

# DO YOU KNOW?

ISSUE 36 - SEPTEMBER 2018

*A free periodical to promote education and alert you to important areas of interest in the financial valuation, fraud, and litigation services profession.*

## Do You Know...

### ... what BV organizations/groups allow the use of calculation engagements?

The quick answer is ALL of them:

- American Institute of Certified Public Accountants(AICPA)
- American Society of Appraisers (ASA)
- The Appraisal Foundation (TAF), who is responsible for USPAP
- Institute of Business Appraisers (IBA)
- National Association of Certified Valuators and Analysts (NACVA)

TYPE OF ENGAGEMENT	TYPE OF VALUE				
	AICPA	NACVA	IBA	ASA	USPAP
Valuation	Conclusion of Value	Conclusion of Value	Conclusion of Value		
Calculation	Calculated Value	Calculated Value	Calculated Value		
Appraisal				Unambiguous Opinion of Value	Opinion of Value
Limited Appraisal				Estimate of Value	
Appraisal Calculation				Approximate Indication of Value	X

The use of calculation engagements has gained increased visibility and discussion over the last few years. Much of this discussion has been controversial. However, Ed Dupke, Jim Alerding and I have been deeply involved in the calculations area for almost two decades. We were on the original AICPA Business Valuation Standards Writing Task Force that produced the Statements on Standards for Valuation Services (SSVS). We spent over six years on that task force and spent an incredible amount of time studying business valuation (BV) standards from many organizations in the U.S. and around the world.

We were also asked by the AICPA to help clarify the use of calculations by valuation analysts. That resulted in the November 2017 release of AICPA, Valuation Services, VS Section, Statements on Standards for Valuation Services, VS Section 100, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset, **Calculation Engagements, Frequently Asked Questions (FAQs)**, Non-Authoritative. [Emphasis added.]

The three of us also wrote the front-page article in the July/September 2018 issue of *Financial Valuation and Litigation Expert*, Issue 74, titled "Calculation Engagements: The REAL Story." This article addresses the following misunderstandings and inaccuracies presented in a recent article: Michael Paschall, ASA, CFA, JD, "'Breaking Bad' in the Business Valuation Profession," *Business Valuation Update*, vol. 24. no. 7, July 2018, Business Valuation Resources, LLC. Our article addresses and responds to the following 12 misleading and/or inaccurate positions presented in the 'Breaking Bad' article on calculation engagements:

1) "Unfortunately, the increasing use of calculation engagements seriously compromises these historical standards of reliability and independence."

***Alerding, Dupke, Hitchner "Takeaway" Response***

The overly broad statement that "the increasing use of calculation engagements seriously compromises historical standards of reliability and independence" is false. The AICPA, ASA, The Appraisal Foundation, NACVA, and the IBA all have calculations as an acceptable service.

2) "By its own definition, a calculation engagement does not have to consider or properly employ the traditional and appropriate methodologies used in a proper valuation and, as such, never gets on the road to arrive at a reliable opinion of value."

***Alerding, Dupke, Hitchner "Takeaway" Response***

What is traditional, appropriate, proper, and reliable is not set in stone. Methodologies are open to argument, whether in a valuation engagement or a calculation engagement. In fact, there are three approaches to value, and all standards of valuation require that they be considered but not necessarily "used."

3) "A calculation engagement is also subject to bias due to the client's ability to choose the methods used and thus engineer a desired value."

***Alerding, Dupke, Hitchner "Takeaway" Response***

Obviously, the AICPA, ASA, The Appraisal Foundation, NACVA, and the IBA cannot be promoting biased services. As such, a flat-out statement that calculations can easily be biased is incorrect. It is up to the valuation analyst to follow the relevant ethics and standards to make sure this doesn't happen.

4) "Worst of all, the vast majority of nonappraisers do not understand the unreliability of a calculation as compared to a real valuation and may treat the two as equals."

***Alerding, Dupke, Hitchner "Takeaway" Response***

Calculations can be reliable, and it is the responsibility of the valuation analyst to educate the client that there are different types of services.

5) "Put simply, the calculation engagement is an incomplete and highly limited exercise. It is concerned only with speed and convenience and not with accuracy."

***Alerding, Dupke, Hitchner "Takeaway" Response***

The valuation analyst has broad discretion as to the level of work required given the facts and circumstances of each engagement, the scope of services, the intended users, and the intended use. Cost is usually the main reason that calculations are used.

6) "Also note that the above provisions in the SSVS do not specify the degree to which a calculation engagement is more limited as compared to a valuation engagement."

***Alerding, Dupke, Hitchner "Takeaway" Response***

The valuation analyst has broad discretions as to the methods and procedures used, but there are minimum requirements.

7) "The calculated value...is not sufficient, reliable, believable, or with reasonable certainty. Why would you want to put yourself in this untenable position? Calculation engagements are not reliable or appropriate, particularly in a litigation setting."

***Alerding, Dupke, Hitchner "Takeaway" Response***

Depending on the amount of work performed, the scope of services, the intended use, and the intended users, a calculated value can be sufficient, reliable, believable, or with reasonable certainty. The AICPA neither prohibits nor endorses the use of a calculation engagement in a litigation setting.

8) "Furthermore, a calculation engagement cannot comply with the Uniform Standards of Professional Appraisal Practice (USPAP, which Congress mandated to eliminate appraisal abuses) as it violates the most fundamental business valuation requirement of USPAP (in addition to violating a number of other sections):

a. Standard 9: Business Appraisal, Development.

i. In developing an appraisal of an interest in a business enterprise or intangible asset, an appraiser must identify the problem to be solved, *determine the scope of work necessary to solve the problem, and correctly complete the research and analyses necessary to produce a credible appraisal.* (emphasis added)

By its own definition, the appraiser does not 'determine the scope of work necessary' in a calculation engagement; the client does (see Bias section below). A calculation engagement also does not 'complete the research and analyses necessary to produce a credible appraisal'; it contains only a fraction of them...The implications of this are clear: A calculation engagement does not provide a credible or reliable opinion of value."

***Alerding, Dupke, Hitchner "Takeaway" Response***

A calculation engagement can comply with USPAP. It does not violate the most fundamental business valuation requirement of USPAP. The appraiser does "determine the scope of work necessary" in a calculation engagement; the client does not. A calculation engagement can provide a credible or reliable value under USPAP.

9) "Remember, a calculation engagement doesn't require an accurate value, only the proper execution of the valuation methodology(ies) the client and the appraiser agreed to (i.e., dictated by the client ...)."

***Alerding, Dupke, Hitchner "Takeaway" Response***

Calculations are agreed upon with the client. The client does not dictate the methods. Also, as said before, the buck stops with the valuation analyst. The standards require the valuation analyst to be free of bias and the analysis must be credible based on the intended use and intended users.

10) "While Hitchner is correct in saying that the client wants a less expensive valuation analysis, the client wants something else even more: a favorable valuation result ... While it is true that most clients are not valuation experts, most clients are intelligent enough to understand which valuation methodologies will result in a high value and which will result in a low value."

***Alerding, Dupke, Hitchner "Takeaway" Response***

Our experience with calculations is that clients want a less expensive fee. We have seen very few clients attempt to rig a calculation. Does it happen? Sure it does. Is it widespread? We don't think so.

11) "The fact of the matter is that calculation engagements are now being offered in a context for which they were never intended. The original intent of the calculation engagement was to give a business owner a 'rough idea' of value (acknowledging that an incomplete analysis would be done, bias was evident, and the indicated value could be highly inaccurate)."

**Alerding, Dupke, Hitchner "Takeaway" Response**

Valuation analysts have long known that there is wide flexibility in the use of calculations. No valuation group hinders the use of calculations and it should stay that way. While we agree that a calculation, by its very nature, is an incomplete analysis, the analysis need not and should not be biased, and the indicated value should be credible.

12) "When a meth lab charges a 50% fee for a project where only 5% to 10% of the work was performed (as compared to the 100% of work that goes into a real valuation), the profit margins of the meth lab go through the roof. As a result, valuation meth is significantly more profitable for meth labs than real valuations (which require all that troublesome and time-consuming analysis). Thus the valuation meth dealer lures his clients with: 'Don't waste your money on a full valuation-all you need is a calculation.'"

**Alerding, Dupke, Hitchner "Takeaway" Response**

All valuation services are real, and valuation analysts are not making more money doing calculations.

Let's review the requirements for calculations for all five BV organizations/groups:

**AICPA** [Note: This would also include the position and similar language for the IBA and NACVA]

*Calculation engagement.* A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement (see paragraph .46).

[Source: Statements on Standards for Valuation Services, "Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset," American Institute of Certified Public Accountants, 2007, "Types of Engagement," paragraph .21.]

**ASA**

An acceptable type of engagement will generally be one of the three types detailed below.

Calculation

a. The objective of a calculation is to provide an approximate indication of value of a business, business ownership interest, security or intangible asset based on the performance of limited procedures agreed upon by the appraiser and the client.

b. A calculation has the following qualities:

- (1) It's [SIC] result may be expressed as either a single dollar amount or a range
- (2) It may be based upon consideration of only limited relevant information
- (3) The appraiser collects limited information and performs limited analysis
- (4) The calculation may be based upon conceptual approaches agreed upon with the Client

[Source: American Society of Appraisers, "ASA Business Valuation Standards, BVS-I General Requirements for Developing a Business Valuation," American Society of Appraisers, 2009, p. 6.]

Notice that the ASA refers to its calculation engagement as an "acceptable type of engagement."

## TAF/USPAP

USPAP states the following:

Some appraisers may not be aware of the inherent flexibility built into the Uniform Standards of Professional Appraisal Practice (USPAP). Because USPAP is a set of standards that is built on the basic principles of ethics and competency, those who do not appreciate such flexibility can sometimes view USPAP as vague. However, the scope of work concept in USPAP enables appraisers to perform many types of assignments while maintaining compliance with standards...

As illustrated in the chart below, USPAP provides tremendous flexibility for appraisers. The Scope of Work Rule in USPAP requires appraisers to produce credible assignment results, but USPAP requires only those analyses that are necessary for credible results, given the intended use. In assignments performed for real property, personal property, or business valuation/intangible assets, USPAP also includes provisions for an abbreviated reporting format. (FN 7: Restricted Appraisal Reports are allowed under STANDARDS 2, 8 and 10.)

Assignment Types	Some Examples	Allowed by USPAP?	How Does USPAP Apply?
Calculation Engagement	A CEO is considering an acquisition and wants to know the calculated result given a specific valuation method.	Yes	Standards 9 & 10

[Source: "Yes, I Can Accept That Assignment! USPAP Flexibility at a Glance," The Appraisal Foundation, 2016, [www.appraisalfoundation.org](http://www.appraisalfoundation.org). Part of chart recreated here.]

## UPCOMING WEBINAR

Jim Hitchner and Jim Alerding will present the two-part webinar series:

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Webinar Dates:

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**Part Two - October 11, 2018, 1-3 pm EDT**

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