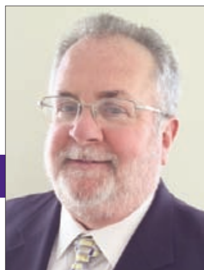
Financial Valuation *and* Litigation Expert

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



Editor's Outlook

Jim Hitchner
jhitchner@valuationproducts.com

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.

Continued on next page

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

Continued on page three

EXPERTS in this Issue

Jim Hitchner
Editor's Outlook ... 1

Jim Alerding, Ed Dupke, and Jim Hitchner
Calculation Engagements: The REAL Story ... 1

Jim Alerding
Have We Lost the Forest for the Trees? ... 12

Don Wisehart
Pension Benefit Obligation: Is It Double Counting? ... 15

Ray Rath
Royalty Rate Estimation for Technology IP: Important Considerations ... 16

Bob Gray and Rob Kester
on To 'QB' or Not to 'QB'? That Is the Question ... 19

Rod Burkert
on Do You Carry a Portfolio of Your Work? ... 23

Special Report - AICPA ABV Credentialing Debate ... 25

Panel of Experts ... 36

Cost of Capital Corner ... 39

Financial Valuation *and* Litigation Expert

Publisher	Valuation Products & Services
Editor in Chief	James R. Hitchner, CPA/ABV/CFF, ASA Valuation Products & Services
Managing Editor	Karen Warner, M.A., Valuation Products & Services
Director of Operations	Janet Kern, B.A., Valuation Products & Services

PANEL OF EXPERTS

R. James Alerding, CPA/ABV, ASA	Alerding Consulting, LLC
Steve Babitsky, JD	SEAK, Inc.
Jeff Balcombe, CPA/ABV/CFF/CGMA, CFA, ASA	BVA Group
Don Barbo, CPA/ABV	VMG Health
Neil Beaton, CPA/ABV/CFF, ASA, CFA	Alvarez & Marsal, LLC
Bruce B. Bingham, FRICS, FASA	Berkeley Research Group, LLC
Kristopher A. Boushie, CPA/ABV/CFF, CVA, CFE	Navigant
Stephen J. Bravo, CPA/ABV/PFS, ASA, CBA, MST	Apogee Business Valuations
Rod P. Burkert, CPA/ABV, CVA, MBA	Burkert Valuation Advisors, LLC
Stacy P. Collins, CPA/ABV/CFF	Financial Research Associates
Larry R. Cook, CPA/ABV/CFF, CBA, CDFA	Larry R. Cook & Associates, PC
Dr. Michael A. Crain, CPA/ABV, CFA, CFE	Florida Atlantic University/Kaufmann Rosin
Mark O. Dietrich, CPA/ABV, MBA, MST	Mark O. Dietrich, CPA, PC
Darrell D. Dorrell, CPA/ABV, MBA, ASA, CVA, CMA, CFF	Financial Forensics
Edward J. Dupke, CPA/ABV/CFF/CGMA, ASA	Dupke Consulting, LLC
W. David Ellrich, CPA/ABV, CVA, ASA, CFE, CFE, MAFF	Ellrich, Neal, Smith & Stohlman, P.A.
Jay E. Fishman, FASA	Financial Research Associates
Carla G. Glass, CFA, FASA	Marcum LLP
Robert P. Gray, CPA/ABV/CFF, CGMA, CFE	Gray Schrupp & Associates, PLLC
Michael A. Gregory, ASA, CVA, MBA, NSA	Michael Gregory Consulting, LLC
Robert J. Grossman, CPA/ABV, ASA, CVA, CBA, MST	Grossman Yanak & Ford, LLP
Lance S. Hall, ASA	Stout Risius Ross
Chris Hamilton, CPA, CFE, CVA	Arxis Financial, Inc.
J. Michael Hill Sr., FASA, CBA	Hill Schwartz Spilker Keller, LLC
Thomas E. Hilton, MSF, CPA/ABV/CFF, CVA, CGMA	Anders Minkler Huber & Helm, LLP
James R. Hitchner, CPA/ABV/CFF, ASA	Financial Valuation Advisors, LLC
Mark G. Kucik, CPA, CVA, CFF, CM&AA	Kucik Valuation Group, LLC
Eva M. Lang, CPA/ABV, ASA	The Financial Consulting Group
Derald L. Lyons, MT, CPA/PFS, CVA	Lyons & Seacrest, PC
L. Gail Markham, CPA/ABV/CFF, CFE®, CFP®	Markham Norton Mosteller Wright & Co., PA
Harold Martin Jr., CPA/ABV/CFF, ASA, CFE	Keiter
Gilbert E. Matthews, CFA	Sutter Securities Incorporated
Z. Christopher Mercer, FASA, CFA, ABAR	Mercer Capital
Katherine E. Morris, MBA, ASA	Morris Valuation Consulting, Inc.
Eric W. Nath, ASA	Eric Nath & Associates
Dr. Shannon P. Pratt, DBA, FASA, CFA, MCBA, CM&AA, MCBC	Shannon Pratt Valuations, LLC
William C. Quackenbush, MBA, ASA, MCBA, ABAR, BCA	Advent Valuation Advisors, LLC
Raymond Rath, ASA, CEIV, CFA	Globalview Advisors
Robert F. Reilly, CPA	Willamette Management Associates
Scott R. Saltzman, CPA, CVA, ASA, ABV, MAFF	Saltzman, LLC
Ronald L. Seigneur, CPA/ABV/CFF, ASA, CVA, CGMA	Seigneur Gustafson LLP
John J. Stockdale, ASA, CPA/ABV/CFF	John J. Stockdale
Chris D. Treharne, ASA, MCBA, BVAL	Gibraltar Business Valuations
Gary R. Trugman, CPA/ABV, MCBA, ASA, MVS	Trugman Valuation Associates
Linda B. Trugman, CPA/ABV, MCBA, ASA, MBA	Trugman Valuation Associates
Stacey D. Udell, CPA/ABV/CFF, CVA	HBK Valuation
Mark S. Warshavsky, CPA/ABV/CFF, CVA, CBA, ASA, CFE, MAFF, DABFA, MBA	Gettry Marcus, CPA, P.C.
Jeff Windham, JD, CFE	Forensic Strategic Solutions, Inc.
Richard M. Wise, CPA, FCA, CFF, FASA, MCBA, FRICS, FCBV, CVA	Wise Consulting
Donald P. Wisehart, ASA, CPA/ABV/CFF, CVA, MAFF, MST	Wisehart, Inc.

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!

SUBSCRIPTION INFORMATION

Financial Valuation and Litigation Expert is published bi-monthly by Valuation Products and Services, LLC, Ventnor Professional Campus, 6601 Ventnor Ave., Suite 101, Ventnor City, NJ 08406. An annual subscription (6 issues) is $240, delivered in electronic (pdf) format. Individual issues are also available for purchase.

Please visit our website, www.valuationproducts.com/fvle, for more information.

Subscription and/or delivery questions can be addressed to Janet Kern, business manager, at jkern@valuationproducts.com or (609) 289-8341.

Editorial questions/comments or article submissions may be addressed to Karen Warner, managing editor, at kwarner@valuationproducts.com or (609) 289-8341.

Although the information in this journal has been obtained from sources that Valuation Products and Services, LLC, believes to be reliable, we do not guarantee its accuracy, and such information may be condensed or incomplete. This journal is intended for information purposes only, and it is not intended as financial, investment, legal, or consulting advice. Valuation Products and Services, LLC, disclaims all responsibility for its content.

While the authors have used their best efforts in preparing these articles, they make no representations or warranties with respect to their applications to a particular assignment. Each financial analyst should analyze his/her own situation carefully in determining the appropriate use of data and information. Each author's views and opinions are his/her own, and the other authors may agree or disagree with the articles presented here.

The opinions (sometimes strong) presented by specific authors of the individual articles in this publication reflect those of that specific author(s). The opinions are not necessarily those of Valuation Products and Services or its Panel of Experts.

© Copyright 2018, Valuation Products and Services (VPS). All rights reserved. This journal may not be reproduced in whole or in part without the express written permission of VPS.

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-

Continued on next page

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-

Continued on next page

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?**

Continued on next page

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

Continued on next page

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

Continued on next page

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]

Continued on next page

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**

Continued on next page

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. ❧

---

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.

VPS STRAIGHTtalk Series
No bias. No agenda. No nonsense.

A NEW webinar presented by Jim Hitchner, CPA/ABV/CFF and Sam Wessinger

S Corp Valuations and the Tax Cuts and Jobs Act
Includes New Detailed S Corp Case Study

Tuesday, August 14, 2018 - 1:00 pm - 3:00 pm (EDT)

We are listening, and the message is loud and clear.
You want more on valuing S corps under the new tax law.

Well, here it is. A definitive presentation on this important area.
Jim and Sam will present a detailed case study on how to value an S corp under the new tax law.

This will include a valuation using the following S corp models:
Treharne Cash Flow model, Van Vleet SEAM model, Delaware MRI model, and the Fannon model.

Our simple pricing plan means you get access to the live webinar for the whole office as well as an archived copy and handouts for later viewing.

CLICK HERE NOW FOR MORE DETAILS OR TO REGISTER

Have We Lost the Forest For the Trees?

"This is valuation. I don't even have 95% confidence regarding the amount of change in my pocket." – Dr. Aswath Damodaran

R. JAMES ALERDING,
CPA/ABV, ASA

Alerding Consulting
Indianapolis, IN
alerdingconsulting@gmail.com

When I first started in business valuation the world was a much simpler place. You still had the three approaches to value—asset, market, and income—and you still had to determine which one(s) to use and apply in determining your value. You also still had to determine whether discounts and premiums were warranted and apply them appropriately. And finally, you had to determine if there were any other assets or liabilities to add to or deduct from your operating value conclusion.

We are going to focus on the income approach in this article and ask the question: "Have we lost the forest for the trees?" Valuation steps have become so complex and so numerous and with so many choices that it begs an answer to our question.

Whenever I teach valuation basics, I always start with the easy part. I tell the students that the valuation premise is very simple: V = I/R where V= Value, I = Income, and R = the required rate of return. Of course, even in the early days of valuation, that simple formula became complex very quickly. In my opinion, in today's world of valuation, we are coming close to the breaking point. How much is enough? Do not think that I am harkening back to the old days. I am not, *but* (there is always a *but*) I do believe that valuation analysts need to think more about the end result and less about how we got there. In 1991 I participated in an all-day program (closed circuit TV—you youngsters can look that up) on a panel with Shannon Pratt, Gary Trugman, Jim Hitchner, Larry Cook, and a special video guest named Butch Williams. The opening question of the day was whether valuation was an art or a science. Everyone agreed that valuation has elements of both and that it was a matter of degree. The trick, of course, is to keep the elements in balance.

So let's look at some of the elements now flooding the process under the income approach. Once again, I am not advocating for eliminating the basic steps required to arrive at a supportable and reasonable value, but it does seem that there continue to be added complications that might confuse rather than aid the process. It hearkens to the old adage, "How many angels can dance on the head of a pin?"

Here is a sampling of the head notes on the methods to define the benefit stream from *Financial Valuation Applications and Models* (FVAM), fourth edition:[1]

- Net Income
- Net Cash Flow
- Defining Net Cash Flow
  - Cash Flow Direct to Equity (Direct Equity Method)
  - Cash Flow to Invested Capital (Invested Capital Method)
- Current Earnings Method
- Simple Average Method
- Weighted Average Method
- Trend Line-Static Method
- Formal Projection Method (Detailed Cash Flow Projections)

Okay, I get that these are all helpful methods and things that should be considered, but the process really starts to become complicated when we move from the "I" in our value equation to the "R," required rate of return, represented in the process by the "cost of capital" (COC), also known as the discount rate. The common measurement for the COC is the modified capital asset pricing model or CAPM. The equation for that model, which all are likely familiar with, is:

$$E(R_i) = R_f + B \times RP_m + RP_s +/- RP_c$$ [2]

Where:[3]

E(Ri) = Expected rate of return on security i
Rf = Rate of return available on a risk-free security as of the valuation date
B = Beta
RPm = Equity Risk Premium (ERP) for the market as a whole
RPs = Risk premium for smaller size
RPc = Risk premium attributable to other company risk factors

The other popular method of determining the COC is the build-up method (BUM). The difference between the MCAPM and the BUM is that the BUM uses an estimate of the

Continued on next page

expert **TIP**

It is the skill in applying the art part of the valuation process that separates the great from the good. So I urge all valuation professionals to value the forest and not to simply count the trees.

industry risk premium (RP_i) instead of a beta.

All of these factors need to be determined in order to obtain a proper COC using the CAPM. With that I have no quarrel. However, within these factors there is a divergence of opinion as to the methodology to be applied in determining the COC. In 2013, Jim Hitchner put together a good analysis of the impact of these differences[4] in methodology, which included:

• BUM:
  - SBBI Historical[5]
  - SBBI SS
  - D&P RPm, RPs
  - D&P Risk
• MCAPM
  - SBBI Historical
  - SBBI SS
  - D&P RPm and RPS

Interestingly, Hitchner's analysis resulted in a fairly tight range of COC conclusions. The low end was in the 18 percent range and the high end was in the 22 percent range. While that can result in a 20+ percent change in value from top to bottom, it nevertheless can complicate the process and perhaps causes the valuation analyst to perform all of the options noted above and then select and support some COC conclusion within the range determined. Not only is this burdensome for the valuation analyst, but it may be difficult to explain to the user of the valuation.

This is just the tip of the iceberg. The new Duff & Phelps Cost of Capital Navigator moves the multitude of data from a print form to an online form and provides the models and modules to calculate the COC "with you." The danger here is two-fold. As with any online model (and there are plenty of others in the valuation arena, so I am not picking on the D&P Navigator), the user will have a tendency to not learn the theory behind the model's purpose. This is more likely with those who are perhaps part-time valuation analysts, but even those who make it a full-time profession can fall into this trap. Second, and closely related to the first issue, is that the COC determined using the Navigator might be more difficult to explain to the user(s) of the valuation.

So now let's take a look at betas. Interestingly, the BUM is often criticized as being too subjective, so we should all herd around the MCAPM so we can find the magic beta that will make our valuation much more precise. Let's squeeze as much of the guesswork out of the process as we can.

Systematic risk refers to the risk that is common to all stocks or what can be considered market-wide risk. Beta is an estimate of the systematic risk of a security. Beta measures the sensitivity or volatility of the return of a security relative to movements or the return of the market as a whole as measured by an index, such as the S & P 500 Index. The market index has a beta of one. A security with a beta greater than one would be considered more risky, whereas one with a beta lower than one is considered less risky than the market. But there are no published betas for privately held companies. So we use the public market as a proxy, and some of the stocks used (usually in the same industry as the valuation subject) have already been rejected for the guideline public company method under the market approach.

Nevertheless, we march forward into the land of betas and there are choices at every turn. We have many types of betas:

1) Ordinary least squares (the standard beta)
2) Lagged or summed beta
3) Adjusted beta
4) Downside beta
5) Implied beta
6) Total beta
7) Fundamental beta (aka a Barra Beta)
8) Size-adjusted beta

But that is only the beginning. Along the way we must choose from a variety of sources that include Bloomberg, Computstat, Duff & Phelps, and Merrill Lynch. And the betas published by different sources can display different results due to differing time periods, methodologies, and adjustments.

Now we all know that it is proper and necessary to unlever and relever our beta in the COC formula so that we account for the different debt structures between the comparative betas (always public companies) and our privately held company that is the subject of our valuation. Not surprisingly, there are several choices on the methodology to use in performing this function. There are the Hamada Formula, the Miles-Ezell Formula, and the Harris-Pringle Formula.

So far we have covered some of the normal channels that a valuation analyst should travel in determining a company value. But what inspired me to write this article was the seeming proliferation of assertions and theories—espoused in many valuation journals—of even more arcane methodologies to apply. For example, the Winter 2017 issue of *Business Valuation Review* features an article on adjusting the terminal value to account for inflation.[6] The thrust of the article is as follows:

> Despite the fact that it typically accounts for the majority of the estimated value of a company, the terminal value in discounted cash flow (DCF) valuations is often treated formulaically without appropriate consideration for the impact of inflation on the inputs.[7]

Okay, so I can buy that inflation could have an impact on the inputs in certain situations, but is this really a universal computation that should be made in every valuation?[8] Interestingly, the article focuses on the depreciation issues. That happens to be one of the focus issues on valuation impact of the Tax Cuts and Jobs Act (TCJA),[9] so the two concepts might actually interfere with each other. Collateral damage, I suppose.

Continued on next page

Speaking of the TCJA, this is the first time in my career that I can remember that a tax act had any impact on the valuation process, or at least not to this extent. Admittedly, valuation was not as refined a process as it is today, but up until the TCJA there was scant consideration of the impact of taxes on the cash flows. *Financial Valuation Applications and Models*[10] offers one table and a few paragraphs to the following statement:

> The determination of tax on future income can incorporate the:
> - Actual tax rate
> - Highest marginal tax rate
> - Average tax rate[11]

In fairness, the table did demonstrate that the value could vary by almost 20 percent, depending on which of these options was selected. However, it was rarely an issue in any particular valuation, including those that might be the subject of a litigation matter. The TCJA has now focused the valuation community on tax issues in determining a value for a business. We are now talking about things like "bolt-on models" and such to determine the impact of depreciation issues in the TCJA on a particular valuation.

I recognize that the lower tax rates will result in higher values for companies, but it appears to me that there is somewhat an overreaction taking place. My informal survey of some business brokers indicates that the TCJA will not have any impact on multiples of income, EBIT, EBITDA, etc. for the values of smaller businesses. As some have pointed out, we will have to wait for a year or two to see if the multiples in the transaction market actually reflect a difference in values.

One good result of this focus is that there is a lot of soul searching going on as to the value of a pass-through entity as a result of the TCJA. Full disclosure: I have never believed in an added value for a pass-through entity, especially in the case of a control interest. The TCJA should put the pass-through premium issue to rest, but alas, it likely will not. At least not until the Tax Court gets off of its false premise of assuming that because there is no corporate-level tax, there is no tax at all.

There are many more overlapping process issues than the ones we have discussed in this article. We have not really touched the market approach and the myriad of process issues there. In fact, there are many more in the income approach that we have not discussed. There are also issues such as discounts and premiums.

So just what am I espousing? I am suggesting that we stand back at the end of whatever process and decisions we make in performing a valuation and take a hard look at the resulting valuation conclusion. Does it really make sense considering all of the other issues that should be taken into account in the determination of the value of a business interest? The AICPA's *Statements on Standards for Valuation Services*[12] outlines the process for performing a valuation engagement. Paragraphs 25 to 30 outline the analysis of the subject interest. It is a good place to start in applying the necessary analysis to the preliminary conclusion of value to an engagement.

Too often I find that the valuation analyst simply follows the process but excludes what I call the "art" part of valuation. All of the BV standards of the major valuation organizations (AICPA, NACVA, ASA, IBA, The Appraisal Foundation, and USPAP) allow for a range of value or a single amount. They realize that the value determined, for example, in a fair market valuation is an estimate of value and not an actual value (as, for example, a "sale price" might be). As a result, there has to be an *art* part of the process or all that has been done is to produce a formulaic answer. The art part is aided by the analysis part of the process. Along the way it can assist in determining the cost of capital under the income approach and/or the multiples to be used in the market approach.

It is the skill in applying the art part of the valuation process that separates the great from the good. So I urge all valuation professionals to value the forest and not to simply count the trees. ꩜

1 James R. Hitchner, ed., *Financial Valuation Applications and Models*, fourth edition (Hoboken, NJ: John Wiley & Sons, 2017), p. 128.
2 Ibid., p. 194.
3 Ibid.
4 "Cost of Capital: Comparisons of Ibbotson and Duff & Phelps Data Inputs in the MCAPM and BUM," *Financial Valuation and Litigation Expert*, Issue 45, Oct./Nov. 2013, Valuation Products and Services, LLC, pp. 1, 3-7.
5 All SBBI data is now part of the Duff & Phelps data and has been renamed.
6 Bradford Cornell and Richard Gerger, "Estimating Terminal Values with Inflation: The Inputs Matter – It Is Not a Formulaic Exercise," *Business Valuation Review*, vol. 36, no. 4, American Society of Appraisers, 2017, pp. 117-123.
7 Ibid., p. 117.
8 The article implies that the inflation impact occurs in valuations using GAAP financial statements and GAAP financial forecasts.
9 Tax Cuts and Job Act, 2017.
10 Hitchner, pp. 125, 126.
11 Hitchner, p. 125.
12 VS Section 100, "Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset," American Institute of Certified Public Accountants, Inc., 2015.

Pension Benefit Obligation: Is It Double Counting?

DONALD P. WISEHART,
ASA, CPA/ABV, CVA, MST

Wisehart, Inc.
Providence, RI
don@wisehart.biz

As baby-boomer owners of large, privately owned manufacturing companies age into generational transfer, fair market valuation will play a critical role. Embedded in fair market value is the unresolved treatment of pension benefit obligations. There are two schools of thought: One is to rely on the auditors' treatment, and the other is to deconstruct that treatment.

We were recently engaged in a litigation matter involving the treatment of this pension benefit obligation. A large manufacturing concern was highly profitable and worth a lot of dollars. Because this company maintained a defined benefit plan, it had a large *"pension obligation"* liability, reflected on the balance sheet as an "other liability." A pension obligation that was booked is what is referred to as a "projected benefit obligation" (PBO), which is an actuarial estimate of the total retirement benefits (at discounted present value and net of pension plan assets) earned to date by the employee members, based on *"estimated future"* compensation levels. This liability is, generally, significantly higher than the "accumulated benefit obligation" (ABO), which is also reported at discounted present value and net of pension plan assets, approximates the liability to the company if the plan was terminated. It is not surprising that the Financial Accounting Standards Board (FASB) would require the highest liability, as it adheres to conservative accounting in order to protect the stakeholders, which in this case are the company's pension members. In this instance, the PBO was approximately $11 million and the ABO about $5 million.

In handling this liability, we took a position that was contrary to the opposing experts, who were two prominent and nationally known firms. With both sides applying the guideline public company method and the discounted cash flow method, the resulting opinions of value were significantly different.

THE GUIDELINE PUBLIC COMPANY METHOD (GPMC)

The selection of the public companies was similar between the two sides. What was common to the public companies selected was the fact that the public companies also had pension obligation liabilities. Both sides ignored the liability in calculating publicly traded market multiples. That is to say, the liability was not treated as interest-bearing debt equivalent as described in the summary section below. Accordingly, the "market" had already priced these companies with the pension obligations included. Our position was that since the market had already included these obligations in its determination of value, we should not make any adjustments to the company's indication of value. Both opposing experts deducted the total pension benefit obligation (PBO) from the indication of value, and, in our mind, double counted. Thus, we had a difference of $11 million in value. If the opposing experts were correct in making a deduction for the liability, they nonetheless erred by not tax-affecting the liability, since the payment of this liability would be tax deductible. Assuming a 40 percent tax rate at that time, their reduction should have been $6.6 million ($11 * (1-40%)).

THE DISCOUNTED CASH FLOW METHOD (DCF)

The company's cash projections, which were based on historical financials, included annual pension costs. Further, the projected pension costs included costs relating to increased salaries and wages and new employee plan participants. Our position was that since the pension expense projections already funded for future salaries and new employee plan participants, we should only reduce the indication of value by the tax-affected ABO - $3 million ($5 X (1-40%)). To do otherwise, i.e., to deduct from the total DCF answer, would be tantamount to "double dipping" when the projected pension costs were already included in the company's projected cash flows.

SUMMARY

The case never went to court. The only "peer" reference to the pension obligation liability that we could find was in *Measuring and Managing the Value of Companies*.[1] The authors state that "excess pension assets should be treated as nonoperating, and unfunded pension liabilities should be treated as a debt equivalent."[2] They also state that one should "add excess pension assets to and deduct unfunded retirement liabilities from enterprise value. Valuations should be done on an after-tax basis, using local tax rules."[3]

Continued on page 18

expert **TIP**

There are two schools of thought on pension obligations: One is to rely on the auditors' treatment, and the other is to deconstruct that treatment.

Royalty Rate Estimation for Technology IP: Important Considerations

RAYMOND D. RATH,
ASA, CEIV, CFA

Globalview Advisors
Irvine, CA
rrath@globalviewadvisors.com

INTRODUCTION

Royalty rate estimates are key assumptions in financial and tax reporting valuations and damages calculations. For financial reporting valuations, the Application of the Mandatory Performance Framework document (AMPF) provides requirements for developing royalty rates. Given the potential challenges by adverse parties, transfer pricing valuations and litigation projects involving technology-related intellectual property (IP) require extensive procedures for the determination of an appropriate royalty rate.

While many are familiar with financial, tax, and management information systems (MIS), and due diligence studies prior to completion of a business acquisition, IP due diligence can be a key factor for transactions where technology rights are important to operations. Much like the other diligence areas, appropriate specialists including IP attorneys should be involved when significant IP is present and the strength of the IP protection is key to a successful transaction.

IP values often tie to their contribution to the operations of an operating firm. IP values can also be derived from income from licensing and litigation strategies. Entities that primarily engage in licensing and litigation rather than incorporating IP in their own products or services are typically referred to as non-performing entities (NPE). Many industry participants believe changes in the legal setting pertaining to IP have reduced the value of IP held by NPEs and increased the value of IP held by operating companies.

CHANGING LEGAL ENVIRONMENT

The legal environment impacts the dynamics of negotiations between market participants. The changing legal environment reduces the comparability of prior transactions. These factors combined with uncertainties on actual comparability further complicate the task of finding true guideline license agreements to develop a royalty rate estimate.

In recent years, changes in the legal environment pertaining to IP have had a downward impact on IP values and, presumably, royalty rates. A discussion of changes in the legal environment follows.

Non-practicing entities are entities that hold IP with the intent of licensing it to others for their use in business operations. NPEs are also involved in litigation actions involving alleged IP infringement. There are a number of publicly traded NPE firms. Many analysts have cited declines in NPE stock prices as a result of adverse changes in the legal environment. Changes in the IP environment have also led some NPEs to change their business strategies.

QUALITY OF LEGAL RIGHTS

Potential investors want to know whether an IP portfolio can be enforced against competitors and exclude competitors from the market. Additionally, investors need to be aware of the relative strength of IP held by competing firms or NPEs.

Important attributes of IP rights include:

- Validity—Is the IP enforceable?
- Breadth of Coverage—If IP rights are enforceable, how broad or narrow are the rights?
- Freedom to operate—A patent allows the owner to use IP and also exclude others from use. As a result, the IP of others does not prohibit an IP holder's actions.

Key factors leading to a less favorable outlook for technology-related IP that is subject to license include:

1) Reduced availability of patent grant
2) Decreased risk of injunction in the event of possible infringement
3) Changes in expense reimbursement in the event an infringement action is unsuccessful. Each of these areas is discussed below.

AVAILABILITY OF PATENT GRANT AND PROTECTION

One basic change impacting technology-related IP is whether protection is even available for certain IP. Many are now increasingly asking the basic question: Is software obvious? Software IP is increasingly viewed as obvious and patents may be harder to obtain and enforce. The U.S. Supreme Court's 2014 ruling in *Alice Corp. v. CLS Bank International*[1] made it significantly more difficult to defend the validity of software patents.

Also, an administrative fast track to challenge, and often invalidate,

Continued on next page

expert **TIP**

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

patents at the Patent Trial and Appeal Board (PTAB) was established by the 2011 Leahy-Smith America Invents Act. The PTAB is an administrative law body of the U.S. Patent and Trademark Office, which decides issues of patentability. The PTAB conducts trials, including *inter partes* (between the parties), post-grant, and covered business method patent reviews and derivation proceedings; hears appeals from adverse examiner decisions in patent applications and reexamination proceedings; and renders decisions in interferences.

One of the fast tracks, called *inter partes review,* allows anyone to challenge a patent as not truly original or because it describes something too obvious to be considered an invention. Since the PTAB was established, NPEs have comprised a substantial portion of defendants in those proceedings. Plaintiffs in those cases are often operating companies that the NPEs have sought licensing fees from or filed infringement suits against in U.S. district courts.

RISK OF INJUNCTION

Another trend reducing the potential value of IP held by NPEs relates to the reduced risk of an injunction for patent infringement. In 2006, Research-in-Motion agreed to a settlement of over $600 million with NTP, Inc. The settlement related to patent infringement pertaining to NTP's mobile email patents that were allegedly infringed by technology included in the Blackberry smart phone. The settlement amount was very high given concern of a permanent injunction against a product of an early stage firm with exceptionally high future growth potential.

A key court case reducing the potential for an injunction for IP infringement was *eBay Inc. v. MercExchange, L.L.C.* 126 S. Ct. 1837, 1841 (2006).[2] In this case, the U.S. Supreme Court held that district courts have the power to deny injunctions in appropriate cases. This case reduces the risk of an injunction that would stop product sales prior to a legal action that settles an infringement claim.

As many products become increasingly complex and incorporate more technologies, the risk of a possible injunction could be expected to decrease given this factor. A research paper, "Patent Holdup and Royalty Stacking," by Mark Lemley and Carl Shapiro,[3] provides important insights on royalty rates for IP. The paper concludes that royalty rates associated with subsets of IP for complex, multi-technology products may overstate the true economic value of the IP component. The civil case, *Microsoft v. Uniloc,*[4] also focused on the complexity of many products and the large number of technologies embedded. This case noted product complexity and threw out profit split methods used in prior years. As the contribution of a specific set of IP is reduced, the expectation of an injunction for infringement would also be expected to decrease.

PAYMENT OF LEGAL FEES

Another factor adversely impacting the value of technology-related IP held by NPEs relates to changing perceptions of the risk of payment of legal fees by the losing party in IP litigation. There is an increased belief of greater risk of fee payment in the event of a loss in litigation. For NPEs, the potential for reimbursement of legal fees of the defendant increases the cost and risk of litigation. Conversant (a private NPE) lost a case against Apple in the Eastern District of Texas and was ordered by the court to pay costs of just over $736,000.

Legal precedent regarding payment of fees has varied. In 2005, the legal discretion to award fees to a successful defendant in IP litigation was made significantly more difficult as a result of the *Brooks Furniture*[5] case requiring "material inappropriate conduct," a case that is "objectively baseless" and is "brought in subjective bad faith." This case reduced the risk of payment of legal fees by NPEs and other plaintiffs. However, the U.S. Supreme Court vested greater discretion in trial courts as a result of the April 29, 2014 decisions in *Octane Fitness v. Icon Health & Fitness*[6] and *Highmark v. Allcare Health Management System.*[7] Discretion to award fees in a particular case was returned to the court that is most familiar with the matter. These cases lead to less risk of overturn of fee award on appeal.

These cases suggest increased risk of "fee shifting" so that the loser of the case may be responsible for the legal fees of both parties. This action would presumably increase the cost to plaintiffs of lawsuits for infringement. As many (but not all lawsuits) are brought by NPEs, the general expectation is that this increased risk would reduce the value of IP held by NPEs and increase the value of IP held by operating entities.

OTHER CHANGES

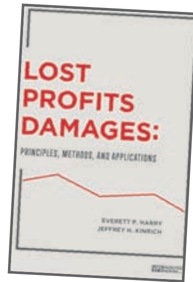
Operating companies are increasingly willing to fight rather than settle litigation. IP litigation is increasing against smaller operating companies. These smaller firms have less management and financial resources needed to defend against litigation aggressively. According to an RPX Corporation study, in 2015 NPEs filed more than 3,600 IP infringement cases (roughly two-thirds of the total cases). Companies with less than $100 million in annual revenue, which are less able to weather large legal bills, made up more than 60 percent of defendants in those cases.

Operating companies and governments are increasingly willing to acquire technology-related IP to reduce the risk of legal actions by NPEs. RPX Corporation buys patents on behalf of a consortium of large technology firms so those patents can't be used in infringement suits against them. Governments are also focusing on IP portfolios to protect IP-focused operating companies.

Continued on next page

Now available from
Valuation Products and Services...

LOST PROFITS DAMAGES: Principles, Methods, and Applications



"Every business litigator and every expert who testifies about lost profits needs to have this book.

It discusses in depth important topics that aren't dealt with in other books on lost profits."

Robert M. Lloyd, JD
Professor Emeritus,
University of Tennessee Knoxville
School of Law

Two expert editors...

Everett P. Harry, III, MBA, CPA, CFF

Jeffrey H. Kinrich, MBA, MS, CPA, ABV, CFF

- 45 distinguished authors
- 23 practical, easy-to-use chapters
- Useful guide for both new and experienced damages analysts
- Valuable educational resource for attorneys

To order the most comprehensive text ever written on lost profits damages, CLICK HERE or go to www.valuationproducts.com/lost-profits

MARKET-BASED ROYALTY CONSIDERATIONS FOR APPRAISERS AND ATTORNEYS

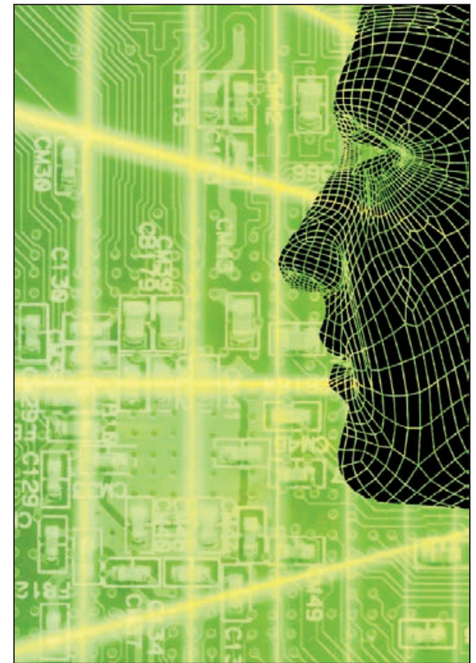
Another challenge in developing royalty rates based on market data is potential selection bias in the available royalties. For disclosure in SEC filings, the relative size of the matter needs to be material to audit. Immaterial situations do not require disclosure.

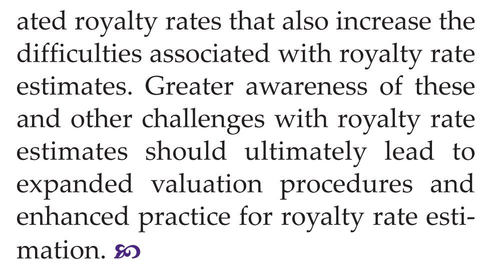
Another concern in using market evidence of royalty rates relates to the ultimate determination of a matter. Disclosure may only occur when the plaintiff wins. For losses, there is no market evidence that results.

The source of a royalty rate also merits consideration. Patents can be viewed as probabilistic rights as a patent's validity is potentially subject to challenge with a risk of patent revocation. Given this risk of possible future invalidity, a negotiated royalty rate should be lower than a royalty rate determined in IP litigation. Once IP has been concluded to be valid, the risk of invalidity is reduced or eliminated, suggesting an increase in the royalty rate. This rate would presumably be higher than a rate where IP validity has not been challenged and upheld.

CONCLUSIONS

This article notes the challenges associated with royalty rate estimates. We focused on changes in the legal environment pertaining to technology-related IP. The changing legal environment suggests increased care when considering royalty rate information that is not close to the valuation date. Changes in the legal environment suggest IP held by NPEs or other plaintiffs may have reduced values. Technology-related IP held by operating companies may increase in value due to the reduced threats associated with litigation. Other challenges associated with developing a royalty rate estimate include royalty rate disclosure, including audit materiality, increasing product complexity (i.e., royalty stacking), and the probabilistic nature of negoti-

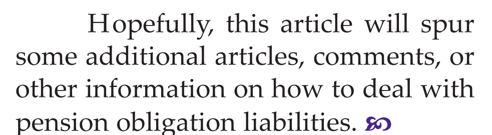




ated royalty rates that also increase the difficulties associated with royalty rate estimates. Greater awareness of these and other challenges with royalty rate estimates should ultimately lead to expanded valuation procedures and enhanced practice for royalty rate estimation. ൱

[1] *Alice Corp. v. CLS Bank International,* https://www.bitlaw.com/source/cases/patent/ Alice_Corp.html.
[2] *eBay Inc. v. MercExchange, LLC,* https://www.law.berkeley. edu/files/EBAY_INC_-_edited.pdf.
[3] Mark Lemley and Carl Shapiro, "Patent Holdup and Royalty Stacking," https://papers.ssrn.com/sol3/papers.cfm? abstract_id=923468.
[4] *Microsoft v. Uniloc,* https://caselaw.findlaw.com/us-federal-circuit/1551259.html.
[5] *Brooks Furniture Manufacturing, Inc. v. Dutailier International, Inc.,* No. 03-1379 (Fed. Cir. Jan. 4, 2005).
[6] *Octane Fitness v. Icon Health& Fitness,* https://www.oyez.org/cases/2013/12-1184.
[7] *Highmark v. Allcare Health Management System,* https://www.oyez.org/cases/2013/12-1163.

WISEHART, continued



Hopefully, this article will spur some additional articles, comments, or other information on how to deal with pension obligation liabilities. ൱

[1] Tim Koller, Marc Goedhart, and David Wessels, *Measuring and Managing the Value of Companies,* 6th edition (Hoboken, NJ: John Wiley & Sons).
[2] Ibid., p. 415.
[3] Ibid., p. 416.

To 'QB' or Not to 'QB'? That Is the Question[1]

ROBERT P. GRAY,
CPA/ABV/CFF, CGMA, CFE
of Gray Schrupp & Associates PLLC
and
ROB KESTER,
CPA/ABV/CFF
of Blue & Company

Dallas, TX
bob.gray.gsa@outlook.com

Recently, the authors have been requested to testify a number of times in discovery-related controversies, including disputes surrounding requests for detailed general ledger information[2] (e.g., QuickBooks software) in connection with dispute matters[3] involving business valuations. Thus, the question is whether the business valuation analyst (a/k/a *"financial expert"* for purposes of this article) should request copies of detailed general ledgers for business valuations being performed in a "dispute" setting.

Although the need to obtain detailed general ledger[4] information might be obvious to the financial expert community, for the most part laypeople (e.g., opposing attorneys, opposing parties in the dispute, and often the judge involved in the matter) don't understand the need for the business valuation analyst to request such data.[5] Generally, opposing counsel who attempt to squash such requests will inform the court that the financial expert is conducting a "fishing expedition" and are fearful that costs will escalate as well as put confidential information in jeopardy. However, it is important to note that many summary financial statements (e.g., a year-end balance sheet, income statement, and/or trial balance) produced in a dispute setting do not have any involvement from an outside independent accounting firm, do not provide additional disclosure information (e.g., footnotes to the financial statements), and are unsophisticated (e.g., incomplete, not prepared/updated timely, are inconsistent with other relevant financial books and records, etc.).

The majority, if not all, of the challenges described above involve business valuations of privately held entities. Many of the subject entities are entangled with multiple related-party entities.[6] The *Handbook of A&A* discusses:

> Concealed relationships and hidden ownerships have been used by corporate management to facilitate deceptions of the auditors and of the public, usually for the purpose of reporting exaggerated revenues or to produce artificially inflated earnings reports, and hence stock values. Related party transactions thus have and aura of illegitimacy disproportionate and consequently have been perceived by legislators and prosecutors from time to time as evils to be exposed, laid bare by punitive disclosure requirements, and finally eradicated. This attitude, of course, is not truly warranted, since many related party transactions are entirely appropriate, are consummated at fair prices, and are fully disclosed in the financial statements.[7]

Granted, the role of the financial expert in a dispute setting is *not to audit* the financial statements, and the above references to related parties and relevant transactions (related-party transactions) are being given for informational and background purposes only. The role of the financial expert in said business disputes is to *perform a business valuation.* The assignment requires the valuation analyst to have a sufficient understanding (and having access to critical materials) of the related entities/parties and their transactions in order to be able to provide a credible business valuation.

SITUATIONS CALLING FOR NEED TO REQUEST DETAILED GENERAL LEDGERS

When performing a business valuation that does not involve a legal dispute, the authors acknowledge that "initially" requesting copies of detailed general ledgers may be unnecessary. However, even in complex assignments (non-dispute settings) the valuation analyst may have to supplement the requests for such materials (see examples and discussion below). Listed below are sanitized examples of recent situations encountered.

Scenario 1

In a stakeholder dispute (e.g., the majority owner 75 percent suing the minority shareholder for theft of trade secrets and loss of business opportunity) there are over 40 business entities

Continued on next page

expert **TIP**

When performing a business valuation that does not involve a legal dispute, the authors acknowledge that "initially" requesting copies of detailed general ledgers may be unnecessary. However, even in complex assignments (non-dispute settings) the valuation analyst may have to supplement the requests for such materials.

(e.g., various corporations, limited liability companies, partnerships, and joint-ventures) involved in the case. The related parties have conducted a significant amount of interrelated business and as a result there are various "due to/from" accounts on the balance sheets of the respective entities that contain balances that are material to the related financial statements. The opposing side produces summary QB financial statements (unaudited, no footnote disclosures, limited to balance sheets and operating statements).[8] The opposing side in this matter has resisted and delayed production of materials related to the case and your client does not have access to most of the books and records of the various entities.

In **Scenario 1**, when the summary financial statements are produced, you find out that on the same dates (e.g., December 31, 2017 and 2016) that the due to/from amounts do not agree when you compare the various entities. The subject books and records involved are maintained by the same accounting personnel of the opposing party in the lawsuit. Other relevant materials produced in the case do not offer any resolution and all financial statements are maintained on the "accrual method"[9] of accounting basis.

Scenario 2

The business valuation analyst is engaged by counsel to perform certain business valuations in a matrimonial dispute. In addition, the financial expert is to assist in the characterization of certain assets (e.g., separate property versus community property). The opposing side only provides summarized QB financial statements for a three-year period (2015 through 2017) and copies of Federal income tax returns for the same periods. The parties have been married since 2000 and at issue are several significant assets that ownership is being disputed in the Matter. The financial expert requests the historical detailed general ledgers (including the periods covered by the aforementioned financial statements and previous periods—2000 through 2014)[10]—because the related balances in the accounts/assets change every year. Opposing counsel objects and refuses to produce the requested materials. Your attorney is forced to ask the court for a hearing and motion to compel the evidence being requested by the business valuation analyst performing the forensic expert work.

In both **Scenarios 1** and **2** the books and records are maintained using QB software for all entities.

WHAT TO DO

When faced with the need to request copies of detailed general ledgers, where can a financial expert turn to justify and support the request for the materials? Unfortunately, there are few if any references in the traditional, commonly accepted business valuation and/or forensic accounting treatises that many financial experts rely upon. Thus, this article was created with the intent to articulate the reasons it can be necessary and relevant in certain circumstances.

Listed below are several reasons a financial expert may want/need to request (and justify the request) the detailed general ledger information to address situations in the above scenarios and other matters.[11]

- ***Verification of Information.***[12] Obtaining copies of the detailed general ledger (a copy of the final file—assuming that all transactions and accounting adjustments for the related period(s) are complete) can be useful in comparing the data/information to copies of summary financial statements and income tax returns produced in the case for consistency. It is not uncommon in a litigation case for the financial expert to receive financial statements, trial balances, and/or income tax returns where the information does not agree amongst those documents and/or other supporting materials. Ignoring intentional manipulation by one party, there can be several reasons for the incorrect information. One possible reason, the summarized financial statements presented in the matter were produced before the subject entity made its year-end closing adjustments to record depreciation and amortization. Many small business wait until year-end to record certain entries with the assistance of an outside accountant).[13] Another possible reason for differences can also be attributed to the general ledger information provided is prepared on the book basis of reporting versus the income tax basis of reporting. Having a final copy of the detailed general ledger can assist the valuation analyst in helping to locate such inconsistencies, if any.

- ***Efficiency and Effectiveness.*** In a stakeholder lawsuit involving a business dispute between the majority and minority stakeholders, the related subject entities had several note receivables/payables and intercompany due to/due from accounts on the related balance sheets for over 20 entities. The year-end balances (all using the same date) did not agree with one another and the differences were material to the matter. In addition, the subject entities had sold various assets and the financial expert was trying to trace the proceeds of the sale for such assets (e.g., one of the subject entities sold at the end of the year, a commercial real estate building for $25 million that had a cost basis for both book/income tax purposes of $15 million that resulted in a gain on the sale of $10 million). The proceeds from the sale of the commercial real estate building were supposed to be split 65 percent ($3.25 million) and 35 percent ($1.75 million) to the majority and minority stakeholders, respectively.

  The financial expert requested copies of the detailed general ledgers for the year in question *and for the next fiscal period.* The oppos-

Continued on next page

ing attorney objected and stated that their client had produced the year-end balance sheet and income statement from QuickBooks (for only the current year) along with the current year's Federal income tax return. In a hearing in front of the judge, the opposing attorney stated that the the request for the detailed general ledgers was overly burdensome. The judge granted the motion to compel the production of QuickBooks files for the current year (and for the next fiscal period after some considerable debate). Upon analyses of the detailed general ledgers (current period and for the next fiscal period), it was discovered that the sale proceeds were recorded incorrectly by the minority owner. The minority owner buried the $5 million of the sales proceeds in cost of sales accounts (a reduction of an expense operating account and not a balance sheet account) and showed no balance owed to the majority stakeholder at the end of the current year.[15] To further complicate the issues with this transaction, the minority owner decided to charge the majority owner for a 6 percent commission on the sale of the commercial real estate building. However, there was no agreement between the parties for this hypothetical commission. The minority owner charged the majority owner for the $1,500,000 in the current period by recording the commission as income and reducing the amount of money owed to the majority stakeholder (e.g., reducing the due to related company balance on the balance sheet).[16]

In analyzing the next fiscal period's detailed general ledger (e.g., two months after the sale date), the minority owner paid the majority owner's sales proceeds to an undisclosed related company that his wife owned. The error was discovered by the financial expert while reviewing the details of cash disbursements in the detailed general ledger in the next period. Had the judge not allowed for the production of the requested materials these facts/observations may never have been discovered in the lawsuit.

The above analyses that the financial expert performed to trace the out-of-balance situations and where the proceeds from the sales were recorded (and ultimately paid to) took approximately 3.5 hours to perform. Having the additional detail minimized the attorneys going back and forth between one another and also avoided having the parties from going back to the judge for additional issues on the lack of production in the matter.[17]

The above example has bearing on the subject entities business valuations, as the valuation analyst for the majority owner would have shown $5 million ($3.5 million from the sales proceeds and $1,500,000 from the disputed commission) more in assets than the financial expert for the minority owner due to out-of-balance situations. This would have resulted in different conclusions by the valuation analysts when they applied the asset approach to their business valuations (and could have resulted in significant differences in the ultimate valuation conclusions between the two financial experts).

✔ ***Cost Effective and Confidential Approach.*** As indicated above, opposing attorneys attempt to resist providing the request for detailed general ledger material by telling the trier of fact that it is an unnecessary fishing expedition, the information being sought is confidential, and granting the request will result in a significant cost-burden to their client to produce the materials. In a recent testimony, one business valuation analyst overcame such arguments by testifying to the Court the following:

- The CPA valuation analyst estimated that she believed the process to provide a backup copy of the subject business's QuickBooks file would require the purchase of a $10 to $25 thumb drive and that the whole process of downloading the back-up file to the thumb drive would entail less than five (5) minutes. The business valuation analyst also attached a copy of instructions on how to back-up a QuickBooks file from Intuit's website in her affidavit on the matter as evidence.

- With respect to confidentiality, the financial expert agreed to sign a "confidentiality agreement" or a "protective order" with the parties if necessary. In addition, during her testimony at a hearing on the motion to compel, the expert reminded the court that CPAs are subject to confidentiality restrictions when complying with professional standards.[18] The court accepted the testimony and did not require any additional agreements in the matter. The business valuation analyst also stressed to the court that obtaining the backup file would not provide the opposing party (her Attorney's client) the ability to access and manipulate the data since it was a backup file.

- During her testimony it was also helpful that the business valuation analyst articulated that in order to provide credible business valuations to the court that it would be extremely helpful to have the ability to analyze *"all sufficient relevant data"* and to comply with her professional standards[19] and other appropriate guidance.[20]

CONCLUSION

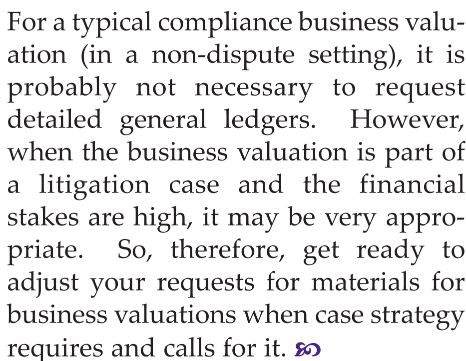
To QB or Not to QB, that is the question! The answer is the general consulting answer—*it depends* (on the facts

Continued on next page

and circumstances). Attorney Mark Fenzel offers the following with respect to this issue:

> Both state and federal judges have broad discretion in imposing limits on the bounds of discovery and are usually willing to allow access to copies of general ledgers and other company records.

Later, Mr. Fenzel, a seasoned trial attorney, further indicated to us:



> In addition, if one of the litigants is an owner of the business, most states have statutes that will allow the owner or shareholder the right to access the books, even absent any litigation. If the business refuses the request, counsel should add this to the list of reasons why the judge should allow the discovery.

For a typical compliance business valuation (in a non-dispute setting), it is probably not necessary to request detailed general ledgers. However, when the business valuation is part of a litigation case and the financial stakes are high, it may be very appropriate. So, therefore, get ready to adjust your requests for materials for business valuations when case strategy requires and calls for it. ജ

The authors would also like to thank Mark Fenzel, Esquire, Middleton Reutlinger, Elizabeth Schrupp, CPA/ABV/CFF, AVA, Gray Schrupp & Associates PLLC, and Dave Duffus, CPA/ABV/CFF, Partner, Baker Tilly Virchow Krause, LLP for contributions to this article.

---

[1] "'To be or not to be' is the most famous soliloquy in the works of Shakespeare—probably, even, the most famous soliloquy anywhere. That is partly because the opening words are so interesting, memorable[,] and intriguing but also because Shakespeare ranges around several cultures and practices to borrow the language for his images, and because he's dealing here with profound concepts, putting complex philosophical ideas into the mouth of a character on a stage, communicating with an audience with a wide range of educational levels. The first six words of the soliloquy establish a balance. There is a direct opposition – to be, or not to be. Hamlet is thinking about life and death and pondering a state of being versus a state of not being – being alive and being dead." ^ https://www.nosweatshakespeare.com/quotes/hamlet-to-be-or-not-to-be/.

[2] "A general ledger represents the formal ledger for a company's financial statements with debit and credit account records validated by a *trial balance.* The ledger provides a complete record of financial transactions over the life of the company. The ledger holds account information that is needed to prepare *financial statements* and includes accounts for assets, liabilities, owners' equity, revenues and expenses." ^https://www.investopedia.com/terms/g/generalledger.asp.

[3] For example, forensic litigation matters involving disputes related to mergers and acquisitions (M&A), loss of value (e.g., stakeholder or trade secret matters), and matrimonial cases.

[4] A recent *PC Magazine* article ("The Best Enterprise Accounting Software of 2018," Oct. 5, 2017) indicated, "By sheer installed applications, entry-level financial apps such as Intuit QuickBooks ['QuickBook' or 'QB'—see above reference] have the numbers when it comes to accounting software." *Note:* See other software applications like Intacct, Oracle Net Suite OneWorld, Acumatica, Accountmate, Cougar Mountain Denali Summit, Open Systems Traverse, SAP Business One Professional, Sage 300, Microsoft Dynamics GP, etc. ^https://www.pcmag.com/article/342998/the-best-enterprise-class-general-ledger-accounting-software.

[5] For purposes of this article, "materials" will address data, documents, and information.

[6] A "related party" is defined as "Viewed from the perspective of the financial statements of the reporting entity, a related party may be any of the following: affiliates; principal owners and close kin; parents and subsidiaries; equity method investors and investees; trusts for the benefit of employees; any other party that has the ability to influence the management or operating policies of the reporting enterprise significantly, the extent that it may be prevented from fully pursuing its own separate interests; and de facto agents of the entity. The foregoing listing, with the exception of the final term, is based on FASB ASC 850-10, which is the principal standard dealing with this subject. De facto agents is a new category defined by FASB ASC 810-10, specifically for use in situations involving a prospective variable interest entity (VIE). WGL Accounting Series, *Handbook of Accounting and Auditing 2014 -1* (*Handbook of A&A*), © 2013 Thomson Reuters/Tax and Accounting, p. C14-5.

[7] *Handbook of A&A,* p. C14-3.

[8] A/K/A income statements for those subject entities that have net income versus those that have net losses.

[9] "Accrual accounting attempts to record the financial effects on an entry of transactions and other events and circumstances that have consequences for the entity in the periods in which those transactions, events, and circumstances occur rather than in the periods in which cash is received or paid by the entity. Thus, accrual accounting is based not only on cash transactions but also on credit transactions, bartering, changes in prices, changes in form of assets or liabilities, and other transactions, events and circumstances that involve no current cash transfers but will have cash consequences in the future." Wiley GAAAP 2014 – Interpretation and Application of Generally Accepted Accounting Principles, Joanne M. Flood, © 2014, John Wiley & Sons, p. 23.

[10] The financial expert also requested most recent year-to-date 2018 financial statements and detailed general ledger information.

[11] These items are not listed in any order of importance and are not meant to be all-inclusive

[12] Even Internal Revenue Service (IRS) agents are now requesting client backup files from small business accounting software "to be more efficient in examining records and reduce the volume of paper involved in audits. The IRS saw this as making audits more efficient for its agents as well." "IRS audit of small business software files – Practitioners should balance risk for their clients," Jim Buttonow, CPA/CITP, *Journal of Accountancy,* Dec. 31, 2011.

[13] Another example could entail the subject entity subsequently filing an amended income tax return and the final general ledger has been adjusted to reflect transactions related to the amended income tax return, but the summary financial statements produced did not reflect such adjustments (e.g., the income tax return was adjusted for an incorrect deduction for the allowance for bad debts).

[14] The year-end balance sheet and income statement from QuickBooks (for only the current year) along with the current year's federal income tax return provided the removal of the asset, sales price, cost (basis), and gain on the sale of the asset, but did not provide where the funds went.

[15] Thus, the intercompany accounts (related due from/due to accounts) were not in balance by at least $3.25 million at the end of the current-year.

[16] The $1,500,000 disputed commission was recorded on the books and records of the minority owner but not on the books and records of the majority owner who had no knowledge of the commission. Thus, the disputed commission was another reason the due to/due from accounts between the parties did not agree at the end of the current year.

[17] In a dispute setting, it is often necessary for the financial expert to also go back in time to look for transactions that occurred prior to the current valuation year. Thus, the request for detailed general ledger information should not be limited to the current year. Depending on the software system being used by the subject entity, the financial expert may have to modify his or her request for materials for specific dates.

[18] "A member in public practice shall not disclose any confidential client information without the specific consent of the client." Rule 301 – Confidential client information. AICPA Code of Professional Conduct, ^http://nxt.gt.com/NXT/gateway.dll/gel/aicpafasb/ps/code_of_professional_con…, p. 102.

[19] *Statements on Standards for Consulting Services, CS Section 100,* par. .06.

[20] "Section 3. Approach to Valuation .01 A determination of fair market value, being a question of fact, will depend upon the circumstances in each case. No formula can be devised that will be generally applicable to the multitude of different valuation issues arising in estate and gift tax cases. Often, an appraiser will find differences of opinion as to the fair market value of a particular stock. In resolving differences, he should maintain a reasonable attitude in recognition of the fact that valuation is not an exact science. A sound valuation will be based upon all the relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and determining their aggregate significance." "Revenue Ruling 59 – 60," *Understanding Business Valuation – A Practical Guide to Valuing Small to Medium Sized Businesses,* fifth edition, Gary R. Trugman, © 2017 by American Institute of Certified Public Accountants, Inc., p. 695.

ROD ON PRACTICE MANAGEMENT
Ideas to Accelerate Your Practice's Growth

ROD P. BURKERT, CPA/ABV, CVA, Burkert Valuation Advisors, LLC

Do You Carry a Portfolio of Your Work?

How do BVFLS professionals like us demonstrate our analytical skill? How do we exhibit our problem solving acumen? How do we showcase our report writing talent? I have an idea … turns out it is somewhat controversial … but read on and let me know what you think.

All creatives—artists, writers, musicians, photographers, graphic designers, website developers, etc.—carry a portfolio of their work they can show to a prospective employer or client and say, "See, I've done this. This is what I'm capable of."

We have … resumes, which only tell a prospective employer or client the things we want to show (or claim). Sure, prospective employers and clients can check references, but there is only so much that will be said. And besides, are we going to list a reference who has something bad to say about us?

Creatives look to be hired by an employer or client who will compensate them fairly for their demonstrated abilities, as evidenced by their portfolio of work. Why should it be any different for BVers? It shouldn't be, at least in my opinion.

So why don't we carry portfolios of the work we've done? For example, sanitized reports that can establish the aforementioned skill, acumen, and talent.

Assuming you are not just too lazy to do it, I ran into another reason for not carrying a portfolio of your work. And that, strangely, turns out to be professional ethics. Ethics that allow us to submit sanitized reports to earn a credential or obtain CPE but not, God forbid, so we can market ourselves to prospective employers or clients. Really?

I say this based on the anecdotal evidence of phone and email conversations I had with one recruiter and one BV organization's ethics committee member (both of whom shall remain anonymous) when I was doing my homework for this article.

Here is a summary of the pushback I received and my reaction to it:

Who owns the report? Well, if we're self-employed, we do! But if we work for a firm, it's a more interesting scenario. Did part of our employment agreement include ownership of work product? Or if the report was prepared for ABC Industries, and they paid for it, do they own it?

A current employer might not appreciate us accumulating reports. First, I'm not advocating a flash drive holding every report we've prepared. I am talking about a few reports in the practice area or industry niche in which we want to validate our expertise. Second, while a current employer might not like it, I imagine it feels differently to a prospective employer when a job candidate shows up with a writing sample.

How does a prospective employer or client know it is the candidate's work product? They don't. But it's only one evaluation criteria. Just like job interviews (which research shows have *no* predictive value about how candidates will actually perform on the job).

Can you ever completely sanitize a report, as there is no guarantee you will remove all of the confidential information? Gosh, I hope so. How else are candidates submitting sanitized reports used in the ASA/NACVA credentialing process? Or for the very few BV firms that do include sanitized reports on their websites for marketing purposes?

Can't you just create an entirely fictitious report from scratch and not base it on any actual report you have done or any client you have advised? I suppose we could. But what if people *think* they recognize the client company we made up? And how useful is it, as an illustration of ability, if the report is entirely fictional? Perhaps as a writing sample, but we don't need a fictitious report to do that.

In summary, here's my argument:

1. Aren't we creatives? Isn't Damodaran correct when he calls our profession a craft? If so, where is our portfolio of work to support that pretense? Because it is NOT our resume.

2. The report absolutely has to be one we wrote. And it must be sanitized to remove any indication for whom it was prepared—just like what we might submit to ASA or NACVA.

Continued on next page

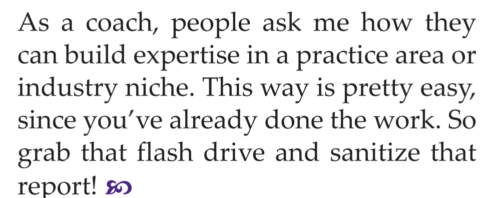
BURKERT, cont.

3. Prospective employers may not read the sample, just be ecstatic that a job candidate had enough confidence in his or her talents to bring one. Prospective clients aren't likely to care because they just want proof we can do the work efficiently and effectively for them.

4. What choice do employers/employees have if they want some degree of confidence that a candidate can do the work? A portfolio is still only one aspect of the candidate being evaluated.

5. We all need to be more practiced in getting our name out there and being top of mind to potential clients. And if you were a prospect, wouldn't you want to see a sample of the report that will be used to solve the problem you have?

As a coach, people ask me how they can build expertise in a practice area or industry niche. This way is pretty easy, since you've already done the work. So grab that flash drive and sanitize that report! ꩜



This column is a place to get actionable advice for growing your practice and improving your processes. Do you have an issue you would like to discuss? Email me at rod@rodburkert.com.

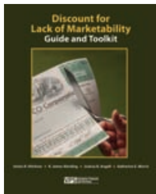
Visit Rod's blog or sign up for his newsletter at https://rodburkert.com

Jim Hitchner's

VPS Valuation Products and Services

Bringing you the TOOLS you need to help you SUCCEED!

DLOM GUIDE AND TOOLKIT

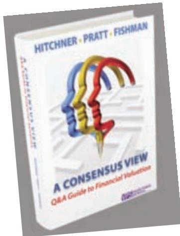


Cutting-edge DLOM methodology explained and modeled for practical application.

- Downloadable Excel files with groundbreaking DLOM calculator
- Electronic (PDF) manual with easy-to-understand instructions
- An 800+ page guide in both print and electronic (PDF) formats

www.valuationproducts.com/DLOM-Toolkit/

BUSINESS VALUATION Q&A GUIDE

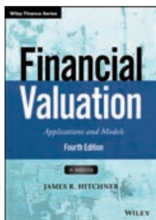


Have a question for three of the top BV industry leaders? Chances are, it's answered here!

- Jim Hitchner, Shannon Pratt, and Jay Fishman present their consensus view on over 150 popular BV topics
- Reviewed by 15 well-known, experienced BV practitioners
- Available in both print and PDF formats

www.valuationproducts.com/HPFQA/

4th EDITION OF "THE BOOK"

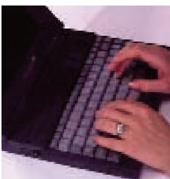


Looking for a primary BV source written in plain English?* Financial Valuation Applications and Models, *4th edition, is it!

- Source for AICPA's/NACVA's national certification courses
- Indispensable reference on various valuation topics, filled with details, practice tips, and examples
- Written by 30 nationally recognized names in the valuation industry

www.amazon.com or www.wiley.com

MONTHLY WEBINARS



Is there a valuation topic you'd like to study?

- Archived monthly webinars presented by industry leaders on timely topics
- Includes interactive PDF files, PowerPoint slides, and handouts

www.valuationproducts.com/webinars-past/

THE JOURNAL

Want to stay current on the hottest BV topics?

- *Financial Valuation and Litigation Expert* journal is the platform for 50+ experienced practitioners
- Keeps you up-to-date on the latest BV issues with practical, concise articles

www.valuationproducts.com/fvle/

SPECIAL REPORT - AICPA ABV CREDENTIALING DEBATE

May 25, 2018: The American Institute of Certified Public Accountants (AICPA) announces a major change to its Accredited in Business Valuation (ABV) credential.

The new AICPA policy can be viewed at:
https://www.aicpa.org/interestareas/forensicandvaluation/newsandpublications/abv-credential-open-to-qualified-finance-professionals.html

Current qualifications for the ABV credential can be found at:
https://www.aicpa.org/membership/join/abv-eligibility-requirements.html

June 18, 2018: A group of CPAs/ABVs voice their opposition to this change in an "open letter" to the AICPA:

> We, the undersigned licensed or retired Certified Public Accountants (CPAs), many of whom are current and former volunteer leaders in our profession, write collectively to express our concern regarding the recent decision by the American Institute of Certified Public Accountants (AICPA) to significantly change the qualifications to obtain the AICPA's certification in business valuation—the Accredited in Business Valuation (ABV) credential.

This document can be viewed in its entirety at http://bit.ly/2MA4ESX

July 16, 2018: AICPA presents a webinar on the ABV changes.

This archived webinar can be viewed at:
http://event.on24.com/eventRegistration/EventLobbyServlet?target=lobby.jsp&eventid=1790422&sessionid=1&key=A596640A642FDA202D1EA0CD92C4488A&eventuserid=207893596

July 18, 2018: The "open letter" group releases a poll showing very strong resistence to the change. (94% of ABVs polled disapproved.)

The poll results can be viewed at https://drive.google.com/file/d/1HGCJ9HlemZm8LYOwf-OEcRSF4OAqAokS/view

July 19, 2018: Susan S. Coffey, CPA, CGMA Executive Vice President—Public Practice responds to the "open letter" on behalf on the AICPA:

> I truly appreciate your taking the time to share your feedback about the Accredited in Business Valuation (ABV) credential's expanded eligibility. Your passion for the credential and the profession comes through loud and clear in your June 18 letter. I also appreciate your leadership and commitment to the profession. You helped build the ABV, establishing its strong reputation and a vibrant community. ...

This document can be viewed in its entirety at https://www.aicpa.org/content/dam/aicpa/interestareas/forensicandvaluation/downloadabledocuments/aicpa-cpa-abv-letter-2018.pdf

Continued on next page

SPECIAL REPORT - AICPA ABV CREDENTIALING DEBATE

July 20, 2018: The AICPA holds a webinar on July 16 titled "The Changing Landscape of Business Valuation." The following presents the AICPA's explanation of the change that was discussed during the webcast. It also includes brief excerpts from a rebuttal statement (July 20) prepared by the "open letter" group to the AICPA. The entirety of the rebuttal comments may be found at: https://drive.google.com/file/d/1gLd_5ZvUlY5fY4zqLLY2tQ-Isgy3cuTj/view

1. Emotional Reaction

a. Quote from *BVWire* article on July 18: "Hilton, who supports the change, 'implored' his fellow members to look beyond the passionate and emotional response and support the move going forward."

i. **Comment:** The signers of the open letter take exception to the comment that their responses were simply a passionate and emotional reaction. Most of these letter signers, including 15 AICPA BV Hall of Famers, spent years as volunteer leaders at AICPA helping create or develop the CPA/ABV brand in the marketplace. Now that brand is severely diminished by a secret process where the AICPA intentionally withheld the change from ABVs at large. The American Institute of Certified Public Accountants is an association that serves CPAs, not non-CPAs. And CPAs do not serve AICPA management. The letter signers have legitimate concerns about AICPA's decision to change the ABV criteria to admit non-CPAs. If AICPA doesn't acknowledge any legitimate concerns from knowledgeable people and simply attributes reactions to passion, they are out of touch with their members.

2. Process

a. Quote from AICPA Webinar (39:00 minutes): Bethany Hearn, Chair of the ABV Credential Committee, stated: "In addition to Council members and AICPA Board of Directors, this was a deliberative process that included over 80 committee members from firms of all sizes, academia, industry, and others who participated in the discussion between 2015 and 2018."

i. **Comment:** We have not seen evidence that this statement is true. We would like to see the evidence such as meeting minutes, records of formal votes, and the identities of the 80 people so we can verify the truthfulness of this statement. If this was such a "deliberative" process, then why didn't the AICPA have an open dialogue with the current CPA/ABVs—who are the primary stakeholders in this matter—prior to the decision to make the change? Why are AICPA committee members constrained by a permanent non-disclosure agreement where they cannot speak to stakeholders about important matters such as the ABV change? At best, the so-called "deliberative" process is a closed, secret process most likely because AICPA management knows most ABVs do not support what management wants. AICPA only elected to tell the CPA/ABVs at large of the decision after it was a done deal. Further, it is readily apparent from the results of a recent survey conducted by a group of CPA/ABVs that the AICPA and the alleged "80 committee members" who participated in the process (and who, incidentally, were picked by AICPA) were either unaware of the majority's viewpoint or simply chose to ignore it. Of the approximately 3,200 CPA/ABVs, 1,406 participated in the survey (a coverage rate of 44%) with 1,326, or 94%, voting "No" to the change. AICPA's so-called deliberative process deliberately goes against the will of a very large group of CPA/ABVs.

Continued on next page

b. Quote from *BVWire* article on July 18: "Thomas E. Hilton (Anders), an ABV and AICPA Hall of Fame member, speaking personally, said that the AICPA should have taken an 'extra step' in communicating the proposed change to its members."

c. Quote From *BVWire* article on July 18: "Eva Simpson, the AICPA's director of valuation services, acknowledged this, saying the organization 'could have done better in making sure people were aware of the changes.' She also noted that the process would be improved in the future."

i. **Comment:** The AICPA representative who moderated the discussion, Eva Simpson, publicly acknowledged that the AICPA "could have done better in making sure people were aware of the changes and we've learned from this and will implement processes in the future to improve." Given that the AICPA has acknowledged that the process was flawed, we believe AICPA should suspend the decision to admit non-CPAs as ABVs, seek input from its members, including ABVs, and bring the question before Council again. What is the harm?

3. Survey

a. Quote from AICPA Webinar (49:00 minutes): The moderator, Eva Simpson, read the following question submitted by a webinar participant: "A group of ABV members sent out a poll to assess issues they've identified. What is the AICPA going to do with this poll?" Bethany Hearn responded: "This poll, by the way, was not anonymous, which often inhibits participation. . . . The poll was not a survey published by the AICPA and it was deployed before members had an opportunity to hear about the benefits of the change as presented in this webcast today."

i. **Comment:** The group of CPA/ABVs who conducted the survey required that respondents provide their names so as to prevent individuals from submitting duplicate responses which would have manipulated the results. To do otherwise would have been unwise and unethical. AICPA has never surveyed CPA/ABVs about the change either before or after Council voted on the ABV change. They never surveyed members mostly likely because they knew ABVs would tend to oppose the change. Council may have voted against the ABV change had AICPA itself conducted a survey showing ABVs generally opposed the change.

4. Timeline

a. Quote from AICPA Webinar (36:07 minutes): Eva Simpson stated "We have adjusted the timeline from what was originally posted on our website. Some of the feedback we received was that the summary language we used didn't accurately reflect some of the events."

i. **Comment:** This is the first public acknowledgement by a representative of the AICPA that the timeline that was originally presented by the AICPA was inaccurate. Further, the AICPA has since made even more revisions to this timeline. More information about the timeline will be forthcoming. Again, given that the AICPA has acknowledged that the timeline was inaccurate, is it not reasonable to request that Council have the opportunity to reassess its decision based on having access to correct information so that it may make an informed

Continued on next page

SPECIAL REPORT - AICPA ABV CREDENTIALING DEBATE

July 28, 2018 - The "Open Letter" group releases this rebuttal.

A Forensic Investigation and Rebuttal to AICPA's Timeline of Internal Process Events Related to its Accredited in Business Valuation (ABV) Certification

INTRODUCTION

In May 2018, the governing Council of the American Institute of Certified Public Accountants (AICPA) held its semi-annual meeting. Council members in attendance voted to change the criteria for AICPA's business valuation certification, Accredited in Business Valuation (ABV), to allow non-CPAs to receive the credential. At the meeting, AICPA made a relatively short presentation to Council members before the vote. As part of that presentation, AICPA gave the governing Council the strong impression that the community of ABV stakeholders supported the change. *However, the majority of the ABV community does not support the change to admit non-CPAs.*

On June 18, 2018, prominent CPAs in the business valuation community published an Open Letter to AICPA expressing their opposition to the change to the ABV criteria to admit non-CPAs. After the Open Letter, AICPA published a rebuttal of sorts arguing that it followed an appropriate process in making the change and presented a timeline of events supporting their process. However, AICPA got its process timeline wrong and has changed its published timeline several times trying to get its story straight. Moreover, to this day, its timeline is still wrong, as we discuss below.

In this paper, we show how AICPA has changed its published timeline of its process multiple times after the Council vote, and we describe where it still has errors. Because AICPA essentially admits that it did not understand its own process leading up to its Council presentation and, as we argue, its current version of the process timeline still has errors, Council members received untrue information just before they voted. Consequently, AICPA's process and the Council vote is flawed. AICPA management should suspend the change to the ABV criteria.

This paper is the result of many hours of forensic investigation, an area where CPA/ABVs have skill because of their knowledge, education, experience, and training. The paper is relatively long and detailed to show that we have done our homework.

We propose the following: first, AICPA management immediately suspend the change to the ABV criteria; second, AICPA redo its internal process of approving any change to the ABV criteria by seeking and considering input from all stakeholders (including current CPA/ABVs) and then have Council revote; and third, if, after reconsideration, AICPA still wants to issue a valuation certification to non-CPAs, it create a second valuation credential separate from the ABV.

EVOLUTION OF AICPA'S TIMELINE

June 27, 2018

Although the AICPA webpage entitled "ABV Credential Eligibility Expanded to Qualified Finance Professionals" is dated May 25, 2018, the timeline that appears on the page was added June 27, 2018, and has been revised several times since then, most recently July 18, 2018. Significant inconsistencies exist between the multiple timelines issued by the AICPA during the period between June 27, 2018, and July 18, 2018.

At least three conflicting timelines have been issued by the AICPA, including the most seriously misstated timeline that was provided in a PowerPoint presentation to all State CPA Society Executives on June 27 in supporting the "transparency" of the process to allow Other Qualified Professionals ("OQPs") to obtain the ABV. Unfortunately, the flawed original timeline provided to them was the first glimpse that the Executives had of the process leading up to the Council vote, effectively poisoning the well for balanced dialogue.

Continued on next page

The original timeline prepared by the AICPA was misleading beginning with the first entry:

April 2015 - NAC votes in favor of offering existing AICPA specialty credentials, and additional credentials to be determined in the future, to both CPAs and other qualified professionals

- o NAC asks credential committees to start looking at determining when it makes sense for each and what eligibility would look like

What the narrative doesn't state is that there were only four people in attendance holding the ABV credential at the National Accreditation Commission (NAC) meeting, including three NAC Commissioners and the chair of the ABV Credential Committee (ABVCC) who attended as a non-voting representative. There is indisputable evidence that during the discussion as to whether specialty credentials should be offered to OQPs, two of the three NAC Commissioners who were ABVs, as well as the ABV Credential Committee Chair, strongly opposed offering the ABV credential to such, with the two NAC commissioners voting against the motion.

There was specific dialogue in the meeting that further future discussions should occur before opening up the ABV credential to OQPs. The concerned ABVs present at the meeting cautioned the NAC of the potential devaluation of the ABV as well as the potential market confusion that would arise due to the existence of multiple valuation related credentials.

The strong opposition of three of the four ABVs at the April 2015 meeting, each of whom were and are leaders in the business valuation profession with a keen understanding of the ABV community, provided ample evidence that existing ABV credential holders should have been part of the process. Instead, it was a prime example of the NAC taking the position that it knew best what was good for the membership and, therefore, did not need to consult the members, perhaps purposely avoiding such dialogue.

May 2015 - AICPA Council approves two new fair value measurement credentials for CPAs and other qualified professionals (Certified in Entity and Intangible Valuations™ (CEIV™) and Certified in the Valuation of Financial Instruments™ (CVFI™))

While on the surface, this timeline entry would appear to have no bearing on the ABV Credential, it was a harbinger of the subsequent devaluation of the Credential. Following AICPA Council approval of the CEIV credential, one of the NAC Commissioners prepared an article for a valuation publication regarding the new CEIV Credential which a member of the AICPA staff reviewed and approved prior to publication. Because NAC Commissioners are subject to the confidentiality and publication provisions in the "Lifetime AICPA Volunteer Service Policy and Copyright and Confidentiality Agreement," the Commissioner was precluded from discussing the status of any other specialty credentials. The AICPA's requirement that volunteers sign a confidentiality agreement to preclude them from discussing issues with members is a prime example of a culture that inhibits transparency.

An example of the agreement that volunteers are currently required to sign may be found at the following link: https://volunteers.aicpa.org/documents/VolunteerAgreements.pdf. It is incongruous to refer to a process as "transparent" when the process is governed by a document that significantly restricts open dialogue.

The mischaracterization of history continues on the timeline with the July 2015 "vote" by the ABV Credential Committee.

July 2015 - ABV Credential Committee votes in favor of expanding eligibility for other qualified professionals

As it states on the previously covered April 15 entry related to the vote to expand AICPA credentials, the NAC asked the "credential committees to start looking at determining when it makes sense for each." The ABVCC met in July 2015 to, among other things, discuss what "made sense" for the ABV Credential. There is indisputable evidence that what the AICPA refers to as a "vote" by the ABVCC to expand eligibility was simply a non-binding straw poll to gauge the interest of the Committee as to exploring expanding eligibility. In a split decision, the Committee members supported *exploring* the expansion. However, in conjunction with the indication of *exploratory* support, the Committee requested addition-

Continued on next page

al information and input from ABV stakeholders before making any final decisions. The additional information and ABV stakeholder input were never provided to the ABVCC.

Subsequent to the straw poll to gauge interest in exploring expansion, the ABVCC prepared a resolution to be provided to the NAC recommending further *exploration* of allowing OQPs to receive the ABV Credential with certain caveats, namely that: The impact of OQPs combined with the launch of the fair value credentials might prove to be too much too soon for the existing ABV Credential holders; the market size and the risk/reward equation for the ABV expansion needed to be assessed; and input from key ABV leaders was necessary as well as the development of a risk mitigation plan due to fallout from unhappy AICPA members. While there are clear indications that members of the ABVCC strongly suggested additional member input was necessary before proceeding with the expansion, AICPA staff chose to ignore the suggestion, seemingly because they knew best what was good for the membership and, therefore, did not need to consult the ABV community.

It is also notable that at the same meeting where the ABVCC narrowly voiced support for *exploring* ABV Credential expansion, the AICPA prematurely asked the committee to provide recommended requirements/framework for ABV expansion, before obtaining any data on the business valuation credential market or input from ABV stakeholders. Notwithstanding the significant pushback from the majority of the ABVs during the April 2015 NAC meeting and several committee members during the July 2015 ABVCC meeting, the AICPA pushed committee members to comply with the AICPA's stated agenda. In a recent letter from upper level AICPA management, it referred to the ABV "vetting process" of the last three years as "shepherding the ABV eligibility proposal through layers of approval." It would be more appropriate to refer to it as "force feeding distasteful food" to existing credential holders because the Institute knows what's best for them.

The AICPA knew or should have known that there would be significant pushback from the existing ABV Credential holders on opening up the ABV to OQPs. Compellingly bearing this out, approximately 44% of current ABVs responded to a recent survey with 94% of them indicating they were against the change. The AICPA responded to the survey, which was communicated to all ABVs and simply asked them to indicate whether they were in favor of the change or not, by attempting to discredit the survey as non-AICPA generated.

July 16, 2018
Subsequent to publication of the original timeline and after being informed that it was misstating the facts, the AICPA changed the timeline as it first appeared on the AICPA website. During the July 16, 2018 AICPA webcast entitled "The Changing Landscape of Business Valuation," AICPA staff stated "We have adjusted the timeline from what was originally posted on our website. Some of the feedback we received was that the summary language we used didn't accurately reflect some of the events." This is the first public acknowledgement by a representative of the AICPA that the timeline that was originally presented by the AICPA was inaccurate.

The original entry related to the July 2015 ABVCC meeting was changed to read "ABV Credential Committee supports** further exploration of allowing OQPs to achieve the ABV Credential based on three caveats related to the timing of the CEIV launch, assessment of market size and risk/reward equation based on market data, and development of a communications plan to mitigate adverse reactions."

As part of the revised timeline, the AICPA tried to show that it had complied with the caveats (as referenced with the asterisks above) with the following comments, in quotes:

1. "With the CEIV credential being launched in May 2015, sufficient time has passed for marketplace to understand credential and the role it plays." Based on anecdotal evidence, there are fewer than 100 professionals who have obtained the CEIV. Since the CEIV Credential is intended for professionals who perform fair value measurements for public company financial statement reporting purposes, the pool of valuation professionals doing such work is relatively small. In addition, obtaining the credential effectively subjects the holder to peer review. As such, it's likely that the CEIV population will always be relatively few individuals. Based on the performance of the CEIV, what the marketplace seemingly understands is that the launch of a credential that is available to OQPs will

Continued on next page

result in fewer credential holders than is anticipated, akin to the AICPA's launch of the Chartered Global Management Accountant (CGMA) Credential. The CGMA Credential has underperformed such that the original three-year breakeven budget was recently significantly extended for lack of interest in the credential. The market place may in fact understand the credential, but its poor performance should have given the AICPA pause before opening up the ABV to OQPs.

2. "Ongoing market analysis has been performed. The changing landscape supports the need for the ABV credential program to evolve." It is disingenuous for the AICPA to invoke the existence of a changing landscape to fit its flawed narrative. The vast majority of existing ABVs perform valuations for divorce, gift and estate taxes, commercial litigation, and mergers and acquisitions. If there has been a notable "changing landscape" over the last 10 years, it has been related to fair value, a practice area where relatively few ABVs practice – and which was the AICPA's stated purpose for creating the CEIV credential.
3. "Risk mitigation plan in place, but due to ongoing response resulting from announcement, additional steps being taken to remedy response." It is noteworthy that nowhere in this comment relating to the third caveat, "development of a communications plan to mitigate adverse reactions," does it mention that the AICPA was the least bit concerned with the communication of the change to the existing credential holders. Due to the AICPA's efforts to not communicate the change and more importantly to hide the upcoming change from existing credential holders, there were only a handful of ABVs that were aware of the change prior to the email of May 25, 2018 that was sent to all existing credential holders.

July 18, 2018
Perhaps realizing that the added explanations hurt its case more than helped it, the AICPA revised the timeline once more on July 18, 2018, *removing all timeline entries prior to October 2017.*

The misstatements continue with the following entry of the original timeline.

September 2015 - Two-thirds of AICPA Council support expanding eligibility for other qualified professionals for all AICPA specialty credentials. Recommendation made to evaluate each independently

At this AICPA Council meeting (which actually occurred in October 2015), there is indisputable evidence that Council approved allowing OQPs for FVM credentials only, not all credentials as it states in the timeline. In a November 2015 AICPA Board of Directors meeting, the Board approved a resolution for the CGMA credential to also be expanded to include OQPs. There was still no mention of the ABV Credential.

While it is not mentioned on the timeline, the NAC held a meeting in October 2015 at which the Commissioners received an OQP update report related to all AICPA Credential Committees, providing their respective input into opening up the credentials to OQPs. At the meeting, AICPA staff presented the NAC commissioners with incorrect information that showed that the ABVCC had recently "voted to allow other qualified credential candidates." As noted earlier, there was never a vote to allow other qualified professionals. It was instead a straw poll to gauge the interest of the ABVCC in *exploring* expanding the eligibility of the ABV Credential. Adding to the obfuscation, there was no mention of the ABVCC resolution drafted in July 2015 recommending further exploration of allowing OQPs to achieve the ABV Credential with certain caveats.

In the time since the misstated events starting in 2015, committee volunteers have inquired as to disclosing what was occurring related to the potential ABV change to the larger ABV community in order to get input. On every occasion, AICPA staff advised the volunteers not to disclose the pending changes. Further, AICPA staff told the volunteers that should they be asked as to changes, they should redirect the questions or indicate that "nothing is changing right now."

The misstatements in the AICPA timeline continue into 2016 and beyond.

Continued on next page

SPECIAL REPORT - AICPA ABV CREDENTIALING DEBATE

2016 - all credential committees begin evaluating and developing requirements for their respective credentials

Multiple ABVCC members indicate that little if any discussion occurred during 2016 related to evaluating and developing requirements for opening up the ABV Credential to OQPs. As indicated earlier, they had requested additional market research and input from the ABV community prior to moving ahead. Receiving none, there was nothing to discuss.

August 2017 - ABV credential committee continues to support plan for expanding eligibility for other qualified professionals

Indisputable evidence shows that the timeline entry is inaccurate. The issue of allowing OQPs to attain the ABV credential didn't appear on an ABVCC agenda nor was it discussed or voted upon in 2016 and 2017. Prior to this time and as discussed previously in this document, the ABVCC only supported the *exploration* of expansion of the ABV credential, *not* the actual expansion.

October 2017 - NAC votes in favor of asking AICPA Board of Directors to support expanding eligibility to ABV to other qualified professionals

Given the indications that the NAC and AICPA staff had of the likely significant resistance to the change and its obvious importance to the ABV community, it would have made perfect sense—and contributed greatly to the transparency—to inform existing ABVs at the annual AICPA Forensic and Valuation Services Conference in November 2017, prior to placing the matter before the AICPA Board and Governing Council. Rather than adequately represent the interests of CPAs in general and ABV credential holders specifically by informing them of the upcoming vote, the AICPA made no mention of the matter at the the single annual AICPA event targeting ABV (and Certified in Financial Forensics) credential holders. Had the AICPA truly exhibited the transparency that they have unceasingly professed since June 27, 2018, an open discussion of such a significant change in eligibility requirements for the ABV credential would have been mandatory at the annual conference occurring only weeks after the NAC vote.

The stark inconsistencies between the multiple timelines issued by the AICPA continue into 2018.

January 2018 - AICPA board supports the recommendation to send ABV proposal for other qualified professionals to regional council

The actual minutes from the AICPA January 2018 Board of Directors' meetings says something very different. "Mr. Melancon gave an overview of the strategic need to open up the Accredited in Business Valuation (ABV) credential to other qualified professionals and responded to questions from board members."

The AICPA's claim of "transparency" in its handling of OQP eligibility would be better described as opaque. The AICPA's board minutes indicated nothing more than an overview of the strategic need, in AICPA management's opinion, to "open up the Accredited Business Valuation credential to other qualified professionals and respond to questions from board members." This conflicts with representations made to State Society Executives.

March 2018 - All four regional councils support ABV proposal for other qualified professionals •New York, •Chicago, •Los Angeles, and •Dallas

The original timeline entry above, sent to State Society Executives in June 2018, suggests that the OQP proposal had the support of Council. However, Council members that were at those meetings indicate that no such "support" was indicated. Likely in response to public correction from a particular Council member, the entry was later changed to read, "At regional meetings, Council informed about the proposal to open the ABV to other qualified professionals, asked to share questions and provide feedback, and was informed that a vote will be taken in May •New York, •Chicago, •Los Angeles, and •Dallas." According to the original timeline, State CPA Society Executives were led to believe that all four

Continued on next page

regional councils *supported* the initiative. This is in striking contrast to the other timelines which simply state "Council is informed about the proposal and asked to share questions and feedback."

WHAT AICPA'S TIMELINE MISSTATEMENTS MEAN

The cumulative effect of the misstatements, misrepresentations, and obfuscation is that it is highly likely that the NAC and Council voted for the change believing that the ABVCC "voted" for the change and there was widespread support from the ABV Community for opening up the credential. The reality is that there was never a vote by the ABVCC supporting the change and the ABV community, except for a select few who were subject to non-disclosure requirements, knew nothing about the potential change, and did not have the opportunity to present opposing positions regarding it.

Over the course of almost three years from July 2015 until May 2018, the AICPA acted in a secretive and opaque manner, devaluing the ABV credential. Prior to the vote, the ABV had become a highly respected business valuation credential, largely because of its primary value proposition: it is the only business valuation credential having the CPA as its foundation. These actions are not representative of a membership organization working on behalf of and supporting its members. Inconsistent official timelines, misrepresentations as to committee and commission activities, inaccurate representations of Board and Council meetings, and disregard for ABV credential holders' opinions clearly indicate that the AICPA has failed in its mission to serve its members. Because of these failures, it is appropriate for the AICPA Board and Council to hear all the facts and opposing views from a representative group of ABV stakeholders and reconsider their votes on the eligibility of OQPs for the ABV credential.

PROPOSALS

We propose the following:

First, AICPA management immediately suspend the change to the ABV criteria.

Second, AICPA redo its internal process of approving any change to the ABV criteria by seeking and considering input from all stakeholders (including current CPA/ABVs) and then have Council revote.

Third, if, after reconsideration, AICPA still wants to issue a valuation certification to non-CPAs, it create a second valuation credential separate from the ABV.

Sincerely yours,

Kevin R. Yeanoplos, CPA/ABV/CFF, ASA
Ronald L. Seigneur, CPA/ABV/CFF, ASA, CVA, CGMA
Harold G. Martin, Jr., CPA/ABV/CFF, ASA, CFE
Michelle F. Gallagher, CPA/ABV/CFF
Mark O. Dietrich, CPA/ABV
Donald J. DeGrazia, CPA/ABV/CFF
Dr. Michael A. Crain, CPA/ABV, CFA, CFE
Judith A. Wagner, CPA/ABV/CFF,CVA
William B. Stewart, Jr.. CPA/ABV/CFF, CFE
Larry R. Cook, CPA/ABV/CFF, CVA, CBA
Chris Rosenthal, CPA/ABV/CFF, ASA, AEP
Stacey D. Udell, CPA/ABV/CFF, CVA
Sheri Fiske Schultz, CPA/ABV/CFF
Neil J. Beaton, CPA/ABV/CFF, CFA, ASA
Nancy J. Fannon, CPA/ABV, ASA, MCBA
Dr. G. William Kennedy, CPA/ABV
Robert W. Levis, CPA/ABV, ASA, CFE
Sharyn Maggio, CPA/ABV/CFF
Michael J. Mard, CPA/ABV, CPCU
L. Gail Markham, CPA/ABV/CFF, CFP, CFE
Barry S. Sziklay, CPA/ABV/CFF, PFS
Jeffrey D. Urbach, CFE, CVA, CPA/ABV/CFF
R. James Alerding, CPA/ABV, ASA
David M. Gannett, CPA/ABV/CFF
Mark I. Harrison, CPA, ABV, CFF, Esq.
Joseph Emanuele, CPA/ABV/CFF, CFA, ASA
Jerome Johnson, CPA/ABV/CFF, CVA

SPECIAL REPORT - AICPA ABV CREDENTIALING DEBATE

August 2, 2018 - The "Open Letter" group sends this email to the AICPA council members.

Dear Council Members:

Re: What You Need to Know About the AICPA ABV Controversy

For here we are not afraid to follow the truth wherever it may lead, nor to tolerate any error so long as reason is left free to combat it.
—Thomas Jefferson

In May 2018, the governing Council of the American Institute of Certified Public Accountants (AICPA) held its semi-annual meeting. During this meeting, the AICPA made a presentation to the Council proposing to change the criteria for the AICPA's business valuation certification, the Accredited in Business Valuation (ABV) specialty credential, to allow non-CPAs to receive the credential. Further, the AICPA gave the Council the strong impression that the community of ABV stakeholders supported the change to admit non-CPAs. The AICPA then made a motion to accept the proposed change and the Council voted in favor of the change. *However, the majority of the ABV community does not support this change.*

On June 18, 2018, prominent CPA/ABVs in the business valuation community published an Open Letter to the AICPA expressing their opposition to the change. The AICPA then published a letter arguing that it followed its process in making the change and presented a timeline of events supporting their process. However, the AICPA made factual errors in the process timeline and, further, it has since changed the timeline several times in an attempt to correct these errors; however, the current version of the AICPA timeline is still incorrect.

On July 16, 2018, the AICPA presented a national webinar to the CPA/ABV community (without including any of the signers of the Open Letter) to discuss (after the fact) why it made the change and the purported benefits. However, during this webinar, the AICPA publicly acknowledged that: 1) *its process for seeking the change in the credential was flawed* and, 2) *the published timeline included errors.*

A detailed analysis of the flawed process conducted by the AICPA is presented here. Given the AICPA's acknowledgment that the process was flawed, it is evident that the AICPA presented incorrect information to Council prior to the vote and, consequently, Council voted in favor of the change without the benefit of the actual facts and without input from the majority of the CPA/ABV community.

On July 18, 2018, the business valuation trade publication, *BVWire,* published the results of a survey conducted by signers of the open letter of current CPA/ABVs and other stakeholders regarding the change. *Of the approximately 3,200 CPA/ABVs, 1,406 participated in the survey—a coverage rate of 44%. Of the 1,406 CPA/ABVs who participated in the survey, an overwhelming majority, 1,326 or 94%, voted "NO" when asked if they were in favor of changing the criteria to admit non-CPAs.* The raw survey results, including the written comments from current CPA/ABVs, may be found here.

In view of the AICPA's acknowledgment that the process was flawed and that the published timeline included errors, we propose that:

1. AICPA management immediately suspend the change to the ABV criteria
2. The AICPA modify its internal process of approving any change to the ABV criteria by seeking and considering input from all stakeholders (including current CPA/ABVs) and then have Council revote
3. If, after reconsideration, the AICPA still elects to issue a valuation certification to non-CPAs, that it create a second valuation credential for non-CPAs separate from the ABV.

We have provided additional links to other relevant materials for Council's consideration which we believe further supports our proposal.

Continued on next page

Finally, publisher Valuation Products and Services is hosting a national webinar on August 8, 2018. The webinar format will consist of moderated panel discussion, including the current Chairs of the AICPA BV Committee and the AICPA ABV Credential Committee, as well as two past AICPA volunteer leader CPA/ABVs who represent the signers of the Open Letter.

Sincerely,

Kevin R. Yeanoplos, CPA/ABV/CFF, ASA
Ronald L. Seigneur, CPA/ABV/CFF, ASA, CVA, CGMA
Harold G. Martin, Jr., CPA/ABV/CFF, ASA, CFE
Michelle F. Gallagher, CPA/ABV/CFF
Mark O. Dietrich, CPA/ABV
Donald J. DeGrazia, CPA/ABV/CFF
Dr. Michael A. Crain, CPA/ABV, CFA, CFE
Judith A. Wagner, CPA/ABV/CFF, CVA
William B. Stewart, Jr., CPA/ABV/CFF, CFE
Larry R. Cook, CPA/ABV/CFF, CVA, CBA
Chris Rosenthal, CPA/ABV/CFF, ASA, AEP
Stacey D. Udell, CPA/ABV/CFF, CVA
Sheri Fiske Schultz, CPA/ABV/CFF
Neil J. Beaton, CPA/ABV/CFF, CFA, ASA
Nancy J. Fannon, CPA/ABV, ASA, MCBA
David M. Gannett, CPA/ABV/CFF
Mark I. Harrison, CPA, ABV, CFF, Esq.
Joseph Emanuele, CPA/ABV/CFF, CFE, CFA, ASA
Jerome Johnson, CPA/ABV/CFF, CVA
Dr. G. William Kennedy, CPA/ABV
Robert W. Levis, CPA/ABV, ASA, CFE
Sharyn Maggio, CPA/ABV/CFF
Michael J. Mard, CPA/ABV, CPCU
L. Gail Markham, CPA/ABV/CFF, CFP, CFE
Barry S. Sziklay, CPA/ABV/CFF, PFS
Jeffrey D. Urbach, CFE, CVA, CPA/ABV/CFF
R. James Alerding, CPA/ABV, ASA

Other Relevant Information

BVWire Articles

AICPA's move to allow non-CPAs to get ABV sparks strong reaction
Make your voice heard in the AICPA ABV controversy
AICPA members kept in dark about pending ABV change
New survey reveals overwhelming criticism of AICPA's ABV change
Amid outcry, AICPA will improve decision process re: credential matters
AICPA stands by ABV decision; critics rebut timeline

AICPA Presentation to Council Prior to the Vote (May 25, 2018)
CPA/ABV Open Letter to AICPA (June 18, 2018)
AICPA Webinar for CPA/ABVs (July 16, 2018)
CPA/ABV Results of Survey – Respondent Comments (July 18, 2018)
AICPA Letter from Susan Coffey, EVP, AICPA to CPA/ABVs July 19, 2018
CPA/ABV Comments on Webinar (July 20, 2018)
AICPA Credential Eligibility Page Including Revised Timeline (on or about July 23, 2018)

R. JAMES ALERDING, CPA/ABV, ASA
is the owner of Alerding Consulting, LLC (Valuation and Forensic Consultation) in Indianapolis, IN. He has over 35 years of experience in valuation and litigation. Jim is a member of the AICPA Business Valuation Hall of Fame and was a member of the AICPA Task Force that developed the AICPA Business Valuation Standards (SSVS No.1).

STEVE BABITSKY, JD
founded SEAK, sponsor of the nation's largest Workers' Compensation and Occupational Medicine conference, in 1980. SEAK is the world's leading provider of expert witness training and texts, writing seminars for doctors and lawyers, and publisher of national directories for Expert Witnesses and IME Doctors. Steve is also the founder and president of Customized Forensic Consulting.

JEFF BALCOMBE, CPA/ABV/CFF/CGMA, CFA, ASA
is president, chief executive officer, and partner of The BVA Group LLC in Houston, TX. With 20 years of experience, he has testified on issues related to economic damages and lost profits analyses, patent and copyright infringement, misappropriation of trade secret violations, purchase price disputes, wrongful contract termination, shareholder disputes, financial fraud allegations, securities class actions and valuation issues.

DON BARBO, CPA/ABV
is a managing director for VMG Health in Dallas, TX. He has extensive experience in healthcare valuation involving mergers and acquisitions, divestitures, partnership transactions, leasing arrangements, divorces, and commercial damages. He speaks to various organizations, has published articles regarding BV issues, and serves as an expert witness.

NEIL BEATON, CPA/ABV/CFF, CFA, ASA
is the managing director at Alvarez & Marsal Valuation Services, LLC. A former member of the AICPA BV Subcommittee, the AICPA Valuation of Private Equity Securities Task Force, and FASB's Valuation Resource Group, Neil is a prolific presenter, teacher and writer and member of the AICPA BV Hall of Fame.

BRUCE B. BINGHAM, FRICS, FASA
is a managing director with the Berkeley Research Group, LLC in New York City. He has previously served as chair of both the RICS-Americas Valuation Council and the ASA BV Committee. Bruce graduated from Rutgers and also has a master's degree from the Yale School of Management. He is a retired brigadier general, US Army Reserve.

KRISTOPHER A. BOUSHIE, CPA/ABV/CFF, CVA, CFE
is a director with Navigant in Washington, DC. He has over 30 years of experience in financial and litigation consulting, with over 20 years focused on intellectual property matters. He has testified in state and federal court on a variety of issues. He is co-author/co-editor of *Calculating and Proving Damages*, Law Journal Press.

STEPHEN J. BRAVO, CPA/ABV/PFS, ASA, CBA, MST
is the founder of Apogee Business Valuations, Inc. He is a frequent speaker and writer on valuation issues and matters. He is a technical editor of *Valuing a Business* and other books written by Dr. Shannon Pratt. He is also a technical reviewer of *Cost of Capital* written by Roger Grabowski and Dr. Pratt.

ROD P. BURKERT, CPA/ABV, CVA, MBA
is the founder of Burkert Valuation Advisors, LLC. His assignments focus on income/gift/estate situations, divorce proceedings, partner/shareholder disputes, and commercial damage/economic loss matters. He also provides independent report review and project consulting services to assist other practitioners with their engagements. Rod is a past chairman of NACVA's Executive and Education Advisory boards.

STACY PRESTON COLLINS, CPA/ABV, CFF
has provided expert witness testimony on valuation/forensic accounting issues in several states. She is a charter member of the Forensic and Business Valuation Division of the American Academy of Matrimonial Lawyers Foundation, past chair of the AICPA's Family Law Task Force, a former member of the AICPA Forensic and Litigation Services Committee, and 2010 AICPA FLS Volunteer of the Year.

LARRY R. COOK, CPA/ABV/CFF, CBA
brings 40+ years of financial advisory services to clients, including valuation, tax, family law, expert testimony, commercial finance, investments, retirement, and entity structure. He has made numerous presentations and is a frequent speaker at conferences. Larry is the author of *Financial Valuation and Employee Stock Ownership Plan Shares* and a co-author of *Financial Valuation Applications and Models.*

DR. MICHAEL A. CRAIN, CPA/ABV, CFA, CFE
is on faculty at Florida Atlantic University and director of its Center for Forensic Accounting. He has over 30 years of experience as a practitioner, still consults with clients, and is affiliated with Miami-based accounting firm Kaufman Rossin. Mike is a past chairman of the AICPA BV committee and has been inducted into the AICPA Business Valuation Hall of Fame. He is a recipient of AICPA's Lawler Award, presented by *Journal of Accountancy* for best article of the year.

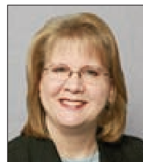
MARK O. DIETRICH, CPA/ABV, MBA, MST
is editor, technical editor and contributing author to the *American Health Lawyers Association/Business Valuation Resources Guide to Healthcare Finance and Valuation,* 4th ed.; co-editor of the BVR/ALA *Guide to Healthcare Industry Compensation and Valuation,* 2nd ed.; and co-author with Gregory Anderson, CPA/ABV of *The Financial Professionals Guide to Healthcare Reform*.

DARRELL D. DORRELL, CPA/ABV, MBA, ASA, CVA, CMA, CFF
is co-founder of financialforensics®. He delivered 120+ forensic accounting training sessions during the last 5 years and has published over 70+ articles in technical journals. He co-authored three forensic accounting publications for the US Dept. of Justice (USDOJ) and co-authored *Financial Forensics Body of Knowledge.* His civil/criminal practice transcends all aspects of civil and criminal financial forensics.

EDWARD J. DUPKE, CPA/ABV/CFF/CGMA, ASA
is the owner of Dupke Consulting LLC, with his practice limited to business valuation litigation defense and business valuation rebuttal consulting. He chaired the task force that wrote the AICPA BV Standard *(SSVS1),* is former chair of the AICPA BV committee and past chair of the Michigan Association of CPAs. With over 35 years of experience, he is a qualified expert witness in state and federal courts and a BV instructor at the state and national level.

W. DAVID ELLRICH, JR., CPA/ABV, CVA, ASA, CFF, CFE, MAFF
is a managing partner of Ellrich, Neal, Smith & Stohlman, P.A. in Palm Beach Gardens, FL. He has worked as an IRS agent and as a special agent for the U.S. Treasury. After his government work, David began his own accounting practice in 1981. He has served on the Judicial Nominating Commission of the 15th Judicial Circuit (FL) and has received numerous court appointments as a special master.

JAY E. FISHMAN, FASA
is a managing director of Financial Research Associates. He has co-authored several books, including *Standards of Value: Theory and Applications* and *Guide to Business Valuations.* He is an expert witness and has taught courses to the IRS, the National Judicial College, the Hong Kong Society of Accountants and World Bank in Russia.



CARLA G. GLASS, CFA, FASA
is a managing director with Marcum LLP, in New Haven, CT. She is former chair of the Business Valuation Committee of the American Society of Appraisers and of the Appraisal Standards Board of The Appraisal Foundation. She served on FASB's Valuation Resource Group and has been a course developer of, and teaches, ASA courses.

ROBERT P. GRAY, CPA/ABV/CFF, CGMA, CFE
is a member/owner of Gray Schrupp and Associates PLLC in Dallas, TX. He is a member of AICPA's Forensic & Valuation Services Committee and the Texas Society of CPA's BV and Valuation Services Committee, where he is current chair of its BV, Forensics & Litigation Conference. He is a nationally recognized speaker on financial/accounting analyses, economic damages, litigation consulting, BV, and forensic/fraud investigations.

MICHAEL A. GREGORY, ASA, CVA, MBA, NSA, Qualified Mediator, is the founder of Michael Gregory Consulting, LLC, a firm that focuses on *conflict resolution* for business-to-business, business-to-government (IRS), and within businesses. As a mediator and negotiator he helps clients to de-escalate situations and works with them to identify, address, and resolve issues. He has written 11 books and over 30 articles.

ROBERT J. GROSSMAN, CPA/ABV, ASA, CVA, CBA, MST
heads the BV and valuation services group at Grossman Yanak & Ford LLP in Pittsburgh. A nationally recognized speaker and instructor of business valuation matters, he has extensive experience in valuation and litigation issues in a broad variety of applications and venues. He is past chair of the NACVA Executive Advisory Board and a contributor to *Financial Valuation Applications and Models.*

LANCE S. HALL, ASA
is a senior advisor in Stout Risius Ross Valuation and Financial Opinions Group. A nationally recognized authority on estate and gift tax valuation, he is a prolific author and speaker who frequently shares his knowledge and insightful analyses of court case decisions with professional audiences and in articles in prominent valuation publications. He has also served as an expert witness on several occasions.

CHRIS HAMILTON, CPA, CFE, CVA
is a partner with The Arxis Group in Simi Valley, CA, and most of his professional time is spent in the areas of business valuations, fraud, forensic accounting and litigation-related engagements. He has published articles and spoken around the country on issues related to valuation and forensic accounting. He is a co-author of *Financial Valuation Applications and Models.*

J. MICHAEL HILL SR., FASA, CBA
is a shareholder in the valuation/litigation consulting firm of Hill Schwartz Spilker Keller, LLC and is former chairman of the BV Committee of the ASA. He also served as chair of the Appraisal Foundation and was a course developer and instructor for the ASA.

THOMAS E. HILTON, MSF, CPA/ABV/CFF, CVA, CGMA
is director of the Forensic & Valuation Services Group at Anders Minkler Huber & Helm, LLP in St. Louis, MO. He is an adjunct professor at the John Cook School of Business, St. Louis University. An experienced forensic accountant and expert witness, he is past chair of the AICPA Forensic & Valuation Services Executive Committee, a board member for the AICPA, and a member of AICPA Governing Council.

JAMES R. HITCHNER, CPA/ABV/CFF, ASA
is managing director of Financial Valuation Advisors, Ventnor City, NJ, a founding member and president of The Financial Consulting Group, and CEO of Valuation Products and Services. He is editor/co-author of *Financial Valuation Applications and Models*; co-author of *Financial Valuation Workbook*; co-author of *Valuation for Financial Reporting;* and editor of *Financial Valuation and Litigation Expert.*

MARK G. KUCIK, CPA, CVA, CFF, CM&AA, CPVA
was named "Instructor of the Year" by NACVA. Mark teaches extensively and is a member of NACVA's Training and Development Team. He co-authored training materials for the CVA certification program, represented NACVA on the CLARENCE committee, and developed a 4-day seminar on business valuation for the IRS. He is a sought-after speaker and media resource for expert information on valuation of closely held businesses.

EVA M. LANG, CPA/ABV, ASA
is the executive director of The Financial Consulting Group, LC, and president of Valuation Products and Services, LLC. She is a a member of the AICPA BV Hall of Fame and a co-author/contributing author to six books, including *The Best Websites for Financial Professionals, Business Appraisers, and Accountants.*

DERALD LYONS, MT, CPA/PFS, CVA
is president of Lyons & Seacrest, P.C., CPAs in Denver, CO. He is a nationally recognized author and presenter on valuation matters. He is a co-author of *Financial Valuation Applications and Models.* He has been qualified as an expert witness and provided testimony regarding valuations and other financial matters on numerous occasions.

L. GAIL MARKHAM, CPA/ABV/CFF, CFE®, CFP®, CERTIFIED FAMILY MEDIATOR
is president of Markham Norton Mosteller Wright & Co., P.A. She is the founding partner of the firm and head of its Forensic Accounting, Litigation & Mediation Services team. Gail has extensive experience in litigation services, mediation and forensic accounting. She has been recognized on numerous occasions as an outstanding community leader in Southwest Florida.

HAROLD G. MARTIN JR., CPA/ABV/CFF, ASA, CFE
is partner-in-charge of Valuation and Forensic Services for Keiter in Richmond, VA, and an adjunct instructor for The College of William and Mary Mason Graduate School of Business. He is a former member of the AICPA BV Committee, former chair of the AICPA BV Conference, an AICPA instructor, and an inductee into the AICPA BV Hall of Fame. Harold is co-author of *Financial Valuation Applications and Models*.

GILBERT E. MATTHEWS, CFA
is chairman of Sutter Securities Incorporated in San Francisco. He has more than 50 years of experience as an investment banker. At Bear Stearns in New York, he was responsible for all fairness opinions and valuations for 25 years. He has written several book chapters and articles on fairness opinions and corporate valuations and has testified in numerous federal and state courts.

Z. CHRISTOPHER MERCER, FASA, CFA, ABAR
is founder/chief executive officer of Mercer Capital, one of the country's leading independent business appraisal firms. He has prepared, overseen, or contributed to valuations for purposes related to M&A, litigation, and tax, among others. Chris is a prolific author (four textbooks and scores of articles) and a frequent speaker on valuation topics.

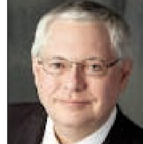
KATHERINE E. MORRIS, MBA, ASA
is president of Morris Valuation Consulting, Inc. providing valuation and consulting services to a variety of industries for 20+ years. She has provided valuation analyses of business and intangible assets for diverse purposes and has worked on behalf of the IRS and the GA Attorney General. She is also a managing director with Valuation Products and Services, LLC.

ERIC W. NATH, ASA
has been a valuation professional since 1985 and founded his own company, Eric Nath & Associates in 1991. He has written landmark articles on control premiums and cost of capital and is a frequent speaker on these topics. One area of focus for Eric is valuing minority interests, and as a member of the BV Standards Subcommittee for ASA he was the principal author of the procedural guideline on valuation of partial ownership interests.

DR. SHANNON P. PRATT, DBA, FASA, CFA, MCBA, CM&AA, MCBC
is chairman/chief executive officer of Shannon Pratt Valuations, LLC; Publisher Emeritus for BV Resources, LLC; and a board member of Paulson Capital Corp. He is the best-known authority in the field of BV and the author of many books, including *Guide to Business Valuations,* now in its 16th edition and *Valuing a Business,* 5th edition.

WILLIAM C. QUACKENBUSH, MBA, ASA, MCBA, ABAR, BCA
is the founder of Advent Valuation Advisors. Bill provides valuation for tax and financial statement compliance and litigation support in damage/economic loss matters. He is the past chair of the ASA's Business Valuation Committee, former editor of the ASA's weekly *BV E-Letter,* and vice chair of IIBV. He teaches for both the ASA and the IIBV and writes and speaks on BV issues.

RAYMOND RATH, ASA, CEIV, CFA
is managing director of Globalview Advisors. With 30+ years of expertise, he has performed valuation projects for financial and tax reporting, transactions and litigation. He has organized and moderated conferences on fair value issues, including presentations by staff of the SEC, PCAOB, FASB and IASB. He has led efforts resulting in an education and certification program for an intangible assets valuation specialty designation.



ROBERT F. REILLY, CPA
is a managing director of Willamette Management Associates, a Chicago-based business valuation firm. Robert is a certified public accountant/accredited in business valuation/certified in financial forensics, chartered global management accountant, certified management accountant, chartered financial analyst, certified business appraiser, and certified valuation analyst. Robert has co-authored 12 textbooks, including *Guide to Intangible Asset Valuation* and *A Practical Guide to Bankruptcy Valuation.*

SCOTT R. SALTZMAN, CPA, CVA, ASA, ABV, MAFF
practices in BV, lost profits and earnings, forensic accounting, professional malpractice, marital dissolution and financial damages. He is the past president of NACVA, past chairman of NACVA's executive advisory and certification boards, past member/chair of the Colorado Securities Board, and past member/president of the Colorado State Board of Accountancy.

RONALD L. SEIGNEUR, CPA/ABV/CFF, ASA, CVA, CGMA
is a partner in Seigneur Gustafson LLP, Lakewood, CO. Ron has over 30 years of experience working with complex valuation, economic damages, financial forensics, and related litigation support matters. He is co-author of *Financial Valuation Applications and Models* and an adjunct professor at the University of Denver College of Law.

CHRIS D. TREHARNE, ASA, MCBA, BVAL
is president of Gibraltar Business Valuations. Combined with 25 years of BV experience, Chris's engineering, production and financial management experience in public and closely held businesses bring unique perspectives to valuation topics. He is a faculty member for the ASA's Principles of Valuation certification program, a member of ASA's Valuation Standards Subcommittee and a member of The S Corporation Association's Advisory Board.

GARY R. TRUGMAN, CPA/ABV, MCBA, ASA, MVS
is president of Trugman Valuation Associates, Inc., a BV/economic damages firm in Plantation, FL and Parsippany, NJ. He is chair of the ASA Constitution and Bylaws Committee and has served on numerous committees of the ASA, IBA, AICPA and various state CPA societies. He is author of *Understanding Business Valuation* and *Essentials of Valuing a Closely Held Company* and has co-authored several other textbooks and articles in various publications. He is on the faculty of the National Judicial College.

LINDA B. TRUGMAN, CPA/ABV, MCBA, ASA, MBA
is vice president of Trugman Valuation Associates, Inc. and serves as a member of the Executive Committee of the ASA. She is a former member of various committees of both the AICPA and IBA and lectures on business valuation topics throughout the U.S. Linda is co-author of *Financial Valuation Applications and Models.*

STACEY D. UDELL, CPA/ABV/CFF, CVA
is the director of valuation and litigation services for HBK Valuation in Cherry Hill, NJ, specializing in valuation and litigation support services. Stacey is a member of the AICPA Forensics and Litigation Services Committee, chair of the AICPA Family Law Task Force, and co-chair of the 2016 and 2017 AICPA Forensics and Valuation Services Conference. In addition, she coauthored or was a contributing author to several books related to BV and litigation support services.

MARK S. WARSHAVSKY, CPA/ABV/CFF, CVA, CBA, ASA, CFE, MAFF, DABFA, MBA
is partner-in-charge of the firm's BV and litigation services group with Gettry Marcus CPA, P.C. in New York. He was chairman of the BV committee for NYSSCPA and currently serves on the editorial advisory boards of several national publications. He is a nationally recognized speaker and founding member of NACVA's Forensic Accounting Academy.

JEFFREY N. WINDHAM, JD, CFE
is an attorney and certified fraud examiner who specializes in fraud examinations, litigation consulting and economic damage analysis. He has experience across many industries including real estate, banking and finance, securities and investments, construction, automotive, technology, insurance, utilities, health care, restaurants, transportation and non-profits. He serves as an expert witness in accountant liability and financial damages matters.

RICHARD M. WISE, CPA, FCA, CFF, FASA, MCBA, FRICS, FCBV, CVA
is owner of Wise Consulting. Past president of The Canadian Institute of Chartered Business Valuators and former Governor of ASA, he is a Fellow of the Ontario Institute of Chartered Accountants, author of *Financial Litigation - Quantifying Business Damages and Values*, co-author of *Investigative and Forensic Accounting Practice Issues* (CICA), and a member of the ASA BV Committee and Standards Subcommittee and NACVA's Litigation Services Board.

DONALD P. WISEHART, ASA, CPA/ABV/CFF, CVA, MAFF, MST
is owner of Wisehart, Inc., a Rhode Island CPA and consulting firm, and a member of The Financial Consulting Group. With 30 years of professional experience, he has given numerous BV presentations and has developed several courses for NACVA, where he chaired the Education Board. Don was also founding president of the Rhode Island Business Appraisal Group.

GUIDE TO ABBREVIATIONS

ABAR Accredited in Business Appraisal Review (NACVA)
ABV Accredited in Business Valuation, American Institute of Certified Public Accountants (AICPA)
ASA Accredited Senior Appraiser, American Society of Appraisers (ASA)
CA Chartered Accountant
CBA Certified Business Appraiser, Institute of Business Appraisers (IBA)
CDFA Certified Divorce Financial Analyst, Institute for Divorce Financial Analysts
CEIV Certified in Entity and Intangible Valuations
CFA Chartered Financial Analyst, CFA Institute
CFE Certified Fraud Examiner, Association of Certified Fraud Examiners
CFF Certified in Financial Forensics, AICPA
CFP Certified Financial Planner, Certified Financial Planner Board of Standards, Inc.
CGMA Chartered Global Management Accountant
CIRA Certified Insolvency and Restructuring Advisor
CMA Certified Management Accountant
CM&AA Certified Merger & Acquisition Advisor, Alliance of Merger & Acquisition Advisors
CPA Certified Public Accountant
CPVA Certified Patent Valuation Analyst
CVA Certified Valuation Analyst, National Association of Certified Valuators and Analysts (NACVA)
DABFA Diplomate of the American Board of Forensic Accounting
FASA Fellow of the American Society of Appraisers
FCBV Fellow of the Canadian Institute of Chartered Bsuiness Valuators
FRICS Fellow of Business Valuation specialty with the Royal Institution of Chartered Surveyors
JD Juris Doctor
MAFF Master Analyst in Financial Forensics (NACVA)
MBA Masters of Business Administration
MCBA Master Certified Business Appraiser, IBA
MST Masters of Science in Taxation
MVS Masters in Valuation Sciences
PFS Personal Financial Specialist (AICPA)

*CPA licensure designation regulated by the State of Florida

•State of Maine

BVS

Business Valuation Support

A Business Valuation Support Service for Valuation Firms and Attorneys

Jim Hitchner and Jim Alerding are pleased to announce their business valuation support service for valuation groups/firms and attorneys.

- Malpractice support
- Expert witness testimony
- Valuation/Appraisal reviews in litigation
- Expert consulting
- Business valuation standards compliance reviews
- Firm/Group quality control reviews
- Valuation arbitration and mediation
- Expert screening for attorneys

JIM HITCHNER, CPA/ABV/CFF, ASA
Managing Director,
Financial Valuation Advisors, Inc.
Ventnor City, NJ

JIM ALERDING, CPA/ABV, ASA
Founder,
Alerding Consulting
Indianapolis, IN

For more information, call 609-822-1808 or email us at jhitchner@businessvaluationsupport.com

COST OF CAPITAL CORNER

Base U.S. Cost of Equity Capital

(Rf + Median RP$_{m+s,\ all\ portfolio\ 25s}$ + ERP Adjustment) [1, 2, 3]

Source: Duff & Phelps Cost of Capital Navigator, Risk Premium Report Study[4]

	Using the Historical Equity Risk Premium, Spot R_f [5]	Using the Supply-Side Equity Risk Premium Spot R_f [5]	Using the Duff & Phelps Conditional ERP & Normalized R_f [6]
December 31, 2017	16.2%	15.2%	15.1%
One Year Ago	17.4%	16.4%	16.7%

	Inflation	Gross Domestic Product
Historical (1926-2017)[7]	2.9%	3.2%
10 yr. forecast[8]	2.3%	2.2%

1 Rf = Risk-free rate

2 Median RPm+s = The median "risk premium over the risk-free rate" associated with portfolio 25 for the eight measures of size used in the Risk Premium Report Study from the Cost of Capital Navigator. The eight size measures are: market value of equity, book value of equity, 5-year average net income, market value of invested capital (MVIC), total assets, 5-year average EBITDA, sales, and number of employees. For each measure of size, 25 portfolios are created (Portfolio 1 is the largest, Portfolio 25 is the smallest).

3 The equity risk premium (ERP) adjustment is needed to account for the difference between the forward-looking ERP as of the valuation date that the analyst has selected to use in his or her cost of equity capital calculations, and the historical (1963–present) ERP that was used as a convention in the calculations performed to create the Risk Premium Report Study "risk premium over the risk-free rates," size premia, and other valuation data. For example, the Duff & Phelps Conditional ERP as of December 31, 2017 is 5.0%, and the 1963–2017 historical ERP used in the calculation of the premia in the Cost of Capital Navigator's Risk Premium Report Study was 5.28%, implying an ERP adjustment of -0.28% (5.0% – 5.28%). For more information about the ERP adjustment, and to ensure you are using the most up-to-date ERP and other cost of capital information, visit www.DuffandPhelps.com/CostofCapital.

4 Beginning in 2018, Duff & Phelps transitioned from print to online delivery of the *Valuation Handbook* series in a new online platform, the Cost of Capital Navigator. The Cost of Capital Navigator guides the Analyst through the process of estimating the cost of capital, a key component of any valuation analysis. The four *Valuation Handbooks* will be transitioned over to the online Cost of Capital Navigator in stages. In the first stage in February 2018, the *Valuation Handbook – U.S. Guide to Cost of Capital* was transitioned over. For more information and to subscribe to the Cost of Capital Navigator, visit dpcostofcapital.com.

5 The Duff & Phelps online Cost of Capital Navigator platform uses long-term risk-free rates from the Federal Reserve Economic Data website at https://www.federalreserve.gov/datadownload/Build.aspx?rel=H15. The series used is the 20-year constant maturity U.S. government bond (as of 12/31/2017 in this example); series unique identifier: H15/H15/RIFLGFCY20_N.B.

6 Risk-free rate (normalized). The Duff & Phelps conditional U.S. ERP as of December 31, 2017 (5.0%) was developed in relation to a 3.5% "normalized" risk-free rate, implying a base U.S. cost of equity capital of 8.5% (5.0% + 3.5%) at that time. The Duff & Phelps conditional U.S. ERP "one year ago" as of December 31, 2016 (5.5%) was developed in relation to a 3.5% "normalized" risk-free rate, implying a base U.S. cost of equity capital of 9.0% (5.5% + 3.5%) at that time. The Duff & Phelps recommended ERP should be used with the risk-free rate that it was developed in relation to. For more information about normalized risk-free rates and the Duff & Phelps recommended ERP and other cost of capital information, visit www.DuffandPhelps.com/CostofCapital.

7 Lawrence H. Officer and Samuel H. Williamson, "Annualized Growth Rate and Graphs of Various Historical Economic Series," www.measuringworth.com, 2017. Inflation as of 2017; GDP as of 2017.

8 Consensus Median Average, *Livingston Survey,* Federal Reserve Bank of Philadelphia, June 2018, p. 4.

Editor's Note: *I highly recommend that all financial experts who rely on Duff & Phelps data purchase the* Duff & Phelps Navigator *and thoroughly understand how the data are compiled and the data choices available.*