AICPA

Forensic and Valuation
Service Section

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International Valuation Standards Council
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commentletters@ivsc.org

Dear Board Members:

AICPA appreciates the invitation to comment on the International Valuation Standards Council (IVSC) Standard Review Board's Agenda Consultation Paper issued May 15, 2017.

The American Institute of Certified Public Accountants ("AICPA") is a professional organization of approximately 418,000 members. Our constituency actually exceeds that number. That is because, under various state accountancy laws, AICPA professional standards also encompass practicing CPAs who are not AICPA members.

The Forensic and Valuation Services Executive Committee ("FVSEC") is a senior technical committee of the AICPA. The FVSEC is empowered to issue valuation standards for our members and to comment on valuation-related topics on behalf of the AICPA. In 2007, the AICPA issued valuation standards, Statement on Standards for Valuation Services No. 1.

This letter presents the FVSEC's comments and responses to certain questions for respondents raised in this Invitation to Comment (ITC).

FOR IVSC GAP ANALYSIS

Question 1
Do you agree with the current categorization and timings of the topics contained in the gap analysis and if not why?

The FVSEC agrees with the current categorization and timings of the topics contained in the gap analysis with the following exceptions:

<u>Inventory</u>

- FVSEC believes that the Business Valuation Board (BV Board) should consider classifying and prioritizing this topic to either 'medium' or 'long-term' instead of 'critical'. The FVSEC believes the authoritative guidance for valuing inventory that currently exists within FASB ASC 805, Business Combinations, and the complementary

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non-authoritative guidance published by membership organizations like the AICPA provide sufficient coverage of the most significant issues regarding inventory valuation.

The FVSEC also believes that the BV Board is taking the appropriate course of action by staying current on related developments related to inventory valuation, specifically as it relates to the upcoming public comment period for the AICPA's Business Combinations Accounting and Valuation Guide.

- FVSEC believes the BV Board should issue a discussion paper on the issues and recommended best practices when valuing inventory instead of pursuing an initiative to draft and issue standards. The BV Board correctly notes that existing guidance is often silent with regards to specific inventory valuation issues. The FVSEC believes, however, that a discussion paper could address the complexities and nuances of inventory valuation much more thoroughly and comprehensively than standards designed for the same purpose. Furthermore, a discussion paper may be more readily updated to stay current with changes in practice and methodologies compared to standards that typically lack that flexibility.

Question 2
Are there any other topics which you believe should be included or deleted from the IVS gap analysis and of so why? (Please state the relevant specialism, categorization and timing for any proposed additional topics).

FVSEC believes the following topics and corresponding categorization and prioritization should be considered:

- <u>FORECASTS. Prioritization – **Critical.** Deliverable - **Discussion Paper.**</u> Forecasts developed by management and by valuation professionals are often the primary component of a valuation. Valuation professionals often rely on management's forecasts without applying the appropriate level of review or scrutiny to the information provided. As a result, valuations that rely solely on forecasts developed by management which are not representative of expected value, properly supported, or both. FVSEC believes that a discussion paper emphasizing the role of the valuation professional and additional factors and common procedures to consider when assessing management's forecasts with proper professional skepticism will help promote higher quality and more consistent valuations.

- <u>EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs). Prioritization – **Critical**.</u> Deliverable – **Discussion Paper**. Complex capital structures normally focus on the familiar topics of preferred stock, convertible debt and various classes of common stock. While this analysis is important for business valuation, there is another area that is often overlooked in business valuation expertise, and that is employee ownership of equity interests or rights in a company. Worldwide there are companies with significant employee ownership that require as much analysis as the more commonly known complex capital structures. Some countries support companies owned as an employee coop, which requires the employee to buy in for their job and requires the company to buy out the employee when they terminate employment. Some countries support broad based employee stock ownership plans subject to the laws of that country. Other common ownership structures include retirement set based on equity value of the company, or deferred compensation set on the value of the company's equity value.

Valuation professionals tend to overlook employee ownership elements in setting a value for equity, or to incorrectly calculate a value per share without considering the cost of employee rights to warrants, options, or equity based retirement benefits. In order to fully address complex capital structures, employee ownership components need to be understood, documented and used in estimating the equity values of the subject interests in business valuations. These employee ownership elements include commitments of future cash flows, jurisdictional requirements for employment law which give rise to claims against equity, dilution of shares outstanding, and possibly debts that are not recorded in the financial statements. Business valuation standards should consider employee ownership elements as part of the analysis of complex debt structures.

- RELYING ON THE WORK OF EXTERNAL EXPERTS. Prioritization – **Medium Term**. Deliverable – **Guidance Note**. On June 1, 2017, the Public Company Accounting Oversight Board (PCAOB) issued for public comment a proposal to strengthen the requirements that would apply when auditors use the work of specialist in an audit. If this proposal is adopted in its current form, many international valuation professionals will be impacted by the augmented requirements placed upon the public accounting firms that retain them as specialists. Therefore, if the standards for when auditors use the work of a specialist in an audit are changed, a guidance note outlining and explaining the new requirements would raise awareness of the new requirements as well as be a useful resource for valuation professionals to help them stay current with changing regulatory landscape.

Finally, we thank the Board for its consideration of our comments and for its continued service to the valuation profession.

Very truly yours,

Annette Stalker, CPA/CFF
Chair, AICPA Forensic and Valuation Services Executive Committee