Certified Valuation Analyst

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QUESTION NO: 1

A general category of taxable events relates to the amount of recognition of income (if any) associated with economic benefits received by a business. Examples of this category of taxable events include all of the following EXCEPT:

A. The valuation of property received, such as rents

B. The valuation (or the solvency/insolvency test) related to the recognition (or nonrecognition)

C. A valuation that is needed when a business (whether the business is a proprietorship, corporation or partnership)

D. A valuation when a tax payer claims a deduction

ANSWER: C D

Explanation:

“A valuation when a tax payer claims a deduction” is an exception because it concerns the measurement and substantiation of an allowable deduction, rather than the valuation of an economic benefit received and included in gross income. Deductions generally reduce taxable income only when authorized by statute, so the relevant valuation issue is the amount properly deductible under the applicable deduction provision. This is conceptually distinct from determining the amount of income recognized from property, services, debt discharge, or another benefit received. The Internal Revenue Code’s general definition of gross income is broad and includes income from whatever source derived, while deductions are separately addressed as statutory allowances. See 26 U.S.C. § 61 and 26 U.S.C. § 161.

“A valuation that is needed when a business (whether the business is a proprietorship, corporation or partnership)” is also an exception as written. It does not identify a receipt of an economic benefit, an income-recognition transaction, or a specified tax event requiring recognition measurement. Entity form alone does not establish an income-recognition valuation issue; further facts concerning a transaction or benefit received would be necessary. Accordingly, neither statement supplies an example of the stated category of taxable events.

QUESTION NO: 2

The amount of detail desired in the inventory list varies from one appraisal to another, depending upon:

A. The inventory’s importance to the valuation conclusion

B. The company’s write-down value

C. To the extent to which inventory accounting methods vary within particular industry

D. The amount of inventory data to be gathered

ANSWER: A C

Explanation:

The inventory’s importance to the valuation conclusion is a proper determinant of the level of detail in an inventory listing. A valuation analyst applies procedures that are appropriate to the engagement’s purpose and the significance of the subject asset to the concluded value. When inventory is a material component of value, its composition, condition, age or obsolescence, turnover, costing, and realizability can materially affect the analysis. Accordingly, a more granular listing supports a well-founded conclusion and allows the analyst to identify value-relevant concentrations or categories.

To the extent to which inventory accounting methods vary within particular industry is also a relevant consideration. Industry practice can affect how inventory costs are accumulated and reported, including the practical use of methods and conventions affecting comparability, margins, and the relationship between book amounts and economic value. The analyst should obtain enough detail to understand the inventory basis used and to make supportable comparisons or adjustments consistent with the relevant industry context. This approach is consistent with the valuation principle that the scope and depth of work should fit the nature of the asset and the intended use of the conclusion. See the International Valuation Standards and the IRS guidance on determining the value of donated property.

QUESTION NO: 3

Depletion is relatively easy to define; it is very difficult to measure. Because of:

A. Percentage depletion

B. Unrelated depletion methods

C. Reasonable estimates can be subject to wide variations

D. None of these

ANSWER: C

Explanation:

Reasonable estimates can be subject to wide variations is correct because depletion accounting requires an allocation of a natural resource property's depletable cost over the units expected to be recovered. While the general concept is straightforward—the resource asset is consumed as minerals, oil, gas, timber, or similar reserves are extracted—the required inputs are inherently estimate-driven. Analysts must estimate economically recoverable reserves, expected production volumes, future extraction conditions, the timing of development, and the amount of costs that should be capitalized and subsequently allocated. Those estimates can differ materially as geological information changes, commodity prices move, technology develops, operating plans are revised, or additional exploration data becomes available. A relatively small revision to estimated recoverable units can significantly affect the depletion rate and the carrying value assigned to the resource interest. This measurement uncertainty is especially relevant in valuation work because reported earnings, cash flows, asset values, and normalized financial results may all be affected by depletion assumptions. The IRS likewise recognizes that depletion calculations depend on the property and applicable method, including the use of cost-based calculations involving recoverable units. See IRS Publication 535, Business Expenses—Depletion and the SEC's Regulation S-X for financial-reporting context.

QUESTION NO: 4

A single rule of thumb that, for example, a satisfactory ratio is 2.0:1 is not widely followed in determining the current ratio, because of vastly different conditions typical in various industries, such as accounts receivable and collection periods and inventory turnover periods. As with most ratios, the adequacy of the current ratios for the given company can be better gauged by:

A. Percentage of sales and total assets

B. Comparison with industry norms than by comparison with any absolute standard

C. Comparison with a market leader than by comparison with any absolute standard

D. Comparison with a market leader than by comparison with industry norms

ANSWER: B

Explanation:

Comparison with industry norms than by comparison with any absolute standard is correct because a current ratio is meaningful only in the operating and economic context of the company being valued. The ratio measures current assets relative to current liabilities, but the appropriate level depends substantially on the business's cash-conversion cycle, credit terms, inventory requirements, seasonality, and access to short-term financing. A retailer with rapid inventory turnover and primarily cash sales may prudently operate with a lower current ratio than a manufacturer that has lengthy production cycles, substantial work-in-process inventory, and extended customer collection periods.

Accordingly, the analyst should benchmark the subject company against comparable businesses within its industry, ideally while also considering historical trends and the composition and quality of current assets and liabilities. Industry comparison helps distinguish a genuinely weak liquidity position from a ratio that is normal for the company's business model. This approach is consistent with standard financial-statement analysis: ratios should be interpreted relative to relevant peer and industry data rather than a universal numeric threshold. See the Corporate Finance Institute's current-ratio overview and the CFA Institute's financial analysis techniques refresher.

QUESTION NO: 5

The income capitalization approach is based on the economic principles of:

A. Risk and expected return investment analysis

B. Anticipation

C. Allowance of curable functional obsolescence

D. Market value of building and improvements

ANSWER: A B

Explanation:

The income capitalization approach rests on **Anticipation** because value is derived from the present worth of the future economic benefits an owner expects to receive. In a business valuation, those benefits are generally forecast earnings, cash flows, or other income measures. Capitalizing a sustainable income stream converts those anticipated future benefits into an indication of value as of the valuation date.

Risk and expected return investment analysis is also fundamental because an income stream has value only in relation to the return required by a rational investor for the risks of receiving it. The capitalization rate incorporates both the investor's expected return and the risks associated with the subject company's prospective income, including uncertainty in operations, growth, financing, industry conditions, and marketability as applicable. Accordingly, the approach links normalized expected income to a risk-adjusted rate of return, consistent with investment decision-making. This reflects the general valuation concept that an asset's value depends on the future benefits it is expected to generate and the risk attached to obtaining them. The IRS similarly describes the income approach as valuing a business through the present value of anticipated future economic benefits. See IRS valuation guidance and the Business Valuation Resources overview.

QUESTION NO: 6

Which of the following is/are NOT out of components of the discount rate?

A.

A. A "Risk-free rate" (the amount that an investor feels certain of realizing over the holding period). This includes:
a) A "rental rate" for forgoing the use of funds over the holding period
b) The expected rate of inflation over the holding periodB. A premium for risk, this includes:
a) Systematic risk (that risk that relates to improvements in returns on the investment market ingeneral)
b) Unsystematic risk (that risk is specific to the subject investment)

B. Premium value

C. Discount rate

ANSWER: B C

Explanation:

"Premium value" and "Discount rate" are not individual building blocks used to construct a discount rate. In an income-approach valuation, the discount rate is the required rate of return used to convert expected future economic benefits into present value. It is the resulting rate, rather than a separate component added into itself. A premium value is generally a conclusion about value or an amount attributable to particular ownership characteristics, depending on the valuation context; it is not a standard rate component. By contrast, a discount rate is commonly developed from a base risk-free return and one or more risk premiums reflecting the risks associated with the investment, such as market, size, industry, company-specific, and other applicable risks. The relevant components must be selected and supported based on the subject company, the forecasted benefit stream, and the valuation date. This distinction is important because a valuation analyst must avoid treating the concluded discount rate, or a value conclusion, as an input risk component. NACVA's professional resources address the valuation analyst's role in applying recognized valuation methods and supportable assumptions; see NACVA. The Internal Revenue Service also describes capitalization and discount-rate concepts in its valuation guidance at Revenue Ruling 59-60.

QUESTION NO: 7

To get an explanation or interpretation of something on the financial statements, or to consult working papers for details that augment the financial statements, it may be necessary to interview the company's outside independent accountant. This is most often the case when:

A. The financial statements are not audited

B. Not completely footnoted

C. Contain some kind of unqualified opinion by the independent accountant

D. Contain some kind of unqualified opinion by the attorney and banker

ANSWER: A B

Explanation:

Interviewing the outside independent accountant is most often necessary when the financial statements are not audited and when they are not completely footnoted. An audit provides the highest level of assurance offered by an independent CPA and ordinarily involves audit procedures, documentation, and communication concerning significant accounting matters. When statements have not been audited, a valuation analyst may need to obtain additional context directly from the accountant regarding accounting policies, unusual entries, adjustments, revenue recognition, related-party matters, or the extent of procedures performed. The accountant may also be able to clarify the underlying records and work performed, subject to client authorization and applicable confidentiality obligations.

Complete financial-statement notes are essential because they augment the face of the statements by disclosing significant accounting policies, commitments, contingencies, concentrations, related-party transactions, and other facts needed to understand reported amounts. If notes are incomplete, the analyst cannot reliably infer all relevant assumptions or risks from the primary statements alone. Direct inquiry of the independent accountant can therefore help obtain the missing explanatory detail needed for a well-supported valuation analysis. The AICPA describes audits and other CPA services in its Audit and Assurance resources, and the SEC describes the role of financial-statement notes in its financial reporting guidance.

QUESTION NO: 8

Automatic reliance on industry rates such as the return on total assets, tangible net worth or equity. This is the procedure which should NOT be used in the estimation of the:

A. Indirect capitalization rate

B. Direct capitalization rate

C. Normalized level of earnings

D. Tangible asset value

ANSWER: B

Explanation:

Direct capitalization rate is correct because a direct capitalization rate must be developed for the specific subject company and the particular economic benefit stream being capitalized. Although industry return data can be a useful reasonableness check or one input among several, automatically adopting a published return on total assets, tangible net worth, or equity bypasses the valuation analyst's required consideration of the company's actual risk characteristics, capital structure, growth expectations, earnings quality, size, customer concentration, and other relevant facts. A direct rate converts a single, sustainable measure of economic income into value, so its derivation must be consistent with both that income measure and the ownership interest being valued. Sound valuation practice therefore requires informed professional judgment and support in the work file rather than mechanical reliance on broad industry benchmarks. This approach is consistent with the factors for closely held business valuation in Treasury Regulation §20.2031-2, including earning capacity and comparable businesses, and with NACVA's emphasis on professional valuation standards and disciplined analyses in its Professional Standards.

QUESTION NO: 9

The FASB says that, for "unobservable inputs," the valuation should include market participant assumptions about risk, even if this adjustment is different to determine. Interestingly, it breaks risk into following categories EXCEPT:

A. The risk inherent in a particular valuation technique

B. The risk inherent in inputs of the valuation technique

C. The explicit risk related to a particular valuation technique

D. The implicit risk related to a particular valuation technique

ANSWER: C D

Explanation:

"The explicit risk related to a particular valuation technique" and "The implicit risk related to a particular valuation technique" are the exceptions because "explicit" and "implicit" are not the risk categories specified in FASB's fair-value measurement guidance for unobservable inputs. Under ASC 820, when a reporting entity uses unobservable inputs, those inputs must reflect the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. The guidance identifies risk at the level of the valuation technique itself and at the level of the inputs used in that technique. This framework ensures that a Level 3 measurement is not simply an entity-specific estimate, but rather incorporates the uncertainty, model risk, and input risk that market participants would consider. Whether a risk adjustment is incorporated directly in a cash-flow assumption, a discount rate, a multiple, or another valuation input does not create separate "explicit" or "implicit" risk classifications under the guidance. Instead, the valuation analyst should apply risk adjustments consistently with the technique and inputs used, while maximizing observable inputs where available and appropriately documenting significant unobservable assumptions. See the FASB Accounting Standards Codification and the PwC guide to valuation techniques under ASC 820.

QUESTION NO: 10

In developing normalized earnings for a closely held company, which of the following adjustments may be appropriate?

A. Adjusting owner compensation to a market-based amount

B. Removing a nonrecurring gain from the sale of equipment

C. Removing depreciation on operating assets used in the normal course of business

D. Eliminating ordinary changes in gross margin caused by market conditions

ANSWER: A B

Explanation:

Adjusting owner compensation to a market-based amount and removing a nonrecurring gain on the sale of equipment are appropriate normalizing adjustments. Owner compensation may differ from the compensation that would be required to retain a qualified, nonowner manager performing similar duties. The analyst may therefore adjust compensation to a reasonable market level when estimating the company's maintainable earnings.

A gain from the unusual sale of equipment is ordinarily not recurring operating income and may be removed when it is not expected to recur as part of normal operations. In contrast, a routine change in gross margin caused by ordinary market conditions and recurring depreciation on productive operating assets are generally part of the company's ongoing economic performance, although their reasonableness may require separate analysis. See IRS Revenue Ruling 59-60 and NACVA Professional Standards.

QUESTION NO: 11

Which of the following are generally characteristics of a properly prepared valuation work file?

A. Documentation of significant data, assumptions, and analyses considered

B. Support for material calculations and valuation adjustments

C. Information sufficient to explain the basis for the conclusion

D. Only documents that support the final concluded value

ANSWER: A B C

Explanation:

A properly prepared work file should document the information considered, significant assumptions, analyses performed, and the basis for the valuation conclusion. It should also preserve support for significant calculations and adjustments so that the analyst can explain how the conclusion was developed. The form and extent of documentation will vary with the engagement, but the file should be sufficient to support the work performed and facilitate appropriate review.

A work file is not limited to documents that support the final conclusion. Information considered but not ultimately relied upon may be relevant to demonstrate the analyst's procedures and professional judgment. NACVA professional standards address documentation and reporting responsibilities in valuation engagements. See NACVA Professional Standards.

QUESTION NO: 12

The determination of which asset-based method to use in a given valuation engagement should be a function of all of the following EXCEPT:

A. The experience and judgment of the analyst

B. The quantity and quality of available data

C. The purpose and objective of the valuation

D. Financial asset account categories

ANSWER: D

Explanation:

Financial asset account categories is the appropriate exception because account labels or classifications, standing alone, do not determine which asset-based valuation method is suitable. Asset-based approaches estimate value from the economic value of a company's assets and liabilities, and the analyst must select and apply a method in a manner consistent with the engagement's valuation objective, relevant facts, available evidence, and professional judgment. A balance-sheet category such as cash, receivables, investments, or other financial assets can be important input to the measurement and adjustment of particular assets, but it is not itself a governing criterion for choosing among asset-based methods. The relevant inquiry is whether the selected approach appropriately develops value under the facts and circumstances, including whether assets and liabilities can be reliably identified, valued, and adjusted to the applicable premise of value. This treatment is consistent with valuation standards' emphasis on professional judgment, sufficient data, and methods appropriate to the valuation purpose. See the NACVA Professional Standards and the IRS's Guide for Income Tax Valuation.

QUESTION NO: 13

Which of the following are categories in which projections are usually necessary?

A. Antitrust, lost business opportunity, breach of contract

B. Infringement of patents, copyrights or trademarks

C. Goodwill

D. Diversified businesses

ANSWER: A B

Explanation:

Projections are usually necessary in "Antitrust, lost business opportunity, breach of contract" matters because the damages analysis commonly requires an estimate of the economic results that would have occurred absent the alleged harmful conduct. A valuation or damages professional may project lost revenue, incremental costs, profit margins, growth, market share, and the duration of the loss, then discount the resulting future cash flows or lost profits to an appropriate valuation date. The assumptions must be grounded in contemporaneous company performance, industry and economic data, customer information, and other evidence that was knowable at the relevant date.

"Infringement of patents, copyrights or trademarks" also commonly requires projections. Intellectual-property damages may involve expected sales of the protected product, incremental profits, a reasonable royalty base, the remaining economic life of the intellectual property, and anticipated market adoption. These forward-looking estimates help quantify lost profits or royalty-based damages in a manner consistent with the specific legal theory and available evidence. The U.S. Department of Justice recognizes that antitrust analysis addresses competitive effects in markets, often requiring economic analysis of market outcomes, while the U.S. Patent and Trademark Office provides resources concerning intellectual-property enforcement and infringement. See U.S. Department of Justice Antitrust Guidance and USPTO IP Enforcement resources.

QUESTION NO: 14

There is an additional ____________ valuation rule, which requires that the appraiser determine whether any of the extraordinary payment rights, if exercised in conjunction with any qualified distribution rights, would lower the total value of the preferred security.

A. Lower of

B. Separate Command

C. Mandatory redemption rights

D. Lower in

ANSWER: A

Explanation:

Lower of is correct because the Treasury regulations under Internal Revenue Code section 2701 contain an additional valuation limitation commonly described as the "lower-of" rule. Section 2701 addresses transfers of interests in corporations and partnerships among family members where senior interests, often preferred equity, have distribution or payment rights that can affect the value transferred. For valuation purposes, an extraordinary payment right cannot simply be valued in isolation when the preferred security also carries qualified payment rights. The appraiser must consider the economic result of exercising the extraordinary payment right together with the qualified distribution rights and use the valuation outcome that produces the lower total value for the preferred interest where the rule applies.

This approach prevents the preferred interest from being assigned a value that overlooks the combined economic effect of its payment features. It therefore ensures that the value attributed to the senior preferred security appropriately reflects the regulatory assumptions required for section 2701 valuation, rather than relying solely on a hypothetical value for one right considered independently. The governing framework is found in Treasury Regulation section 25.2701-2, available through Cornell Law School's CFR text, and the statutory foundation appears in 26 U.S.C. § 2701.

QUESTION NO: 15

It is important to point out that ______________of the business can have an impact on the valuation conclusions, especially when it comes to partnership and limited liability companies.

A. Interim statements

B. Financial Schedule

C. The importance of seasonality to the subject company

D. The legal status

ANSWER: D

Explanation:

The legal status of the business can materially affect valuation conclusions because it establishes the entity's ownership structure, governing rights, transfer restrictions, liability framework, and tax classification. This is particularly important for partnerships and limited liability companies, where the governing partnership or operating agreement may define distribution rights, liquidation preferences, voting or management authority, buy-sell provisions, and restrictions on an owner's ability to transfer an interest. Those features affect the specific economic interest being valued and may influence cash-flow expectations, the appropriate level of value, and applicable discounts or premiums.

Legal form also affects tax treatment. A partnership generally passes income, deductions, gains, losses, and other tax items through to its partners, while an LLC may be classified differently for federal tax purposes depending on its membership and elections. A valuation analyst must therefore understand both the legal entity and the rights attached to the subject interest rather than treating every ownership interest as economically identical. The IRS summarizes partnership pass-through reporting in its partnership guidance and explains entity classification rules in its LLC guidance.

QUESTION NO: 16

In comparing companies with very different accounting practices, one way for an analyst to adjust for intangible items on the financial statements is to eliminate:

A. All intangible assets from the balance sheets

B. All amortization expense from the income statements

C. Identifying the true economic value

D. Both A and B

ANSWER: D

Explanation:

Both A and B is correct because eliminating recognized intangible assets from the balance sheet together with the related amortization expense from the income statement creates a consistent analytical adjustment. Intangible-asset reporting can differ significantly among otherwise comparable companies because accounting standards distinguish between acquired intangibles, which are generally recognized separately, and many internally generated intangibles, which are expensed as incurred. Consequently, one company's reported asset base and earnings may reflect prior acquisitions and subsequent amortization, while another company that developed similar economic resources internally may report neither an equivalent asset nor amortization expense.

Removing both the asset and its related periodic amortization avoids making only a partial adjustment. The balance sheet is relieved of the recorded intangible carrying amount, and the income statement is relieved of the expense arising from that same recognized asset. This helps an analyst focus on operating performance and invested capital on a more comparable basis when differing accounting treatments—not necessarily differing economics—drive reported amounts. The treatment is consistent with the recognition and amortization framework for finite-lived intangible assets described in FASB ASC Topic 350 and the requirements in IAS 38, Intangible Assets.

QUESTION NO: 17

Basic ways of approaching the valuation of non-controlling ownership interests are the following EXCEPT:

A. The discount approach

B. The direct comparison approach

C. The market-based approach

D. The bottom-up-approach (income approach)

ANSWER: C

Explanation:

The market-based approach is the exception because it is not the specific basic framework normally used to describe the valuation of a non-controlling ownership interest. The relevant framework focuses on identifying the economics attributable to the particular minority holder: its expected distributions and cash flows, the holder's lack of control over operating and distribution decisions, and the effect of those rights on value. A valuation analyst must distinguish the value of the enterprise or a controlling block from the value of the actual interest being valued, then apply an approach that directly reflects the minority interest's characteristics. The phrase "market-based approach" is a broad label for valuation evidence drawn from market data; standing alone, it does not identify the recognized ownership-interest methodology or establish that the observed pricing data represent comparable non-controlling interests with similar rights, restrictions, growth expectations, and marketability. NACVA standards require analysts to select methods that are appropriate to the assignment's facts and to support the assumptions and valuation conclusion. See NACVA's Professional Standards and the IRS's Revenue Ruling 59-60, which addresses the need to consider the specific interest and relevant valuation factors.

QUESTION NO: 18

Family law courts generally recognize three basic approaches to value. Which of the following is NOT out of those approaches?

A. Income approach (both direct capitalization and, increasingly, discounted cash flow)

B. Market approach

C. Asset-based approach (including the capitalized excess earnings method)

D. Asset-based approach (excluding the capitalized excess earnings method)

ANSWER: D

Explanation:

The correct response is *Asset-based approach (excluding the capitalized excess earnings method)*. The recognized valuation framework used in family-law business valuations comprises the income approach, market approach, and asset-based approach. Within that framework, the capitalized excess earnings method is commonly treated as an asset-based valuation method because it begins with a return on the company's identifiable tangible assets and capitalizes earnings that exceed that required return to quantify intangible value or goodwill. Thus, an asset-based approach described as excluding that method does not accurately state the customary set of methods included under the three basic approaches.

The method also has long-standing valuation authority. IRS Revenue Ruling 68-609 describes the formula method of valuing goodwill through excess earnings and recognizes its relationship to underlying tangible assets and capitalized earnings. Although the specific facts, governing state law, and valuation date determine how a family-law valuation is performed, the foundational classification of methods remains important when selecting and reconciling valuation indications. NACVA's professional resources address the application of recognized valuation approaches and standards in credentialed business-valuation practice. See IRS Revenue Ruling 68-609 and NACVA.

QUESTION NO: 19

Which of the following factors is NOT considered, among others, when determining if quantitative adjustments to the sales comparison data are necessary?

A. Age of each transaction

B. Land-to-building ratio of each property

C. Absolute location and relative location of each property in relation to population centers, highways, and so forth

D. Safety aspects of each property

ANSWER: D

Explanation:

“Safety aspects of each property” is the factor not ordinarily used as a distinct quantitative-adjustment criterion in sales-comparison analysis. Quantitative adjustments are developed when a comparable sale and the subject differ in market-recognized, measurable characteristics that buyers and sellers demonstrably price. The analysis begins with establishing comparability and identifying differences in transaction timing, location, site characteristics, and improvements. Age of the transaction addresses changing market conditions; absolute and relative location captures differences in access and market appeal; and the land-to-building relationship can affect a property’s utility, highest and best use, and buyer perception. These characteristics can therefore support a market-derived adjustment when supported by adequate sales evidence. “Safety aspects” is too broad and is not a standard independently quantified comparison element. A safety-related condition may affect value only when it is identified as a specific, market-measurable property condition or external influence and is supported by market evidence; it is not, by itself, the conventional factor described in this question. This treatment is consistent with sales-comparison guidance requiring appraisers to analyze relevant differences between the subject and comparable sales and make supportable adjustments. See Fannie Mae’s guidance on adjustments to comparable sales and The Appraisal Foundation’s USPAP overview.

QUESTION NO: 20

Calculating the volatility of the underlying stock is more complicated. Volatility is the standard deviation is the price of underlying stock. The volatility used in the Black Scholes model is the total volatility of the underlying stock’s price. It is not its bets, which measures

A. The relative movement of the stock’s price to the market

B. That the stock’s price changes are relatively constant

C. Implied volatility

D. The number of outstanding shares of the issuer

ANSWER: A

Explanation:

The relative movement of the stock’s price to the market is correct because the final word in the question is evidently intended to be “beta.” Beta measures systematic risk: the tendency of a security’s returns to move in relation to changes in the overall market’s returns. In contrast, the Black-Scholes model uses the volatility of the underlying asset’s returns, conventionally expressed as the annualized standard deviation of those returns. This is total volatility, incorporating both market-related and company-specific price variation. Beta therefore is not a substitute for the volatility input in Black-Scholes; it describes sensitivity to a benchmark market rather than the dispersion of the stock’s own returns. The distinction matters in valuation because the option’s sensitivity to uncertainty in the underlying share price is modeled through volatility. Volatility may be estimated from historical return data or inferred from observed option prices, provided the estimate is expressed consistently with the model’s annualized-input convention. For background on beta as a measure of systematic market sensitivity, see Investor.gov’s explanation of beta. For the Black-Scholes framework and the role of stock-price volatility among its inputs, see Macroption’s Black-Scholes formula reference.

QUESTION NO: 21

“Tag along rights” are Buy-Sell agreements which:

A. Often call for the sales of interest on the same terms if the controlling owner sells

B. Have become more common these days

C. Allow the issuer first priority to buy the interest and other stockholders or partners the secondplace option to buy

D. Both A & B

ANSWER: D

Explanation:

Both A & B is correct. Tag-along rights, also called co-sale rights, protect a minority owner when a controlling owner proposes to sell an ownership interest to a third party. The right permits the minority holder to participate in that transaction and sell a proportionate amount of their own interest on the same price, terms, and conditions offered to the controlling owner. In a closely held business valuation and buy-sell planning context, this protection helps prevent the minority holder from being left with an interest in a company controlled by an unfamiliar purchaser while the former controlling owner receives a liquidity opportunity.

These provisions have also become a more frequent feature of shareholder agreements and other private-company governance arrangements, particularly where minority investors seek contractual protection against a change in control. Tag-along rights therefore combine the defining same-terms co-sale feature with their increasingly common use in modern ownership agreements. Cornell Law School describes tag-along rights as rights allowing minority shareholders to join a sale by a majority shareholder on the same terms; see Cornell Law School's definition of tag-along rights. A practical overview of their role in shareholder agreements is available from Investopedia's tag-along rights reference.

QUESTION NO: 22

The practical effect/s of Special Valuation Rules is/ are:

A. Cumulative dividends or distribution rights

B. Non-voters having voting rights

C. Flexible and optional redemption rights

D. Non-lapsing conversion rights

ANSWER: A D

Explanation:

The practical effects reflected in "Cumulative dividends or distribution rights" and "Non-lapsing conversion rights" arise from the qualified-payment-right and exception provisions of the special valuation rules in Internal Revenue Code Section 2701. A preferred distribution right is generally a qualified payment right only when it is a cumulative right to receive a payment at least annually. This requirement limits the ability to use discretionary or noncumulative senior-equity payment features to shift value to junior interests in a family entity transfer.

Likewise, a non-lapsing conversion right is specifically excluded from the definition of an extraordinary payment right when it permits conversion into a fixed number or fixed percentage of shares of the same class. This treatment permits an economically fixed conversion feature without causing that feature to be valued at zero under the special valuation framework. Together, these provisions illustrate how Section 2701 channels planning toward objectively measurable, continuing rights rather than rights that can be manipulated to depress the value of a retained senior interest. The governing statutory definitions appear in 26 U.S.C. § 2701; Treasury regulations further address qualified payment rights and extraordinary payment rights in Treas. Reg. § 25.2701-2.

QUESTION NO: 23

There are some allowable methods for determining the basis of property received in exchange for other property. Which of the following is/are out those methods?

A. Income basis of tax on the property

B. If a taxpayer receives property for services, then the original basis of the property when it is received is its original price

C. The basis is the fair market value of the property exchanged for it, increased by any payments made or decreased by any payments received, when the two properties are of unequal value

D. The basis is the fair market value of the property when it is received

ANSWER: C D

Explanation:

The basis is the fair market value of the property when it is received is a permissible general rule for property acquired in a taxable exchange. Fair market value establishes the recipient's cost basis when an exchange is treated as a sale and purchase rather than as a qualifying nonrecognition transaction. This approach is especially relevant where the transaction is taxable and the acquired property's fair market value can be determined reliably.

The basis is the fair market value of the property exchanged for it, increased by any payments made or decreased by any payments received, when the two properties are of unequal value also expresses the economic adjustment used in an exchange involving cash or other unequal-value consideration. Paying additional consideration increases the investment in the acquired property, while receiving consideration reduces the net investment. The resulting value is consistent with determining basis from the value transferred, adjusted for the net amount paid or received, where that measure reflects the fair market value of the property acquired.

These principles are subject to specialized basis rules for transactions qualifying for nonrecognition treatment, including like-kind exchanges. The IRS explains the general basis concepts and the distinct rules applicable to exchanged property in IRS Publication 551, Basis of Assets and describes like-kind exchange basis rules in IRS Topic No. 701, Sale of Your Home.

QUESTION NO: 24

There is no universally accepted conclusion as to what accounts should be "netted out" in the estimation of net tangible asset value. For example, various analysts have interpreted net tangible assets to mean any one of the following EXCEPT:

A. Gross assets net of accumulated depreciation

B. Net current value of the financial assets and the tangible assets less current liabilities only

C. Net current value of the financial assets and the tangible assets minus all liabilities

D. Probable future earnings

ANSWER: D

Explanation:

"Probable future earnings" is the correct exception because it is an income-based concept, not a measure of net tangible asset value. A net tangible asset calculation is a balance-sheet-based valuation approach: the analyst identifies tangible assets, adjusts them to an appropriate current or fair value when warranted, and deducts liabilities according to the definition adopted for the engagement. The scope of liabilities deducted can vary in practice—for example, some formulations focus on current liabilities while others use all liabilities—which is why the question notes that there is no universally accepted netting convention.

Future earnings may inform an income approach, such as a capitalization-of-earnings or discounted-cash-flow analysis, and they can be relevant when considering whether intangible value exists. They do not, however, constitute an asset or liability account to be netted in arriving at the net tangible asset value itself. The selected answer therefore falls outside the alternative balance-sheet interpretations of net tangible assets described in the question. NACVA's standards emphasize using appropriate valuation methods and clearly communicating the assumptions and procedures applied in a valuation engagement. See NACVA Professional Standards and the IRS discussion of the asset-based approach in IRS Publication 561.

QUESTION NO: 25

(1) Partly because of its fairly wide dissemination (2) Partly because of its apparent simplistic nature, _______________ valuation method is widely adopted in one form or another for other valuation purposes, such as material dissolution.

A. Capitalized excess earnings method

B. Asset-based approach

C. Market based approach

D. Discounting a terminal value

ANSWER: A

Explanation:

The **Capitalized excess earnings method** is the intended answer. This method, often called the excess earnings method or formula approach, estimates intangible-asset value by identifying earnings remaining after a reasonable return has been attributed to the company's tangible assets. Those residual, or "excess," earnings are then capitalized to derive the value associated with goodwill and other intangible assets. Because the calculation combines an asset return with an income-based capitalization step, it has historically been easy to communicate and apply in settings where goodwill must be allocated or estimated, including closely held business matters such as marital dissolution.

Its broad historical dissemination is closely tied to IRS Revenue Ruling 68-609, which describes the formula approach for valuing intangible assets and goodwill when more direct valuation evidence is unavailable. Although professional valuation practice requires analyst judgment regarding normalized earnings, reasonable rates of return, and capitalization rates, the method's recognizable structure accounts for the description of it as apparently simple and widely used in modified forms. The word "access" in the supplied answer is evidently a typographical error; the established valuation term is "excess earnings." See IRS Revenue Ruling 68-609 and the IRS guidance on business valuation approaches.

QUESTION NO: 26

There are some factors that determine whether the buy-sell agreement is conclusively binding for estate tax purposes. Which of the following is/are out of those factors?

A. The agreement must restrict the transfer of the securities to the buy-sell price during the owner's life as well as at death.

B. There must be a valid business purpose for establishing the agreement

C. The value may not reflect those typical of arm's length transactions in the subject company's industry

D. The value established in the agreement must have been an adequate and fair price at the time the agreement was executed

ANSWER: A B D

Explanation:

For a buy-sell agreement to control the estate-tax value of a decedent's business interest, it must function as a genuine, enforceable business arrangement rather than merely as a mechanism to transfer property at a discounted value. The agreement must restrict the transfer of the securities to the buy-sell price during the owner's life as well as at death. This lifetime restriction demonstrates that the stated price is a real limitation on ownership and not a valuation device triggered only by death.

There must also be a valid business purpose for establishing the agreement. Examples include preserving continuity of ownership, providing liquidity, and preventing unwanted third parties from acquiring an interest. In addition, the value established in the agreement must have been an adequate and fair price at the time the agreement was executed. A price negotiated on fair terms supports the conclusion that the arrangement represents full and adequate consideration rather than a testamentary transfer. Current federal law similarly requires a bona fide business arrangement, prohibits arrangements that operate as devices to transfer property for less than full consideration, and requires comparability to similar arm's-length arrangements. See 26 U.S.C. § 2703 and Treas. Reg. § 25.2703-1.

QUESTION NO: 27

One unique aspect of the valuation provision in a Bu-Sell agreement, as opposed to other valuation problems, is the extreme uncertainty concerning when a future event that triggers a transaction under the agreement will occur. This is one of the key reasons why:

A. Is no single approach to the problem of establishing the price?

B. Is no single method for a buy-sell agreement that one can recommend as completely satisfactory for all situations

C. There is no negotiation among the parties

D. Independent outside appraisal

ANSWER: A B

Explanation:

The correct conclusions are that there is no single approach to establishing the price and no single buy-sell-agreement valuation method that can be recommended as completely satisfactory in every situation. A buy-sell provision must establish a value or valuation process today for a transaction that may be triggered years later by death, disability, retirement, termination, or another specified event. At the unknown future trigger date, the company's earnings, capital structure, industry outlook, ownership rights, tax environment, and economic conditions may differ substantially from those existing when the agreement was drafted.

Accordingly, a sound provision must be tailored to the entity, its owners, the anticipated triggering events, and the desired balance of certainty, fairness, liquidity, and administrative practicality. Depending on those facts, the agreement may use a periodically updated agreed value, a formula, an appraisal process at the triggering date, or a combination of these mechanisms. Valuation practice likewise requires consideration of all relevant facts and use of appropriate valuation approaches rather than reliance on a universally applicable formula. This principle is consistent with the broad, fact-specific valuation guidance in IRS Revenue Ruling 59-60 and the professional valuation guidance published by NACVA Standards.