
MATRIMONIAL VOLUME 8 / ISSUE 2 NEWSLETTER
2007

SUBSEQUENT EVENTS
STATEMENT ON STANDARDS FOR VALUATION SERVICES

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Recently, the Consulting Services Executive Committee of the American Institute of Certified Public Accountants (AICPA) released its long awaited Statement on Standards for Valuation Services (BV Standards), which applies to all AICPA members regardless of their technical disciplines.

Questions surrounding subsequent events are often encountered in our litigation practice and are addressed in the new BV Standards. Consider the following fact pattern: A business valuation firm is contacted by counsel in May 2007 and engaged to prepare a valuation of a closely held business as of December 31, 2006. In performance of normal due diligence procedures, the analyst becomes aware of the loss of a major customer in March 2007. This event will result in a 40% decrease in future operating profits. Should the analyst consider this event in the valuation analysis?


BV Standards-Subsequent Events

Under paragraph 43, the AICPA states that “generally,” the valuation analyst should consider only those circumstances that existed as of the valuation date and events occurring up to the valuation date. Subsequent events are defined within the standard as indicative of conditions that were not known or knowable as of the valuation date. In a litigation setting, the Court may order a departure from the standards. Notwithstanding such an order, the valuation report should not reflect subsequent events or conditions.

The BV Standard further states that the valuation report would typically not include a discussion of the subsequent event. Because a valuation is performed as of a point in time (i.e. the valuation date) events occurring subsequent to that date are not relevant to the value. However, the BV Standard does allow for disclosure in a separate section of the report. Such disclosure should clearly indicate that information regarding the subsequent event is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

Practice Tip

In the aforementioned example, a competent valuation analyst would reflect the concentration risk of a large customer in the capitalization (cap) rate. Even in the best of circumstances, loss of a major customer is a reality of business which must be considered. As perceived risk increases so does the cap rate. As the cap rate increases, value decreases. Revenue concentration is a significant risk factor and should be adequately addressed in the valuation report.

In a recent case, counsel for one business owner who operated a successful software company argued for a change in the valuation date. Approximately one year after the date of commencement, the subject company lost 50% of its business to Microsoft. The Court opined that this was an event beyond the company’s control and ordered an update of the valuation as of the current date. 

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