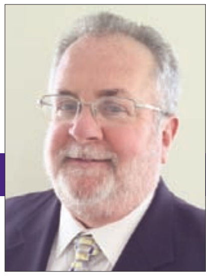
Financial Valuation *and* Litigation Expert

VIEWS AND TOOLS FROM LEADING EXPERTS ON VALUATION, FORENSIC/FRAUD AND LITIGATION SERVICES



Editor's Outlook

Jim Hitchner

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Greetings! I've recently run across some information on calculation engagements that I found to be misleading. Since this topic seems to continually vex our readers, I decided to contact two colleagues, Jim Alerding and Ed Dupke, who are excellent sources of information on this topic, and together we have tackled it in depth! I hope this detailed article will put an end to misinformation and bring clarity to this important topic.

In another article, Jim Alerding expresses his view that "valuation steps have become so complex and so numerous and with so many choices that it begs an answer" to an important question: Have we lost the forest for the trees? Check out Jim's article to see if you agree!

Next up, Don Wisehart examines two schools of thought on pension obligations: reliance on the auditor's treatment and deconstruction of that treatment. Through an actual case study, Don presents the dilemma of pension benefit obligation and questions if it is actually double counting.

Ray Rath focuses on IP due diligence, which he says can be a key factor for transactions where technology rights are important to operations.

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Calculation Engagements: The REAL Story

R. James Alerding, CPA/ABV, ASA; Edward J. Dupke, CPA/ABV/CFF/CGMA, ASA; and James R. Hitchner, CPA/ABV/CFF, ASA

Editor's Note: *In terms of the use of calculation engagements, the article referenced in footnote 1 describes clients as "meth addicts," valuation analysts as "meth dealers," valuation groups/firms as "meth labs," and calculation engagements as valuation "meth." The term "meth head" is also collectively used to describe clients and valuation analysts who use calculations. While the author undoubtedly used these analogies as attention grabbers, other than in direct quotations, we refrain from the use of these unfortunate terms.*

Recently there has been some misinformation concerning the use of calculations.[1] It is our intention to clarify this issue. 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

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EXPERTS in this Issue

Financial Valuation *and* Litigation Expert

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Greater awareness of challenges with royalty rate estimates, Ray tells us, should ultimately lead to expanded valuation procedures and enhanced practice for royalty rate estimation.

Bob Gray and Rob Kester address the dilemma of requesting detailed general ledger information in a business valuation. The authors present several scenarios in which they feel the request for such information may be necessary.

Practice development expert Rod Burkert next proposes an interesting idea— a business valuation "portfolio." Other professionals carry portfolios, says Rod, so why not BV analysts? Rod suggests presenting a sanitized, original report to prospective clients to demonstrate competence.

A special addition to this issue is a summary of the controversy surrounding the AICPA's awarding of the ABV credential to non-CPAs. This has been a hot topic in the BV world. I invite you to share your thoughts with us on this, or any of the topics addressed in this issue, by emailing me at jhitchner@finvaluation.com. Enjoy what's left of the summer, and I'll see you at the fall conferences!

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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.]

We have also given numerous presentations on BV standards. In other words, when it comes to BV standards, we know what we are talking about. We will address these inaccuracies one by one.

1) "Unfortunately, the increasing use of calculation engagements seriously compromises these historical standards of reliability and independence."[2]
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."[3]
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."[4]
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."[5]
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."[6]
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."[7]
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."[8]
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.*"[9]
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 …)."[10]
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."[11]
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)."[12]
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.'"[13]

1) "Unfortunately, the increasing use of calculation engagements seriously compromises these historical standards of reliability and independence."[14]

There is a misconception that the AICPA was the first group to allow calculations. This is false. Let's talk a little history here. Since at least 1996, the American Society of Appraisers (ASA) has specific standards concerning acceptable types of engagements. "An acceptable type of engagement will generally be one of the three types detailed below."[15] The three types of "acceptable" engagements are as follows: Appraisal, Limited Appraisal, and a Calculation. Note that the ASA acknowledges that a calculation is an

Continued on next page

acceptable type of engagement. A calculation has the following features:

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[16]

The AICPA did not have any specific BV standards (particularly calculations) until 2007, at least a decade later than the ASA. The AICPA standards describe a calculation as follows:

b. 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).[17]

These two descriptions of a calculation are very similar. That was on purpose. The AICPA BV Standards Writing Task Force tried, and we would say succeeded, in aligning the AICPA Standards to those of the ASA, The Appraisal Foundation (USPAP), NACVA, the IBA, etc.[18] There are some differences, but the standards of all of these organizations are very similar.

Takeaway

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."[19]

First off, what is a "traditional" and "appropriate" methodology? Given the fast pace of ideas, methods, and applications in business valuation, what does tradition have to do with this? We started doing valuation work in the early 1980s. Back then there were no real transaction databases; the modified capital asset pricing model was fairly new, with little in the way of agreement to its application; large public company multiples were being used to value different size businesses; the excess earnings method was popular, etc. We say good riddance to those traditions. You want to be humbled, look at one of your reports from 10 to 15 years ago.

As to appropriate methodologies, valuation analysts who do valuation engagements instead of calculation engagements often argue over what the appropriate methodologies and applications are. This situation is not limited to calculations. For smaller businesses, most analysts use two methods: the capitalized cash flow or discounted cash flow methods of the income approach and the guideline company transactions method of the market approach. The guideline public company method is seldom used. What other "traditional and appropriate" methodologies are we talking about?

Takeaway

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 and 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."[20]

All valuations can be subject to bias. We have seen enough of these tainted valuations. See "How to 'Rig' a Valuation: The Discount Rate," *FVLE* Issue 41, February/March 2013 and "How to 'Rig' a Valuation, Part Two: Long-Term Growth Rates," *FVLE* Issue 42, April/May 2013.

Furthermore, the ethics and standards of all the U.S. BV groups and organizations prohibit bias for any type of valuation services. For example, *SSVS* states the following:

The code [AICPA Code of Professional Conduct] requires objectivity in the performance of all professional services, including valuation engage-

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ments. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest.[21]

USPAP states the following:

An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests.[22]

An appraiser:

- must not perform an assignment with bias;
- must not advocate the cause or interest of any party or issue;
- must not accept an assignment that includes the reporting of predetermined opinions and conclusions;
- must not misrepresent his or her role when providing valuation services that are outside of appraisal practice;
- must not communicate assignment results with the intent to mislead or to defraud;
- must not use or communicate a report or assignment results known by the appraiser to be misleading or fraudulent ...[23]

The ASA Principles of Appraisal Practice and Code of Ethics state the following:

The appraiser's primary obligation to his/her client is to reach complete, accurate, and credible conclusions and numerical results regardless of the client's wishes or instructions in this regard.[24]

If an appraiser is supplied with information that he/she knows or suspects is incorrect, it is considered unacceptable to merely use the information and try to hide behind a limiting condition.[25]

It is unethical for an appraiser to act as an advocate for anything or anyone other than his/her own value conclusion, regardless of the circumstance or situation as the appraiser and appraisal will lack credibility.[26]

Takeaway

Obviously, the AICPA, ASA, The Appraisal Foundation, NACVA, and the IBA can not 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) "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."[27]

First off, calculations are not always unreliable. If that was the case, attorneys, clients, and valuation analysts would not use them. Also, if you believe these false accusations, you must then believe that the five U.S. valuation groups/organizations are allowing an "acceptable" type of engagement that is known to be unreliable. How can that be correct? Depending on the engagement and the amount of work performed, calculations can be reliable or unreliable. Valuation engagements can be unreliable too.

The new AICPA FAQs on calculations states:

26. Q: How does a valuation analyst approach a calculation report where the client has no understanding of valuation approaches, methods, and procedures? Are you not basically explaining to the client what the best method is and what the procedures will be and telling the client that he or she has to agree?

A: The answer is yes. If the client doesn't understand the components of a calculation engagement, the valuation analyst should explain it to them, including the differences between a calculation engagement and a valuation engagement. See VS Section 100 .16-.17, "Establishing an Understanding with the Client."

27. Q: Can a valuation analyst be the one to suggest the approaches and methods to be used and the extent of the procedures to be used?

A: Yes, the valuation analyst can make these recommendations as long as the client agrees, preferably in writing.[28]

SSVS further addresses this as follows:

The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers ... Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she encounters circumstances during the engagement that make it appropriate to modify that understanding.[29]

The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. The understanding should include, at a minimum, the nature, purpose, and objec-

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> tive of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities, the applicable assumptions and limiting conditions, the type of report to be issued, and the standard of value to be used.[30]

Takeaway
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."**[31]

Calculations are always incomplete. This is by design; otherwise they would not be calculations.

> A calculation engagement does not include all of the procedures required for a valuation engagement (see paragraph .46).[32]

Calculations are not always a highly limited exercise. Calculations can be as detailed or as limited depending on what the valuation analyst agrees to do. We have seen many detailed calculations. In fairness, we have also seen very limited calculations.

> 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) …[33]

There is no language, at all, specifying a highly limited exercise. The calculation can be highly limited or highly detailed, as long as the procedures are more limited than a valuation engagement.

Furthermore, we have not seen speed and convenience as a reason to prepare a calculation. Our experience is that the majority of calculations are prepared because they are less costly. The client simply wants a cheaper alternative type of engagement.

Takeaway
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."**[34]

Of course *SSVS* doesn't explicitly specify the limitations of a calculation. This is intentional. However, note the minimum requirements for a calculation engagement:

> a. Identity of the client
> b. Identity of the subject interest
> c. Whether or not a business interest has ownership control characteristics and its degree of marketability
> d. Purpose and intended use of the calculated value
> e. Intended users of the report and the limitations on its use
> f. Valuation date
> g. Applicable premise of value
> h. Applicable standard of value
> i. Sources of information used in the calculation engagement
> j. Valuation approaches or valuation methods agreed upon with the client
> k. Subsequent events, if applicable (see paragraph .43)[35]

SSVS further states:

> The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.[36]

The AICPA Calculations FAQs addresses this issue as follows:

> **31. Q: Is there any requirement in the Standards about the length of a calculation report?**
> **A:** No. As long as a valuation analyst meets the requirements as to what must be in the report, there is no restriction on the length. There are no restrictions on the format either.
>
> **34. Q: What should not go into a calculation report?**
> **A:** The Standards only identify items that should be included in a calculation report. There are no prohibitions stated in the Standards about what may not go into a calculation report, but a calculation report should never contain a reference to the estimated value as a conclusion of value. This reference is reserved exclusively for a valuation engagement.
>
> **40. Q: In a calculation report are you required to detail the procedures omitted or limitations imposed for that valuation?**
> **A:** No. However, there's no prohibition against disclosing what the valuation analyst did not do.
>
> **47. Q: How short or long can a detailed report, a summary report, or a calculation report be?**

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A: Minimally, as long as it takes to document the information required in the VS100 by paragraphs .51 through .70 for a detailed report in a valuation engagement, or for the information required by paragraph .70 for a summary report for a valuation engagement, or for the information required by paragraphs .73 through .77 for a calculation report for a calculation engagement. There are no requirements on length as long as the required information is included.

48. Q: Can a limited-scope analysis, such as a calculation, be so limited it does not render a credible analysis and a credible estimate of value?
A: A limitation of scope can be so severe as to prevent an analyst from performing a calculation engagement. It might or might not be possible to perform a calculation in such a situation but would depend on the scope limitation.[37]

Takeaway
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."[38]**

In the *Financial Valuation and Litigation Expert* journal, Alerding, Dupke, and Hitchner presented the following viewpoints on calculation engagements:

1) Agreement with the client
This is not a big deal unless you allow it to be a big deal. Most clients are unfamiliar with all the approaches, methods, procedures, assumptions, applications, data choices, etc. that make up a valuation analysis, whether a valuation engagement or a calculation engagement. Let's be serious. The client doesn't ask for a calculation engagement; most don't even know what it is or that it even exists. What the client wants is a less expensive process to estimate a value. They simply want a cheaper valuation analysis.

What this means is that although the client has to agree to the extent of the work performed, it is the valuation analyst who really decides what is to be done. As long as you are the one telling the client what work is to be performed, you should be able to withstand criticisms that you and the client are in cahoots and that the client is telling you what to do to drive the process and obtain a desired result. Sure, that can happen. Just make sure it doesn't involve you. The proverbial buck stops with you.

2) More limited procedures that do not include all the procedures required in a valuation engagement, and had a valuation engagement been performed, the results might have been different
This is a big deal, particularly in a litigation setting. How does this sound? "My opinion of the calculated value of XYZ Company is $4,000,000." Sounds fine on the surface, right? Let's parse this some. What you are really saying is, "My opinion (which is sufficient, reliable, believable, and with reasonable certainty) of the calculated value (which is not sufficient, reliable, believable, or with reasonable certainty) of XYZ Company is $4,000,000." This sounds odd, as it should. So, while an opinion of a calculated value is not prohibited by SSVS No. 1, from a practical respective, why would you want to put yourself in this untenable position?[39]

So, how easy is it to parse this against the use of calculations. Let's give it a try.

- "This is a big deal, particularly in a litigation setting."
- "The calculated value … is not sufficient, reliable, believable, or with reasonable certainty."
- "Why would you want to put yourself in this untenable position?"

Giving an opinion of a calculated value is a big deal in a litigation setting. It's also controversial with two main points of view. You will notice that these two points of view have nothing to do with reliability, appropriateness, speed, convenience, etc. It's about the marketplace for valuation services and money.

Calculations Position Number 1
The marketplace for valuation services demands a less expensive service, particularly in the area of divorce valuations. To compete and serve the marketplace, valuation analysts are offering calculation services. Attorneys want a less expensive calculation of value to attempt to settle the case at hand. This is a good and allowable use for calculations. There are also valuation analysts that are offering an opinion of a calculated value in a litigation setting.

Calculations Position Number 2
Valuation analysts that are offering calculations in a litigation setting are lowering the bar for fees and this is affecting the marketplace and the ability of

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other valuation analysts that are against this position.

"The calculated value … is not sufficient, reliable, believable, or with reasonable certainty." This is not a black or white issue. This can and does happen. However, a calculated value can be sufficient, reliable, believable, or with reasonable certainty. Again, it depends on the facts and circumstances of the engagement and the amount of work prepared, the scope of services, the intended use, and the intended users.

"Why would you want to put yourself in this untenable position?" This was meant in the context of doing much less work than in a valuation engagement.

> For CPAs, the use of the word "opinion" has special meaning from an audit perspective and the word "opinion" was purposely left out of the AICPA's Statement on Standards for Valuation Services No. 1 (SSVS No. 1). However, the bottom line is that there is no prohibition in SSVS No. 1 on the use of an opinion of a calculated value or an opinion of a conclusion of value. However, there is no explicit endorsement either. It is silent on this issue. That means it is up to the valuation analyst to decide whether he or she can provide an opinion of calculated value in a calculation engagement. Calculations were intended to provide wide flexibility, and valuation analysts can provide calculations any way they see fit, as long as they comply with SSVS No. 1.
>
> The AICPA and NACVA allow for either a "conclusion of value" or a "calculated value." Both are considered "estimates of value." The ASA allows three types of value: "unambiguous opinion of value," "estimate of value" and "approximate indication of value." USPAP allows for only one explicit type of value, "opinion of value/conclusion."[40]

Takeaway

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.*"[41]

All of this is convoluted and wrong. Let's stay with whether USPAP allows a calculation. The answer is an unequivocal *yes.* See below.

> 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...[42]
>
> 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

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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

> 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.)

In March of 2014, Carla Glass wrote an article in *Financial Valuation and Litigation Expert* titled "The Question of Calculations and USPAP — Another Round."[43] Ms. Glass served as chair of the Business Valuation Committee of the American Society of Appraisers (ASA) and chair of the Appraisal Standards Board of The Appraisal Foundation, which is the board that promulgates the Uniform Standards of Professional Appraisal Practice (USPAP). Jay E. Fishman, the only other business valuer to have recently served on the board, as well as in many other roles on bodies representing our profession, and Jim Hitchner reviewed this article and agreed to the content.

Some excerpts follow:[44]

> It is my belief that these previous paragraphs and quotes indicate that what is called an *appraisal* in USPAP covers both a *valuation engagement* and a *calculation engagement.* In USPAP, a *valuation engagement* would have a more extensive scope of work than a *calculation engagement.* So, the answer is yes, a *calculation engagement* can be performed in compliance with USPAP.
>
> To perform a *calculation engagement,* USPAP would require that the lesser scope of work be deemed appropriate for the intended use of the conclusion (said another way, appropriate for the purpose of the engagement). USPAP indicates that the appropriateness of a given *scope of work* is to be determined in the context of the intended use of the assignment results. Also, USPAP indicates that the appraiser is responsible for making sure that the scope of work performed is appropriate. To emphasize the point, whether a *calculation engagement* is appropriate for a given project is a judgment for which USPAP holds the appraiser responsible/accountable. USPAP gives appraisers "broad flexibility," but also responsibility, in determining the appropriate scope of work.
>
> USPAP requires that the appraiser not allow the *scope of work* to be limited "to such a degree that the assignment results are not credible in the context of the intended use."
>
> There are certain reporting requirements regarding disclosure of the scope of work performed. It is my view that these requirements of the Scope of Work Rule give further evidence that a *calculation engagement* is an *appraisal* in USPAP. The Scope of Work Rule was specifically written to allow for a full spectrum of extents of research and analysis.

A calculation engagement can be performed in compliance with USPAP. In USPAP terms, it is simply called an appraisal with a lesser scope of work. The most important differences are that, under USPAP, the reduced scope of work must be appropriate for the intended use (purpose) of the assignment and the responsibility for this decision rests with the appraiser.

A calculation report can, with relatively few changes, be made compliant with USPAP.

One final point on the USPAP issue is that the congressional mandate that required USPAP does not apply to business valuation. USPAP is followed by the BV profession only on a voluntary basis and only then through the requirement by the ASA that its members must follow USPAP. There is no other requirement for USPAP to be followed.

Takeaway

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...)."[45]

The calculation method(s) are very seldom dictated by the client. As said prior, most clients do not know what we do, let alone how we do it so that it can be manipulated.

The general statement that a calculation doesn't require an "accurate" value doesn't make sense. Does a valuation engagement require an accurate value? Nowhere in SSVS or ASA BV standards or in USPAP does it say any value has to be accurate. (Note: ASA Principles of Appraisal Practice and Code of Ethics do refer to accurate conclusions and numerical results.) A valuation or a calculation is an estimate of value.[46] In what way can an estimate be "accurate"? An estimate is "to judge tentatively or approximately the value, worth, or significance of."[47]

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Takeaway
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."**[48]

This is a preposterous statement. When planning and starting an assignment, whether a valuation or a calculation, the brightest and best valuation analysts do not know what valuation methodologies will result in a low or high value. We almost never know this until well into the valuation. To say that the average client knows this as a flat-out statement is ridiculous. Some clients may have this acumen, but most do not. As pointed out earlier, a valuation engagement can also be rigged.

Takeaway
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)."**[49]

The term "rough idea" is not found anywhere in the standards. Other terms are used. For example, *SSVS* labels both calculations and valuations as "estimates of value."

> An engagement to estimate value culminates in the expression of either a conclusion of value or a calculated value (see paragraph .21).[50]

ASA calculations result in an "approximate indication of value."[51] USPAP requires a calculation to be:

> **CREDIBLE:** worthy of belief.
>
> *Comment:* Credible assignment results require support, by relevant evidence and logic, to the degree necessary for the intended use.[52]

As previously discussed, evidence of so-called bias is not something a client and a valuation analyst agree to. If the valuation analyst believes the client is biased, the analyst should refuse to prepare the calculation. Bias is simply not an agreed-upon procedure. Also, the term "highly inaccurate" is used here in too broad a statement.

Takeaway
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**

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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

> **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.'"[55]**

We do not know what a "real" valuation is? All the services in the previous chart are real valuation services.

We have never met a valuation analyst who believed that calculations had higher profit margins. This is pure unsupportable conjecture. We have seen many analysts say that they use calculations because the market wants them. Most analysts we have talked to would prefer doing a valuation engagement because the fees are higher.

Takeaway

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

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[1] 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.

[2] Ibid., p. 15.

[3] Ibid.

[4] Ibid.

[5] Ibid.

[6] Ibid., p. 16.

[7] Ibid.

[8] Ibid.

[9] Ibid., p. 17.

[10] Ibid.

[11] Ibid., p. 18.

[12] Ibid., p. 19.

[13] Ibid., p. 20.

[14] Ibid., p. 15.

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

[16] Ibid.

[17] *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.

[18] Uniform Standards of Professional Appraisal Practice (USPAP), National Association of Certified Valuators and Analysts (NACVA), Institute of Business Appraisers (IBA).

[19] Paschall, p. 15.

[20] Ibid.

[21] *SSVS,* "Objectivity and Conflict of Interest," paragraph .14.

[22] Uniform Standards of Professional Appraisal Practice, 2018-2019, Appraisal Standards Board, The Appraisal Foundation, p. 11.

[23] Ibid.

[24] *Principles of Appraisal Practice and Code of Ethics*, American Society of Appraisers, June 2015, p. 9.

[25] Ibid., p. 13.

[26] Ibid., p. 17.

[27] Paschall, p. 15.

[28] 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," Q&As 26 and 27.

[29] *SSVS,* "Understanding with the Client," paragraph .16.

[30] Ibid., paragraph .17.

[31] Paschall, p. 16.

[32] *SSVS*, "Types of Engagements," paragraph .21b.

[33] Ibid.

[34] Paschall, p. 16.

[35] *SSVS*, "Types of Engagements," paragraph .46.

[36] Ibid.

[37] 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," paragraphs .31, .34, .40, .47, and .48.

[38] Paschall, p. 16.

[39] Calculations and Opinions: Bringing Clarity to a Cloudy Issue, *Financial Valuation and Litigation Expert (FVLE),* Issue 50, August/September 2014, pp. 3-4.

[40] Ibid., pp. 1 and 3.

[41] Paschall, p. 17.

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

[43] Carla Glass, "The Question of Calculations and USPAP— Another Round," *Financial Valuation and Litigation Expert (FVLE),* Issue 47, Feb./Mar. 2014, pp. 7-10.

[44] Ibid.

[45] Paschall, p. 17.

[46] *SSVS,* paragraph .02.

[47] Merriam Webster, www.merriam-webster.com.

[48] Paschall, p. 18.

[49] Ibid., p. 19.

[50] *SSVS,* paragraph .02.

[51] ASA, p. 6.

[52] USPAP, p. 4.

[53] Paschall, p. 20.