

To Calculate or Not to Calculate: Revisiting the AICPA's SSVS-1

By Nathan DiNatale, CPA/ABV, CVA

Since its release in 2007, there has been some misunderstanding about the AICPA's Statement on Standards for Valuation Services or "SSVS." This frequently misunderstood and often misinterpreted guidance has CPAs and valuation analysts wondering when and how it applies to the services they perform. Questions such as "is this a calculation engagement or a valuation engagement?" and "what information do I need to include in my report when preparing for litigation?" are all too common in applying the new standard. In this day of dueling experts, IRS examinations, and litigation scrutiny, valuation experts should brush up on this standard and be prepared to defend their report.

Types of Engagements. SSVS spells out two distinct types of engagements that a valuation analyst can employ to estimate the value of a company: a *valuation engagement* and a *calculation engagement*. A valuation engagement results in a conclusion of value while a calculation engagement results in a calculated value. The SSVS defines each of these as follows:

a. Valuation engagement—A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.

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 (paragraph 46).

To summarize, the valuation engagement gives valuers the freedom to apply the valuation approaches and methods they deem appropriate, while the calculation engagement relies on the client providing input regarding the valuation procedures to be performed and methodologies to be used in the valuation.

In my opinion, each of these engagements has its proper place. Valuation analysts are often required to value a business to reconcile a dispute, to determine the value of stock options, or for estate and gift tax purposes, to name a few. In these scenarios, valuation analysts are tasked with determining the value of the business, or pro rata share, in an objective manner, using the most appropriate valuation methods based on the company-specific information and their own valuation expertise. The resulting conclusion of value is an unbiased, undirected opinion.

Reprinted with permissions from Business Valuation Resources, LLC

BUSINESS VALUATION UPDATE

Executive Editor: Jan Davis
 Legal Editor: Sherrye Henry Jr.
 CEO, Publisher: David Foster
 Managing Editor: Janice Prescott
 Contributing Editors: Adam Manson,
 Vanessa Pancic, Doug Twitchell
 Graphic & Technical Designer: Paul Erdman
 Customer Service: Stephanie Crader
 Sales and Site Licenses: Linda Mendenhall
 President: Lucretia Lyons

EDITORIAL ADVISORY BOARD

NEIL J. BEATON
 CPA/ABV, CFA, ASA
 GRANT THORNTON
 SEATTLE, WASH.

JOHN A. BOGDANSKI, ESQ.
 LEWIS & CLARK
 LAW SCHOOL
 PORTLAND, ORE.

NANCY J. FANNON
 ASA, CPA/ABV, MCBA
 FANNON VALUATION GROUP
 PORTLAND, ME.

JAY E. FISHMAN
 FASA, CBA
 FINANCIAL RESEARCH
 ASSOCIATES
 BALA CYNWYD, PA.

LYNNE Z. GOLD-BIKIN, ESQ.
 WOLF, BLOCK, SCHORR
 & SOLIS-COHEN
 NORRISTOWN, PA.

LANCE S. HALL, ASA
 FMV OPINIONS
 IRVINE, CALIF.

JAMES R. HITCHNER
 CPA/ABV, ASA
 THE FINANCIAL
 VALUATION GROUP
 ATLANTA, GA.

JARED KAPLAN, ESQ.
 MCDERMOTT, WILL & EMERY
 CHICAGO, ILL.

GILBERT E. MATTHEWS CFA
 SUTTER SECURITIES
 INCORPORATED
 SAN FRANCISCO, CALIF.

Z. CHRISTOPHER MERCER
 ASA, CFA
 MERCER CAPITAL
 MEMPHIS, TENN.

JOHN W. PORTER
 BAKER & BOTTS
 HOUSTON, TX.

RONALD L. SEIGNEUR
 MBA CPA/ABV CVA
 SEIGNEUR GUSTAFSON
 LAKEWOOD, COLO.

BRUCE SILVERSTEIN, ESQ.
 YOUNG, CONAWAY, STARGATT
 & TAYLOR
 WILMINGTON, DEL.

JEFFREY S. TARBELL
 ASA, CFA
 HOULIHAN LOKEY
 SAN FRANCISCO, CALIF.

GARY R. TRUGMAN
 ASA, CPA/ABV, MCBA, MVS
 TRUGMAN VALUATION
 ASSOCIATES
 PLANTATION, FLA.

KEVIN R. YEANOPLOS
 CPA/ABV/CFF, ASA
 BRUEGGEMAN & JOHNSON
 YEANOPLOS, P.C.
 TUCSON, ARIZ.

JAMES S. RIGBY, ASA, CPA/ABV
 IN MEMORIAM (1946 – 2009)

Business Valuation Update™ (ISSN 1088-4882) is published monthly by Business Valuation Resources, LLC, 1000 SW Broadway, Suite 1200, Portland, OR, 97205-3035. Periodicals Postage Paid at Portland, OR, and at additional mailing offices. Postmaster: Send address changes to *Business Valuation Update*™, Business Valuation Resources, LLC, 1000 SW Broadway, Suite 1200, Portland, OR, 97205-3035.

The annual subscription price for the *Business Valuation Update*™ is \$359. Low cost site licenses are available for those wishing to distribute the *BVU* to their colleagues at the same address. Contact our sales department for details. Please feel free to contact us via email at customerservice@BVResources.com, via phone at 503-291-7963, via fax at 503-291-7955 or visit our web site at BVResources.com. Editorial and subscription requests may be made via email, mail, fax or phone.

Please note that by submitting material to *BVU*, you are granting permission for the newsletter to republish your material in electronic form.

Although the information in this newsletter has been obtained from sources that BVR believes to be reliable, we do not guarantee its accuracy, and such information may be condensed or incomplete. This newsletter is intended for information purposes only, and it is not intended as financial, investment, legal, or consulting advice.

Copyright 2010, Business Valuation Resources, LLC (BVR). All rights reserved. No part of this newsletter may be reproduced without express written consent from BVR.

In such a scenario, where a third party is relying on the independence and objectivity of the valuation analyst's opinion, a valuation engagement is more appropriate.

Alternatively, a calculation engagement is more appropriate when third-party reliance is not present. Calculation engagements closely resemble agreed-upon-procedure engagements, where the client retains the ability to dictate the procedures followed. Ultimately, the valuation analyst's choice of engagement should be documented in the engagement letter with the client.

Minimum Requirements. In performing the engagements discussed above, the valuation analyst must include the minimum requirements for each. According to SSVS, in a valuation engagement the valuation analyst should:

- Analyze the subject interest;
- Consider and apply appropriate valuation approaches and methods; and
- Prepare and maintain appropriate documentation.

While these three basic requirements oversimplify the amount of research, financial analysis, and calculations required in even the smallest company valuation, they are detailed in the SSVS so that even the most inexperienced valuation analyst has a road map to follow. In addition, they mimic the general requirements of both the National Association of Certified Valuation Analysts (NACVA) and the American Society of Appraisers (ASA) reporting requirements.

The requirements for the calculation engagement are more relaxed. The valuation analyst must provide an analysis of the subject interest and comply with the same documentation requirements as a valuation engagement, but only has to discuss the valuation approaches or valuation methods agreed upon with the client. This engagement does not specifically require the consideration of all valuation approaches or

**Reprinted with permissions from
 Business Valuation Resources, LLC**

methods. To reiterate, calculation engagements have a very limited use, in my opinion, and are not appropriate when the valuation will be relied upon by third parties, such as the fair value standards under generally accepted accounting principles (GAAP), estate and tax purposes in accordance with the IRS, and litigation.

Choosing the Engagement Type. There are a few things to keep in mind when determining which engagement is the most appropriate for your client. First, a calculation report is nothing more or less than specific valuation approaches, valuation methods, and the extent of valuation procedures that the valuation analyst and client have agreed upon. The valuation analyst is not free to perform an unbiased estimate of value. In addition, keep in mind that the calculation engagement does not include all of the procedures necessary for a valuation engagement. The procedures have been specifically limited by the client for a particular purpose, thus restricting the valuation analyst in the performance of the valuation. On the other hand, the valuation engagement includes all of the procedures necessary to render an opinion of value that is solely the analyst's, without restriction to the procedures performed.

Regardless of which type of engagement you choose, the SSVS applies to all AICPA members and all engagements that require the valuation analyst to estimate value. However, the following exemptions apply:

- a. The SSVS is not applicable to a member who participates in estimating the value of a subject interest as part of performing an attest engagement defined by Rule 101 of the AICPA Code of Professional Conduct (for example; as part of an audit, review, or compilation engagement).
- b. The SSVS is not applicable when the value of a subject interest is provided to the member by the client or a third party and the member does not apply valuation approaches and methods, as discussed in this Statement.
- c. The SSVS is not applicable to internal use assignments from employers to employee members not in the *practice of public accounting*, as that term is defined in the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 92. 25).
- d. The SSVS is not applicable to engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) unless those determinations include an engagement to estimate value.
- e. The SSVS is not applicable to mechanical computations that do not rise to the level of an engagement to estimate value; that is, when the member does not apply valuation approaches and methods and does not use professional judgment.
- f. The SSVS is not applicable when it is not practical or not reasonable to obtain or use relevant information; as a result, the member is unable to apply valuation approaches and methods that are described in this Statement.

Litigation Considerations. In connection with the SSVS, valuation analysts may issue three types of reports to communicate the results of an engagement. For a valuation engagement, they may issue a detailed report or a summary report, and for a calculation engagement, they may issue a calculation report. Regardless of which type of engagement is chosen, there is a general reporting exemption for certain controversial proceedings. In other words, while the valuation analyst still needs to complete the work required under the applicable engagement chosen, the report does not have to follow a prescribed format or include specific information to be in accordance with the SSVS.

Summary. While it is important to understand the standard and the requirements applicable to each type of engagement, it is equally important to remember these differences when proposing on a new valuation. If you are performing all of the required procedures, providing an unbiased

Reprinted with permissions from Business Valuation Resources, LLC

opinion and not being restricted, then the most appropriate engagement is a valuation engagement. Without the ability to form an unrestricted opinion, valuation analysts have been limited by the party they represent. This imposed limitation may or not may not have a significant impact on the opinion, but be aware that this type of opinion is not appropriate for most compliance purposes and is certainly not the best choice when representing a client in litigation. Thus, the engagement you choose will not only impact the level of work and fees, but it could lead to additional scrutiny if the valuation is contested.

***Nathan DiNatale**, CPA/ABV, CVA, is a senior manager in the firm SC&H Group LLC, located in Sparks, MD.*

Reprinted with permissions from Business Valuation Resources, LLC