Exposure Draft

PRACTICE STANDARD NO. 110

VALUATION REPORTS

REPORT DISCLOSURE STANDARDS

1. A Valuation Report is any written communication containing a conclusion as to the value of shares, assets, liabilities or any other interest in a business, prepared by a Valuator acting independently and objectively.

2. There are three levels of Valuation Reports: Comprehensive (containing a Comprehensive Valuation Conclusion), Estimate (containing an Estimate Valuation Conclusion) and Calculation (containing a Calculation Valuation Conclusion).

3. A work product that is in the process of being completed (e.g., draft or preliminary) is not a Valuation Report provided that it is issued to a client or knowledgeable third party in circumstances where all four of the following conditions are met and explicitly disclosed on the work product:

    A. the work product is clearly marked as being in draft form and subject to change, and cautions that changes may be significant;

    B. the work product is issued for the purpose of obtaining comment, further instructions or information from the client(s), required to complete the Valuation Report;

    C. the Valuator knows, or reasonably ought to know, that the intended reader(s) does not intend to rely on the work product or distribute the work product to a third party who might in turn rely on such work product; and

    D. the Valuator has a reasonable expectation at the time the work product is provided that a Valuation Report will be completed and issued in due course.

4. A summary of a Valuation Report is exempt from this Practice Standard provided that it clearly refers to the Valuation Report and cautions the reader that the Valuation Conclusion should be assessed having regard to the full Valuation Report.

5. A Valuation Report may vary in length and depth . The content and level of detail of any Valuation Report must be appropriate for the engagement (based on professional judgment and given its purpose and the needs of the intended users), subject to the minimum disclosure requirements in this Practice Standard**. The Valuation Report must provide the intended user(s) with a clear understanding of how the Valuator arrived at the Valuation Conclusion and include all information necessary to provide the client and intended user(s) with a clear description of the Scope of Work performed, information relied**

upon, professional judgments made, significant inputs and assumptions and the basis for conclusions reached. Given the differences in Scope of Work between report levels, a Calculation Valuation Report is generally expected to be briefer than an Estimate Valuation Report or a Comprehensive Valuation Report).

6. At a minimum, Valuation Reports must contain the following information, which is set out below in bold characters. "*Explanatory comments*" provide additional guidance and interpretation. The minimum disclosure requirements apply equally to all three levels of Valuation Reports (Comprehensive, Estimate, Calculation).

General Disclosure Standards

7. The Valuation Report must include the following bolded information:

   A. **The party to whom the Valuation Report is addressed, the identity of the client that engaged the Valuator and any other intended users of the Valuation Conclusion and Valuation Report;** (*Explanatory comments*: intended users are those parties which are expected to access and possibly rely on the Valuation Conclusion. Intended users can be referred to as a class or group, without necessarily naming every individual party. The intended users disclosed in the Valuation Report should be consistent with those in the engagement agreement);

   B. **A description of the shares, assets, liabilities or interest in the business being valued;**

   C. **The date of the Valuation Conclusion (the "Valuation Date");**

   D. **The date of the Valuation Report;** (*Explanatory comment*: the Valuation Report should be dated when issued or at the time when pertinent information was last obtained and analyzed).

   E. **The purpose and intended use for which the Valuation Report has been prepared;** (*Explanatory comments*: The purpose is the reason the valuation is performed, (e.g., dispute between certain parties, estate planning), and the intended use refers to the circumstances in which the Valuation Report is meant to be used, (e.g., for mediation, in court, to support tax filings, etc). The purpose and intended use are based on communication with the client. The Valuation Report should include a disclaimer that the Valuation Report has been prepared for specific intended users having specific needs and/or knowledge in specific circumstances, and that the Valuation Report should not be accessed or relied upon by other users or for other purposes).

   F. **The name of the Valuator (and the firm) responsible for issuing the Valuation Report;**

   G. **A statement that the Valuation Report was prepared by the Valuator acting independently and objectively;**

   H. **A statement that the Valuator's compensation is not contingent on an action or event resulting from the use of the Valuation Report;**

I. **A statement that the Valuation Report has been prepared in conformity with the Practice Standards of The Canadian Institute of Chartered Business Valuators (CBV Institute);**

J. **The level of Valuation Conclusion being provided (i.e., Comprehensive, Estimate, or Calculation); and**

K. **A statement that professional judgment is applied by the Valuator in determining the appropriate Scope of Work for the engagement and also for classifying a particular Valuation Conclusion as Comprehensive, Estimate or Calculation, based on discussions with the client(s) regarding purpose and intended use.**

Report Limitations

8. The Valuation Report must disclose the applicable report limitations:

A. **A Valuation Report providing an Estimate Valuation Conclusion must disclose that the conclusion expressed is based on the extent of review, inquiry, analysis and independent corroboration procedures performed and that such procedures would have been more extensive had a Comprehensive Valuation Conclusion been completed. Therefore, the conclusion expressed may have been different had a Comprehensive Valuation Conclusion been provided.**

B. **A Valuation Report providing a Calculation Valuation Conclusion must disclose that the conclusion expressed is based on the extent of review, inquiry, analysis and independent corroboration procedures performed and that such procedures would have been more extensive had either a Comprehensive Valuation Conclusion or an Estimate Valuation Conclusion been completed. Therefore, the conclusion expressed may have been different had a Comprehensive Valuation Conclusion or an Estimate Valuation Conclusion been provided.** (*Explanatory comment*: For example, a Valuation Report providing a Calculation Valuation Conclusion should disclose the following recommended language:

Caution to Reader of this Calculation Valuation Conclusion:

There is substantial professional judgment applied by the Valuator in classifying a particular Valuation Conclusion as a Comprehensive, Estimate or Calculation.

This Calculation Valuation Report contains a Valuation Conclusion that is based on generally accepted valuation theory and principles.

Readers are cautioned that this Calculation Valuation Conclusion is based on a minimal Scope of Work, and therefore may not be suitable in all circumstances. The Valuation Report has been prepared from information provided primarily by management with little independent corroboration by the Valuator.

The procedures undertaken by the Valuator in arriving at this Calculation Valuation Conclusion would have been more extensive had either an Estimate Valuation Conclusion or a Comprehensive Valuation Conclusion been undertaken. Accordingly, the conclusion expressed may have been different had an Estimate Valuation Conclusion or a Comprehensive Valuation Conclusion been provided.

Readers are cautioned that a Calculation Valuation Conclusion may not be suitable in all contexts.)

Specific Disclosure Standards

9. Valuation Reports must include the following information:

A. **The premise of value, the basis of value, as well as the valuation approach(es) and method(s) used, explaining the rationale for their selection**; (*Explanatory comments*: the premise of value (e.g., going concern) is an assumption regarding the circumstances that may be applicable to the subject valuation. Basis of value, also known as the standard of value, is the definition of value used in a valuation (e.g., Fair Market Value). Valuation approaches include the cost, income or market approach. Valuation methods will vary depending on the selected valuation approaches. The basic mechanics of the valuation methodologies used should be outlined).

B. **Definitions for the basis of value used (such as "fair market value", "market value", "fair value", or "adjusted net asset value") and any other technical terms which might not be self-evident, along with the source of the definition;** (*Explanatory comment*: reference should be made to Practice Bulletin No. 2 *International Valuation Glossary – Business Valuation* unless an alternative source for definitions is more applicable in the circumstances).

C. **A description of the business and interest being valued that is appropriate for the intended purpose and users;**

D. **A summary of the relevant industry and economic factors that affect the Valuation Conclusion;**

E. **A summary of relevant financial information**; (*Explanatory comment*: this would typically include current and historical financial position information, earnings/cash information, as well as forward-looking financial information, where available)

F. **The significant inputs to the Valuation Conclusion and identification of the source or explanation of how the inputs were developed;** *(Explanatory comments:*

determining which inputs are “significant” is necessarily a matter of professional judgment. Judgments about significance should be made in light of the facts and circumstances of the valuation engagement and the nature of the interest being valued. Aspects of a valuation are considered significant if their impact on the Valuation Conclusion could reasonably be expected to impact the decisions of the intended users of the Valuation Conclusion. The Valuator must explain in the Valuation Report the source of significant inputs (whether they were independently developed or provided by management) and, if applicable, the work that the Valuator performed to corroborate the significant inputs. The Valuator should consider identifying and listing all significant inputs in a standalone section of the Valuation Report for the benefit of the users. Examples of significant valuation inputs may include, but are not limited to:

- adjustments leading to the selection of normalized earnings or cash flow levels,
- future cash flows,
- growth rates (e.g., industry and economic outlooks),
- rates of return earned (e.g., ROE, ROA)
- rates of return required by capital providers and the corresponding discount rates (e.g., WACC, cost of equity), capitalization rates (e.g., WACC or market multiples)
- a discussion of relevant earnings/cash flow risk factors,
- tax rates,
- redundant assets,
- excess or deficient working capital,
- minority interest or other discounts or premiums).

G. **The significant assumptions made in arriving at the Valuation Conclusion and the basis for making each assumption;** (*Explanatory comments*: the Valuator must explain in the Valuation Report the source of significant assumptions (whether they were independently developed or provided by management) and if applicable, what work the Valuator performed. The Valuator should consider listing all significant assumptions in a standalone section of the Valuation Report for the benefit of the users. Examples of significant assumptions may include, but are not limited to:

- the fair market value of capital assets, which might include an assumption regarding the fair market value of real estate,
- assumptions regarding market compensation for positions held by shareholders or related parties,
- assumptions regarding key or significant normalizing adjustments, such as discretionary expenses,
- applicable tax rates,
- reliance on conclusions of other experts such as real estate appraisers,

- the assumption that information in financial statements is fairly presented,
- assumptions regarding the existence and/or measurement of highly uncertain liabilities (litigation, environmental claims, etc.)).

H. **The significant valuation calculations used to arrive at the Valuation Conclusion;** (*Explanatory comment:* this could be in the form of schedules and/or tables, and/or a narrative description of the significant calculations);

I. **Whether potential 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).

Report Scope of Review

10. **The Valuation Report must contain a scope of review section that clearly identifies the specific information (e.g., documents, data, interviews) the Valuator relied upon to arrive at the Valuation Conclusion.** *(Explanatory comments:* scope of review is the information obtained and reviewed by the Valuator, including the documents and data reviewed. Scope of review is not the same as the Scope of Work (refer to Practice Standard No. 120); however, Scope of Work includes a review of the information summarized in the Valuation Report's scope of review section).

Scope Limitations

11. **A scope limitation occurs when significant relevant information is denied by the client or some other party or otherwise unavailable to the Valuator limiting the ability of the Valuator to perform an appropriate Scope of Work. A scope limitation may also occur if the Valuator considers the quality of the information to be inadequate and/or unreliable. When a scope limitation exists, it must be identified in a prominent manner in the Valuation Report and adequately explained, setting out the reasons for the limitation and its possible impact(s) on the Valuation Conclusion.** (*Explanatory comments*: determining whether a scope limitation exists, and how significant it is in the context of the engagement, is a matter of professional judgment. Scope limitations may exist for every level of Valuation Conclusion (Comprehensive, Estimate, Calculation). Some scope limitations may be insignificant, in which case they need not be disclosed, while others may be considered significant, and must be disclosed prominently in the Valuation Report. Understanding and disclosing scope limitations is significant for transparency as they can affect the reliability of the Valuation Conclusion. If any scope limitation(s) are significant to a degree that they are likely to jeopardize the credibility of the Valuation Conclusion, the Valuator must not render a Valuation Conclusion).

Report Restrictions

12. **Valuation Reports must disclose any restrictions that affect the Valuation Conclusion, as noted below:**

   A. **A statement restricting the use of the Valuation Report to the persons for whom the Report was prepared and only for the stated purpose and intended use;**
   B. **A statement denying responsibility for losses resulting from any unauthorized or improper use of the Valuation Report; and**
   C. **A statement giving the Valuator the right (but not the obligation) to make revisions and/or to further support the Valuation Conclusion under specified circumstances, such as when facts existing at the Valuation Date become apparent to the Valuator after the Valuation Report is issued.**

Conclusion

13. **The Valuation Report must contain a Valuation Conclusion as to the value of the shares, assets, liabilities, or any other interest in a business being valued, subject to significant valuation context, including any scope limitations.** (*Explanatory Comment*: the Valuation Conclusion section should include a reference to the level of Valuation Conclusion being provided, the Valuator's scope of review, significant inputs and assumptions relied upon, and any restrictions and/or scope limitations in the Valuation Report.).

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