

Institute of Business Appraisers
CBA Body of Knowledge

Effective: January 25, 2010

The purpose of this document is to outline what the Institute of Business Appraisers (IBA) expects those who have obtained the Certified Business Appraiser (CBA) designation to understand and be able to apply to appropriately.

This list will also be used to check available curriculum offered by the IBA to make sure that these topics are well covered, or that the IBA can guide an applicant to find the training necessary to meet the requirements of holding a CBA designation.

A Certified Business Appraiser is expected to be able to appraise an interest in a privately held operating or holding company. The interest may be either an equity or invested capital interest. In order to do this, a CBA must be able to competently do the following:

- I. Obtain appraisal assignments
 - a. Marketing
 - b. Referrals
 - c. Understand and be able to explain to potential clients the IBA Standards and IBA Code of Ethics

- II. Be engaged to do an appraisal assignment
 - a. Engagement agreements
 - b. Assumptions and Limiting Conditions
 - c. Have the capacity to use word processing and spreadsheet software to write reports, create exhibits, and generate graphs/charts
 - d. Document request list

- III. Company Analysis
 - a. Perform a Site Visit
 - b. Describe accurately exactly what is the subject of the appraisal
 - i. Name of the business
 - ii. Location of the business
 - iii. Interest being appraised
 1. Equity interest?
 - a. Stock valuation
 - b. Understand economic benefits and prerogatives of control for different types of equity (e.g. Class A LLC Units, Preferred Stock)
 2. Invested Capital?
 - a. Assets typically included in a sale
 - iv. Why it is being appraised
 1. Applicable Standard of Value

- a. Fair Market Value
- b. Fair Value
- c. Investment Value
- d. Intrinsic Value
2. Applicable Premise of Value
 - a. Going concern
 - b. Assemblage of assets
 - c. Liquidation Value
 - i. Forced liquidation
 - ii. Orderly liquidation
- v. Date of Valuation
 1. The “As of” date
 - a. Who picks the date?
 2. Date the Report was finished
- vi. Ownership of the subject
- vii. What sources of documentation were available for use
 1. Tax returns
 2. Financial Statements
 - a. Audited statements
 - b. Reviewed statements
 - c. QuickBooks printout
 3. Leases
 4. Management interviews
 5. Real estate appraisals
 6. Machinery and equipment appraisals
- viii. History of the Company
 1. Description of anything that might impact the value
 2. Prior transactions
- ix. Restrictions on transfer
 1. Buy/Sell agreements
 2. Rights of first refusal
 3. Restrictive partnership agreements
- x. Products/Services of the Business, i.e. what does the Company do?
- xi. The expected future outlook for the business
- c. Spread financial statements, i.e. use Excel or some other spreadsheet program
 - i. Identify non-operating expenses
 - ii. Identify trends
 - iii. Identify and adjust for one time occurrences such as:
 1. Insurance windfall for a fire
 2. One time factory tooling expense
 3. Lawsuits (Except for when they may be operating expenses such as a hospital)
- d. Obtain industry financial ratios

- i. Perform a ratio analysis
 - ii. Explain what the ratios mean for the value of the subject company
 - e. Obtain pertinent economic data
 - i. Globally, if needed
 - ii. Nationwide
 - iii. State specific
 - iv. City Specific
 - v. Describe how the economic data impacts on the value of the business
 - f. Obtain pertinent industry data
 - i. Describe how the industry dynamics impact the value of the business (e.g. industry growth, competition, government regulations, fragmentation of market)
- IV. Perform a supportable financial forecast or review management's forecast for credibility
 - a. Determine how many years need to be forecasted
 - i. Single-year forecast
 - 1. If so, explain why
 - ii. Multi-year forecast
 - 1. If so, how many years?
 - 2. Explain why (x) number of years were forecasted
 - b. Normalization Adjustments
 - i. Following review of financial analysis, make normalization adjustments to sales and expenses
 - ii. Understand when it is appropriate to make the following adjustments:
 - 1. Control Adjustments
 - 2. Comparability Adjustments
 - 3. Non-Operating / Non-Recurring adjustments
 - 4. Discretionary Adjustments
 - iii. The purpose of normalization adjustments of historical results is to aid the appraiser in creating a reasonable approximation of future expectations.
 - c. Forecasting sales
 - i. Explain how each sales figure was obtained
 - 1. Specific expected growth rates for individual years?
 - 2. Specific amounts are expected?
 - 3. Sales are tied to a random occurrence?
 - a. Hydro-power plant is tied to rainfall
 - b. Commodities dealer is tied to the commodities market movement
 - 4. Average of historical sales

- a. Explain why historical measurements may be a reasonable proxy for future events.
 5. Other
 - ii. Expenses
 1. Some expenses are generally expected to stay at the same percentage of sales – explain
 2. Some expenses are expected to increase with inflation each year – explain
 3. Some expenses require much further attention to detail and explanation – explain them
 - a. Forecast Depreciation & Amortization
 - b. Market rents
 - c. Officer salary
 - d. Forecast Interest expense
 - iii. Forecasting Net Cash Flow
 1. Determining forecast depreciation and amortization
 - a. Make sure it matches with your forecast depreciation and amortization expense
 - b. And Capital Expenditures
 2. Determine Capital Expenditures
 - a. Rely on management’s assertion
 - b. Compare to industry
 - c. Other methods
 3. Calculating forecast changes in Long-term debt
 - a. Make sure it matches with your forecast interest expense
 - b. And Capital Expenditures
 4. Calculating forecast changes in Working Capital
 5. If the subject is an ‘S’ Corporation, dealing with the tax affecting issue
 - a. Several different methods are available
 - b. Know how to use the specific method and be able to explain it
- V. Determine which approaches are appropriate for the subject assignment
 - a. Asset Approach
 - i. Adjusted book value method
 1. Often the only method available for use in appraising a holding company, but often requires appraisals of the underlying assets
 2. Be able to describe in detail why “Book Value” is not an appraisal method
 - ii. Excess earnings method

1. Know the pitfalls, problems, and advantages (if any) and how to correctly apply this method
2. Know what this method actually appraises
3. How to differentiate between practice and personal goodwill, if applicable
- iii. Liquidation
 1. Orderly
 2. Forced
- b. Market Approach
 - i. Direct market data method
 1. Know how to adjust the indicated values to apply to an equity interest
 2. Know how to adjust “term” valuation multiples into “cash equivalent” valuation multiples
 - ii. Guideline Public Company Method
 - iii. Guideline Merged and Acquired Method
 - iv. Prior transactions/offers in subject company interests
 1. Know how to determine if these transactions are comparable to the assignment
 - a. Arms length
 - b. Fair market consideration
 - c. Not too old of a transaction
 2. Accounting concepts vs. fair market value
- c. Income Approach
 - i. Defining the applicable income stream to use
 1. Net cash flow
 2. Pretax net income
 3. Earnings before interest, taxes, depreciation and amortization (EBITDA)
 4. Other
 - ii. Determining the appropriate capitalization/discount rate to use
 1. Build-up method determines rates applicable to net cash flow
 - a. Know what rates are included in the Build up method and where to find them or how to support them
 - i. Risk free rate
 - ii. Equity risk premium
 - iii. Size risk premium
 - iv. Industry equity risk premium
 - v. Company specific risk premium
 1. How to determine/support this one is key
 - vi. Long-term sustainable growth rate

2. Market extracted rates when available could apply to a variety of income streams.
 3. When the use of the Weighted Average Cost of Capital (WACC) is appropriate.
 - a. For example, most privately owned companies have to provide a personal guarantee on any monies borrowed, thus negating any advantage borrowing might provide as both sides of the equation bear the equity risk at that point.
 4. Capital asset pricing model (CAPM)
 - a. Determining and using beta
 - iii. Using the Single Period Capitalization Method
 1. Proper development of a rate of return for use as a capitalization rate.
 - iv. Using the Discounted Future Benefits Method
 1. Know how to calculate the present value of each forecasted income stream
 2. Know how to treat growth in the terminal year
 3. Know when to use the mid-year discounting convention versus the end of year discounting convention
 4. Make sure that the terminal year is actually stabilized in the forecast.
 - a. For example, depreciation should be less than capital expenditures in the terminal year.
 - b. Make sure that there is enough working capital built into the forecast in the terminal year to continue with the expected long-term growth rate.
- VI. Discounts and premiums
- a. Know the difference between the various levels of value and what methods determine value indications on each level of value
 - i. Control, marketable
 1. Controlling interest in a publicly traded company
 - a. Guideline M & A Transactions might determine an indication of value at this level
 - ii. Control, non-marketable
 1. Most small privately-owned companies
 - a. Adjusted book value method
 - b. Excess earnings method
 - c. Single-period capitalization method using a control adjusted income stream
 - d. Multiple-period discounted method using a control adjusted income stream
 - e. Direct market data method

- f. Prior transactions/offers might also land in this category
 - iii. Non-controlling, marketable
 - 1. Minority interests in publicly traded companies, stock you and I might own in Microsoft, IBM, etc.
 - a. Single period capitalization method using a minority adjusted income stream
 - b. Multiple period discounted method using a minority adjusted income stream
 - c. Prior transactions/offers might also land in this category
 - iv. Non-controlling, non-marketable
 - 1. The level of value we are most often engaged to appraise. A minority interest in a privately held company such as a 30% interest in Ma and Pa Industries.
 - a. No valuation methods determine indications of value at this level of value directly
- b. Discount for lack of control (DLOC)
 - i. Know why DLOCs are required
 - 1. No methods currently exist to determine the value of a minority interest in a privately held company directly
 - ii. Know where DLOCs come from
 - 1. Various public market studies
 - iii. Know how to support the DLOC chosen for the subject interest
 - iv. Know Morningstar's position – there is no distinction between a minority or majority interest holder in their data
- c. Discount for Lack of marketability (DLOM)
 - i. Know why DLOMs are required
 - 1. No methods currently exist to determine the value of a minority interest in a privately held company directly
 - ii. Know where DLOMs come from
 - 1. Various public market studies
 - 2. Various quantitative models
 - iii. Know how to support the DLOM chosen for the subject interest
- d. Discount for lack of voting rights (DLOVR)
 - i. Some limited partner interests have no voting rights therefore an additional discount might be warranted
 - ii. Know how to select a DLOVR
- e. Control Premium
 - i. Rarely used as it is easier to support a calculated controlling value than to support a premium applied to a minority value
 - ii. If it is used, know how to support and explain it
- f. Others
 - i. Key-man discounts

- ii. Premiums for guaranteed sales
 - iii. others
- VII. Reconciliation
- a. Confidence weighting towards final opinion of value
 - i. Determining how much weight to give each method used
 - ii. Discuss advantages and disadvantages of each method developed
 - b. Simply select one method's indication of value as the best
 - c. Other
- VIII. Check for reasonableness
- a. Is the final concluded value reasonable?
 - i. Check rules of thumb to see if concluded value falls somewhere in the ballpark?
 - b. Would a hypothetical buyer and seller likely conclude a transaction at the concluded value and if so, would it cash flow?
 - i. Purchase justification test