

Alert

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Communication Between Auditors and Valuation Professionals Key to Successful Engagement

“The engagement process was managed effectively and, therefore, the engagement was completed within the required timeframe...”

MANAGEMENT CHECKLIST

1. Identify assets
2. Clarify assumptions
3. Determine valuation approaches/methodology
4. Discuss timing and deliverables

For years auditors have depended on opinions of value supplied by valuation specialists. With the current focus on independence and avoiding conflicts of interests, more companies are choosing to engage outside specialists for non-audit services, such as valuation work. However, the use of a specialist does not allow a company's auditor to delegate his or her responsibilities. Auditors need to have an in-depth understanding of the approaches and assumptions used by valuation professionals. Given the complexity of many valuation assignments, communication between a company's audit team and its outside valuation experts has become critical. Consider the following scenarios:

1) A valuation firm is engaged to provide a valuation for a division of a well-known retailer. The asset to be valued is a program agreement connected with a third party transaction. The company's audit team and the outside valuation firm do not meet at the start of the engagement. The valuation specialists decide to use both a qualitative and quantitative analysis for this unique valuation assignment to arrive at fair value conclusions. When the audit team and valuation professionals meet after the report is issued, the audit team expresses that they would have preferred a different approach than the one that the valuation professionals utilized. Due to the lack of clarity, the engagement required significant additional time and expense.

2) A multilocation national retail company engages a valuation firm to provide valuations for financial reporting purposes in accordance with SFAS 141. The audit team and outside valuation professionals meet at the onset of the engagement to identify the assets to be valued, including real estate, personal property and intangible assets. Of particular concern were the intangible assets which included customer relationships, trade names, brand names, leases, noncompete agreements, and software. The valuation professionals discussed with the audit team the approaches which would be employed for the valuation. Additional details and concerns about the engagement were discussed in the initial meeting. The engagement process was managed effectively and, therefore, the engagement was completed in the required timeframe without additional cost to the client.

Which one of these examples sounds like the most recent valuation assignment handled by your audit team and outside valuation specialists? The scenarios above represent engagements completed by our valuation professionals. We have been involved in many engagements with characteristics of both of these scenarios. We have found that the better the communication between both parties, the smoother the engagement goes. Additionally, handling the engagement effectively from the start will save time and costs. Before beginning an engagement, the audit team and valuation specialists should communicate with each other to clarify the details of the engagement. For first-time valuations, the initial meeting is particularly important.

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Based on our experience, we have pulled together a "checklist" for management to use when working with auditors and outside valuation professionals:

Identify assets. Identify all real estate, personal property, and intangible assets which will be valued in the engagement. Consider all forms of intangible assets including trade names, noncompete agreements, leasehold interests, and customer-related intangibles, such as customer lists and customer relationships.

Clarify assumptions. According to the Statement on Auditing Standards (SAS) No. 101, *Auditing Fair Value Measurements and Disclosures*, auditors do not function as appraisers, but they are required to review the valuation model and evaluate the reasonableness of the assumptions used in the valuation.

Determine valuation approaches/methodology. This issue is particularly important in the case of unusual assets, such as the program agreement previously mentioned. For "typical" assets, methodologies have been accepted and refined. On the other hand, if the assets are less common, methodology often has not yet been established. In these situations, it is particularly important for all parties to be clear on the approaches which will be utilized to arrive at the value conclusion.

Discuss timing and deliverables. Clarify the manner in which the value conclusions will be delivered as well as when the deliverables are due. Although management letters typically outline these considerations, discussions relative to timing and deliverables may uncover potential problems which can often be resolved if they are addressed upfront.

The valuation industry has experienced a significant increase in time allocated to auditors in the review process. In many instances, client management is also an active participant in the review. For the most effective use of time, prior to a scheduled meeting, a comprehensive list of the auditor's questions should be sent to the client and the valuation firm. All involved parties should recognize that a more thorough review process provides a greater degree of comfort and assurance against any perceived conflict of interest. For more information concerning valuations, contact your Valuation Research representative or Bryan Browning at (414) 221-6249. **VR**

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