

The Evolving Role and Impact of the CPA Business Appraiser/Expert Witness

By Tony Garvy

Abstract: This article is a brief discussion regarding the new appraisal standard for certified public accountants and the evolving issues concerning expert witness testimony in Illinois and elsewhere.

“Based on SSVS 1 and guidelines of NACVA and the ASA to its membership, the appraisal of a business interest is becoming more easily understood.”

Due to recent court decisions and a newly enacted standard, the role of the professional business appraiser/expert witness continues to evolve, with important ramifications for the legal community. The role of the appraiser/expert witness in trial work, estate and tax planning, and other legal environments has become so important that attorneys practicing in these areas should become familiar with the changes to effectively manage their clients' legal matters. This article will provide an overview of some of these large issues facing business appraisers and expert witnesses.

The biggest change impacting appraisal practice is the American Institute of Certified Public Accountants (AICPA) Statement on Standards for Valuation Services No. 1, or “SSVS 1” as it is commonly called. SSVS 1, which was issued on June 21, 2007, constitutes a historic change to appraisal work. Basically, SSVS 1 provides that only accredited certified public

accountants (CPAs), who either have a valid business appraiser accreditation or are technically proficient in business valuations and can perform their work in compliance with SSVS 1, should be performing appraisal work.¹ Indeed, in various decisions, courts have held similarly.

Although appraisers who do not have the CPA credential do not need to adhere to SSVS 1, the large pool of financial consultants who are practicing CPAs must adhere to SSVS 1. Therefore, CPAs can no longer perform a quick or casual appraisal as an accommodation – they must exercise the professionalism and execution set forth in SSVS 1. While there are many other accreditations, including Certified Valuation Analysts (CVA), Accredited Senior Appraisers (ASA), and Chartered Financial Analysts (CFA), their representation in the professional appraisal community is dwarfed by the more than 350,000 active CPAs in the U.S., some of whom are becoming Accredited in Business Valuation (ABV), an accreditation offered by the AICPA.² Regardless of whether a CPA earns an ABV accreditation or not, that CPA still must follow SSVS 1 in his or her appraisal practice. An appraiser who is a CVA or an ASA, and is also a practicing CPA, must incorporate the SSVS 1 standards in his or her appraisal practice and reports. Attorneys working with their CPA colleagues on valuation engagements should check to make sure that they are in compliance



Mr. Garvy is a Certified Public Accountant (CPA) and Certified Valuation Analyst (CVA). He has appraised equity interests for over twelve years and given trial testimony in numerous cases. He earned his MBA from the Kellogg School of Management and is a member of the Business Valuation Association, NACVA, ASA and the AICPA.

with SSVS 1.

SSVS 1: The New Standard for Business Valuations by CPAs. SSVS 1 is effective for all appraisal engagements accepted by CPAs on or after January 1, 2008. The 76-page standard can be found online at www.aicpa.org/bvstandard. The benefits of standardizing valuation services are obvious: improved professional work product through consistency and focus in adhering to the standard, transparency, and a standard by which to measure the quality and credibility of an appraiser's work product.

The AICPA took close to five years to promulgate SSVS 1. Despite the lengthy process, however, in many ways the AICPA got it right. By setting a standard that mandates compliance, and not a memorandum or guideline to its membership, the AICPA flexed its muscle over its large membership of CPAs. It incorporated many of the current appraisal methodologies and encompassed most valuation assignments, including appraisal of intangible assets.

In general, this standard prescribes valuation methodologies very similar to those promulgated by the National Association of Certified Valuation Analysts (NACVA) and the American Society of Appraisers (ASA). For valuing an equity interest, business interest or intangible asset, there are generally three generally accepted valuation approaches: income-based approach, asset-based approach, and market-based approach. In order to comply with SSVS 1, a sound valuation report must state explicitly the appraiser's consideration and employment or rejection of each of these approaches.

Based on SSVS 1 and guidelines of NACVA and the ASA to its membership, the appraisal of a business interest is becoming more easily understood. However, with the complexity of these standards and the uniqueness of each business interest, including what discounts

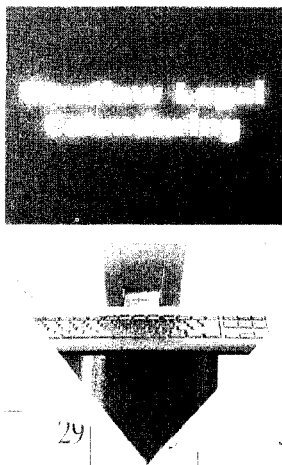
or premiums may result depending on the facts and circumstances of each appraisal engagement, a typical valuation engagement can take many weeks to culminate into a valuation report. After such time, a competent business appraiser should have a good working knowledge of the business, its industry, its competitors, its peer group and its financial performance if called upon for trial testimony.

However, SSVS 1 varies from USPAP³ in a couple of distinct respects. First, since USPAP was first promulgated back in 1987, it followed closely IRS Revenue Ruling 59-60, which sets forth eight factors⁴ that must be considered in valuing a business interest. USPAP requires the appraiser to address those eight factors in a USPAP compliant appraisal report. SSVS 1 does not require those eight factors to be specifically addressed. Accordingly, a report that satisfies SSVS 1 may not be in compliance

with USPAP's more defined standards.

SSVS 1 also has a looser standard than USPAP in regard to defining the standard of value. USPAP Rule 10-2(vi) provides: "State the standard (type) and definition of value and the premise of value and cite the source of the definition." In contrast, SSVS 1 (paragraph 52) requires the appraiser to include information regarding the standard of value and premise of value. Again, USPAP is a bit more exacting in its requirements.

Since SSVS 1 applies to CPAs, and USPAP applies to non-CPA appraisers, there are also some minor differences in terminology; however, these differences are logical. For example, USPAP requires appraisers to make certain warranties, called "certifications," in their appraisal reports. In contrast, the SSVS 1 uses the term "representations."



Productivity breakthrough: Westlaw Legal Calendaring

Westlaw[®] Legal Calendaring automatically calculates your litigation deadlines based on the applicable federal, state and local court rules – then adds the information directly to your Microsoft[®] Outlook[®] calendar. As dates change, you can recalculate accordingly – and repopulate your calendar with the updates.

Know with confidence you'll never miss key dates again – no matter how often they change. For more information, call our Reference Attorneys at **1-800-733-2889 (REF-ATTY)**.

In sum, the differences between SSVS 1 and USPAP are material, but the differences do not make it insurmountable for a CPA appraiser to practice under both of these standards. However, these differences could be a source of problems and subject to a line of attack if the CPA appraiser practicing under both standards is not familiar with their differences.

The Impact of SSVS 1 on the Expert Witness. As the role of the financial expert witness grows in trial testimony, the role of SSVS 1 as the standard of the largest professional body of financial consultants will have a large impact in litigation. In the federal courts and in most state courts, but not including Illinois and a handful of other states, expert witnesses are challenged through “Daubert challenges.”⁴ These “Daubert challenges” give the trial judge the power to preclude the admission of expert witness testimony. Often these successful challenges are granted if an expert witness is not accredited or sufficiently experienced in the areas of expert testimony.

The 2004 Illinois Supreme Court decision in *In Re Commitment of Simons*⁵ created a *de novo* review standard for the admission of expert testimony. The trial court can look to sources both within trial testimony and sources outside the court in determining whether a *Frye*⁶ hearing is warranted. So, whereas Daubert allows for challenges to dismiss an opponent’s witness, *Simons*, based on the *Frye* case, simply necessitates that the testifying expert employ generally accepted principles within the particular field of testimony.

However, in either Illinois courts or federal courts, the courts will look to see that the expert testimony is given in accordance

with acceptable practices within the (valuation) industry.⁷ This “general acceptance test” from the *Frye* and later *Miller* case increases the importance for proper training and accreditations about employing generally accepted methodologies. It would be advisable for counsel to understand what accreditations, experience and particular industry/specific appraisal experience your prospective expert witness has. Further, if a prospective expert witness is a practicing CPA, determine whether the expert report and testimony conform to SSVS 1.

As the expert witness’s role grows, there will undoubtedly be further refinements to what constitutes a proper expert witness and the expert’s role in evidentiary testimony. There is no doubt that courts are taking a closer look at the credibility of experts in light of *Daubert* challenges and the *Simons* ruling in Illinois. For expert witnesses on matters of business valuation and valuation testimony, it is imperative that their work is reflective of the standards and methodologies promulgated by NACVA, ASA or the AICPA. Thus, as a result of the tightening court standards and the new standard promulgated by the AICPA, litigants who need the use of an expert appraiser should choose a professional who has both the experience and accreditations to

produce a sound, credible result using accepted methodologies.■

¹ Paragraph 11 of SSVS 1 quotes Rule 201A Professional Competence, AICPA Rules of Professional Conduct: “Performing a valuation engagement with professional competence involves special knowledge and skill...”

² For Reference, Certified Valuation Analyst (CVA) is an accreditation of the National Association of Certified Valuation Analysts, the Accredited Senior Appraiser (ASA) is an accreditation of the American Society of Appraisers, the Chartered Financial Analysts (CFA) is an accreditation of the CFA Institute.

³ USPAP is the Uniform Standards of Professional Appraisal Practice, which is the appraisal standard adopted by the American Society of Appraisers and first promulgated by the Appraisal Foundation in 1987 in response to the need tighter real estate appraisal standards to the savings and loan crisis.

⁴ Illinois state courts seem to be in the minority in not adhering to *Daubert v. Merrell Dow Pharmaceuticals* (92-102), 509 U.S. 579 which is the 1993 US Supreme Court decision that has precipitated “Daubert challenges” due to the inherent “gatekeeper” role that this decision placed on the judge.

⁵ In *Re Commitment of Stephen E. Simons* (The People of the State of Illinois, Appellant, v. Stephen E. Simons, Appellee). Opinion Filed December 16, 2004. Docket No. 97026.

⁶ See *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923)

⁷ In *Simons* ruling, Chief Justice McMorrow cited from the opinion of *People v. Miller*, 173 Ill. 2d 167, 187 (1996): “is the fact that the general acceptance issue transcends any particular dispute.”

LAWYERS LENDING A HAND

Come Do Yourself Some Good...By Helping Others

We will conduct our annual **December Toy Drive**. Donate new, unwrapped toys between **December 1 until 5:00 pm on December 15**. We will also collect toys at the DCBA Holiday Party at Maggiano's Oak Brook on Wednesday evening, December 10. At 5:00 pm on December 16, the committee will meet at the Bar Center to sort toys for delivery to various agencies throughout the county.

The Lawyers Lend A Hand project for **January** is scheduled for **THURSDAY, January 22nd at 5:00 PM**. We will meet at the DuPage Children's Museum to help with a mailing and prepare art supplies for a children's project. The museum is located at 301 N. Washington Street, Naperville. This promises to be a fun event.