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CPA objectivity important when valuing a business

As cliché as it may sound, one of the pillars of the accounting profession is integrity.

The role of the accountant is so crucial for the successful operations of a business that CPAs have always been looked to with respect for their ability to advise business owners on a myriad of topics. It has long been established that the CPA must meet certain standards of independence, objectivity and integrity when performing attest services such as financial statement audits or reviews. Similarly, certain standards are called into play when a CPA performs a business valuation.

When working with a client on a business valuation, the CPA assumes one of the following roles: an adviser who is compensated to determine a value that – within the constricts of sound valuation theory – is most advantageous to the client or, alternatively, one who is compensated to perform an objective valuation of a company. A CPA can assist the client either as independent expert or an advocate.

The CPA should be very clear to communicate which of these very different roles he or she is being paid to take on and document it in an engagement letter. This possibility of being an advocate versus being neutral requires knowledge and a commitment to remaining independent.

The foundation in accounting literature for the concept that a CPA performing a business valuation is objective can be found in the American Institute of Certified Public Accountant's (AICPA) Code of Professional Conduct, Rule 102 – *Integrity and Objectivity*:

“In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.”

This hallmark for CPA conduct is amplified by even newer literature, namely the AICPA Statement on Standards for Valuation Services No. 1, which states:

“ ... The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. If necessary, where a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent as required under Interpretation No. 102-2.”

Consider the impact the work of a CPA has in preparing a business valuation when it comes to a divorce engagement. The value determined by the valuation analyst will be used to establish equitable distribution between the spouses. Not only will the value of the business be factored into asset allocation and division, but some of the procedures performed for the valuation may also serve in determining the true income of the business-owning spouse. This has very significant consequences because it is a basis on which alimony is determined.



Clearly, it is the objectivity and integrity of the CPA that attorneys seek when hiring a valuation analyst. Even more, these qualities must be beyond reproach when considering the fact that often the CPA is an expert who may be called upon to testify at trial or even to assist in mediating the case between all parties.

The same standards of independence and objectivity apply in the purchase or sale of a business, valuation for estate planning and gifting, the buy-in or buy-out of a business owner and many other scenarios. Certainly there are parts of any business valuation that require the valuation analyst's judgment, and one CPA may differ with another in one of these areas. However, this does not negate the need for an independent analysis.

While the CPA adviser may discuss negotiation strategies with clients, this does not eliminate the need for independence. Independence is discussed in terms of "fact" and "appearance." While the "facts" of independence violations are delineated in accounting literature, the "appearance" violations are occasionally subject to debate. For example, what if a CPA performs write-up work for a company and prepares the owner and spouse's income tax return. When the couple divorces, should the CPA perform the valuation?

On the one hand, the valuation analyst could make his role clear to the attorneys and disclose it in an engagement letter and subsequent report. But is that sufficient?

On the other hand, how does the CPA defend himself from potential charges that he intended to keep the business owner as a client in the future (with the write-up work, of course) and that this fact did not influence the work product?

Another factor to consider is that of self-review. A CPA in the above situation would effectively be reviewing his own write-up work as he prepares the business valuation. While he may claim to be independent with respect to each party, it is very difficult to be perceived as "intellectually honest" when reviewing one's own work.

Further, if the valuation analyst later testifies to a valuation report that found issues with the write-up work, the credibility of the entire firm may become an issue.

While CPAs often try to be a one-stop shop for all their clients' needs, considering the absolute need for independence and objectivity when performing a business valuation, they may need to consider passing the valuation work to others outside the firm in certain situations.