



# Scope of Appraisal Review Procedures for Business Valuations

by **Raymond Rath, ASA, CEIV, CFA**

*Best practices for appraisal reviews of business valuations are evolving. Appraisal review for real estate lending has received significant attention from bank regulators for decades. With increased reliance on fair value estimates for financial reporting, the SEC and Public Company Accounting Oversight Board (“PCAOB”) expressed concerns about the quality of fair value estimates and the depth of appraisal review procedures of auditors and their valuation specialists. Many articles on BV review focus on technical issues. This article focuses on better understanding possible elements of the scope of work for a BV review. My focus is on reviews that express a conclusion pertaining to the reasonableness of the appraiser’s fair value estimate. While my comments focus on financial reporting, the scoping issues are relevant to BV reviews for other purposes.*

## **USPAP Insights**

The Uniform Standards of Professional Appraisal Practice (“USPAP”) promulgated by The Appraisal Foundation provides high-level guidance on the review process. USPAP guidance is principles and not rules based. USPAP guidance is generic and not by discipline or specific type of asset. USPAP notes the scope of work for a valuation and a review is a function of complexity of the asset and the use of the appraisal review. The valuation of Level One assets as set forth in ASC 820, Fair Value Measurements, is straightforward. The valuation of Level Three assets involves numerous often highly subjective assumptions.

The scope of procedures for an appraisal review influence the quality of the review opinion. While a review that consists of simply reading an appraisal report and reacting to the information in the report is a form of limited scope review, this

set of procedures would not be viewed favorably in many situations.

With the focus on confirming if a valuation estimate is reasonable, elements of a comprehensive review include:

- Confirm appropriateness of valuation with use
- Confirm key facts and data presented
- Confirm methodologies
- Confirm assumptions
- Check the math
- Express opinion on the value estimate

Within each area, there are numerous procedures that are beyond the scope of this article to cover.

USPAP Standards Rule 3-1 indicates that “In developing an appraisal review, the reviewer must:

- Not commit a substantial error of omission or commission that significantly affects an appraisal review; and
- Not render appraisal review services in a careless or negligent manner ...”

#### Audit Insights

CPAs recognize the differences between an audit and a review for financial statement preparation. The objectives of each are described in the *AICPA's Guide to Financial Statement Services: Compilation, Review and Audit* published in 2015.

“Review — To obtain limited assurance as a basis for reporting whether the CPA is aware of any material modifications ... primarily through the performance of inquiry and analytical procedures.”

“Audit — To obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement ... in all material respects ...”

A financial statement review is substantially narrower in scope than an audit. A review does not contemplate obtaining an understanding of a business's internal control; assessing fraud risk; testing accounting records through inspection, observation, outside confirmation or the examination of source documents or other procedures ordinarily performed in an audit.

As the highest level of assurance, an audit typically is appropriate and often required for third-party reliance such as obtaining financing and credit. An audit is often required by potential outside investors or in advance of the sale of a business.

In assessing these audit concepts and tying them to BV appraisal reviews, an appraisal review based on inquiry rather than verification should be viewed as a limited scope review. A full-scope

review would likely include procedures such as assessing third-party and other data in assessing management projections among other procedures.

#### PCAOB Insights

Guidance from the PCAOB helps us better understand an appraisal review. PCAOB inspections of audit firms have questioned the coordination of fair value reviews by audit teams and their valuation specialists (whether em-

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ployed by the audit firm or a third-party consultant). PCAOB inspection teams questioned the documentation of the agreement on the scope of work to be performed by the valuation specialist. PCAOB inspections indicate failure to agree in advance to a specific scope of work by the valuation reviewer is not a best practice.

PCAOB reviews assess procedures performed by the assurance team and

the valuation reviewer, and coordination between the two groups. The goal is to conclude whether the total procedures performed provided an adequate basis to support the review conclusion.

AS 2502 (AU 328): Auditing Fair Value Measurements and Disclosures was issued by the PCAOB to help auditors better address audits of fair value estimates. AS 2502 indicates substantive testing of fair value measurements

may involve:

- Testing management’s significant assumptions, the valuation model and the underlying data
- Developing independent fair value estimates
- Reviewing subsequent events and transactions

**Mandatory Performance Framework**

Other resources available to help determine the scope of an appraisal review include the Mandatory Performance Framework and Application of Mandatory Performance Framework documents (collectively, the “MPF”). The MPF was issued by Corporate and Intangibles Valuation Organization, LLC, a not-for-profit entity owned by the AICPA, ASA and Royal Institute of Chartered Surveyors (“RICS”). The MPF are intended as guides to help preparers and reviewers of fair value estimates perform adequate procedures to support a valuation estimate.

Many articles on BV review focus on technical issues. This article focuses on better understanding possible elements of the scope of work for a BV review. Recently, auditors’ opinions have started to include language like “We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.” A full-scope appraisal review report should contain similar language. For an appraisal review, an example might be, “We believe the appraisal review evidence obtained is sufficient and appropriate to provide a basis for our appraisal review opinion.” Reflection on this proposed language and the current level of procedures performed in many BV reviews may lead to expanded procedures by reviewers and a clearer communication of the scope of the BV review to users. ●

**Raymond Rath, ASA, CEIV, CFA**, is with *Globalview Advisors LLC*. He will be a speaker at the *Business Valuation and Forensic & Litigation Services Conference* on Dec. 18, 2019. See page 14 for more details.

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