, there are situations where Members might nonetheless decide, using their professional judgment, that an illustrative pricing analysis is not appropriate and that a Valuation Report should be prepared in accordance with Practice Standard No. 110. This decision might arise if the scope of work undertaken for a pricing analysis reaches that of a valuation conclusion, or if the Member assesses a high risk of the work product being relied upon as a valuation conclusion, or if the client requires a Valuation Report, etc. Members should also be mindful that scope of work can change over time – an engagement may start out as an illustrative pricing analysis, but over time, due to changes to the scope of work, the work product might end up containing a valuation conclusion in which case the Member should prepare a Valuation Report in accordance with the Practice Standards.

12. For greater clarity, the following situations would **not** meet the spirit of an illustrative pricing analysis:

   i. Shareholder(s) transacting with another existing shareholder(s) (known as "shareholder buyouts"). Typically, a situation whereby shareholders are transacting with each other tends to remove the "usual" forces of open market transactions between arms' length parties; therefore, in these circumstances, Reporting Standards apply.

   ii. Employee buy-in – Similar to the above, the relationship between the shareholder(s) as the employer and the employee may not be subject to the "usual" forces of open market transactions, thus, Reporting Standards apply.

iii. Transactions between related parties (e.g., family, friends, partners, etc.) because of the higher risk that they will share the work product with the counterparty.

iv. Any situations where third parties will have access to or rely upon the work product as a valuation conclusion (e.g., prospective purchasers or the Canada Revenue Agency). Members should consider not just who their client is, but also other ultimate, intended users or recipients of the work product.

v. Any analysis or value determination for a dispute or in a situation where it is reasonable to expect that a dispute may result (e.g., where communications between counterparties have already broken down).

Communications that do not include a conclusion (opinion) and are clearly noted as such

> The Reporting Standards apply when issuing written communications which conclude on value (Practice Standards Nos. 110 and 210); when issuing conclusions of a financial nature in the context of litigation, such as a conclusion on financial gain or loss (Practice Standard No. 310); when commenting on the conclusions of others (Practice Standard No. 410); when issuing fairness opinions (Practice Standard No. 510); and when issuing an independent conclusion assessing the reasonableness of values determined by a third-party or manager for an Investment Entity (Practice Standard No. 610).

13. Some examples of communications that might not express a conclusion include:

    a. Communication of valuation theory, approaches or methodologies.

    b. General advice in the context of litigation or a dispute (e.g., possible approaches, illustrative scenarios where each is conceivably possible under the circumstances, etc.).

    c. A range of value advisory services, typically focused on helping businesses improve their overall value through strategic planning, operational improvements, and financial management (e.g., advice on succession planning, M&A advisory, debt advisory, value creation advice).

14. In circumstances where the Member has determined that the communication does not contain a conclusion, the Member should:

    a) Ensure that the services and the resulting work product are appropriately described in the terms of the engagement (without a reference to a “conclusion” or “valuation” or other terminology that has a defined meaning under the Practice Standards).

b) Ensure that the communication does not appear confusingly similar to a work product prepared under the Reporting Standards. For example, the work product should not be described as a “valuation” or “expert report”, it should not include a “conclusion” that looks like the conclusion of a report prepared under Reporting Standards, and it should not use other terminology that has a defined meaning under the Practice Standards.

c) Include a clear, prominent and unambiguous statement to the effect that it is the Member’s assessment that the Reporting Standards do not apply, and the Reporting Standards have therefore not been followed, such as:

“*This communication does not represent the author(s)’s opinion or conclusion of value, of financial gain/loss or of a financial nature in the context of litigation. It is not to be construed as a Valuation Report or Expert Report as defined by the Practice Standards of The Canadian Institute of Chartered Business Valuators (CBV Institute).”*

15. The Member’s independence, or lack of independence, in providing the services is not relevant to the determination of whether a communication contains a conclusion.

16. If unable to determine whether a communication contains a conclusion, Members should consult with the appropriate Institute staff.

17. If the Member, after consulting with the appropriate Institute staff, is still unable to make a clear determination as to whether a communication expresses a conclusion, the Member should assume that a conclusion is being expressed and that Reporting Standards apply.

Communications intended solely for internal use within the Member’s own organization

The Reporting Standards apply to communications with clients or their representatives.

18. The Reporting Standards are not intended to apply to communications intended solely for internal use within the Member’s own organization (employer). Therefore, when the communication is strictly for user(s) within the same organization to which the Member belongs or is employed, the Member may issue the communication without following the requirements of the applicable Reporting Standards. However, Members must still comply with the applicable Scope of Work and Documentation requirements found in Practice Standards 120, 130, 220, 230, 320, 330, 420, 430, 520, 530, 620, and 630.

19. Members should consider not just who their internal users are, but also other ultimate, intended users or recipients of their communications. In other words, Members who are

employed “in-house” and prepare analyses or work product for their employers should not make blanket assumptions that the Reporting Standards do not apply. Rather, Members must assess each communication on a case-by-case basis. The following are intended as clarifying examples based on frequently asked questions:

> *Q: If a work product is being provided to auditors, such as a purchase price allocation done “in-house”, does this mean that the work product is no longer strictly internal?*
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> *A: No. A communication does not become “external” by virtue of having auditors as potential users. While auditors can reasonably be expected to review Members’ communications in several scenarios (e.g., a Purchase Price Allocation), auditors perform their procedures on the accounts, books and records of the business, including internal calculations; therefore, they are not ‘intended users’.*
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> *Q: What if a Member is employed “in house” by an insurance company? This Member quantifies losses related to a claim (e.g. lost income due to an accident or business interruption losses) and provides their analysis internally to the company’s adjuster. In the normal course, the adjuster sends the communication externally to the insured party. Is this an Expert Report?*
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> *A: Yes, this is an external use requiring an Expert Report under the Practice Standards. The Member knows (or should reasonably be expected to know) that the work product has an ultimate end user (the insured party) that is external to the organization. The Member must comply with the relevant Practice Standards, including the relevant reporting standards.*
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> *Q: I was asked to prepare a valuation of a client’s company for a tax reorganization by the assurance/tax partner of my firm. Is this considered internal?*
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> *A: No, the ultimate user is the firm’s client who is external. Furthermore, the Canada Revenue Agency is another external user that is foreseeable. Therefore, Reporting Standards apply.*

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