

Value is as Value Does

Pretty much unnoticed by those outside of the CPA valuation community, there have been (in theory) some pretty dramatic changes in our doing valuations over the past few years. That's because a few years ago the governing body of our profession, the American Institute of CPAs (AICPA) belatedly came out with its first ever standards specifically addressing business valuations – issuing its proclamation from on high titled *Statement on Standards For Valuation Services – 1* (SSVS-1). Note that these standards apply only to the valuation of a business, or an interest in a business; and apply only to CPAs.

For the most part, the essence of SSVS-1 is we need to do a credible and competent job – no surprise there, and hardly radical in the sense of what is expected from professionals. When you drill down a little further, and cut through the obligatory language obfuscation, the new standards basically restrict CPAs to performing one of two types of valuations – either a conclusion of value or a calculation of value. Putting aside the relatively poor choice of titling (to other than a select few, those words at best provide no insight into what is expected, and more likely only confuse the issue), what we are talking about here is whether the job is a “full” valuation (conclusion of value), or is a shortcut approach to value (calculation of value). It is irrelevant whether the value number we provide you is in the form of a written report or a verbal report – the standards apply to any expression of value.

Especially for our readers who are familiar with business valuation reports done within the context of litigation, it is important to recognize that these Standards do not affect, that is have no bearing on, the all critical aspects of forensics – the accounting investigation that gets us to the normalized net income numbers upon which we base our valuation. That is, the standards are specifically only to valuation – they have nothing to do with the investigative accounting phase.

As mentioned above, there are two types of valuation under our standards – the full job without restrictions (conclusion of value), and the shortcut or subject to agreed limitations approach to valuation (calculation of value). To oversimplify, the difference essentially is that in a conclusion of value, the valuation expert needs to be free to exercise full professional judgment without restrictions and scope limitations, and is not restricted in any meaningful way in respect to doing his/her job. To roughly illustrate, this means that the appraisal expert needs to adequately consider the cost, income and market approaches, and take whatever additional steps are necessary to give that expert confidence that he/she has fully/adequately covered all significant aspects of the valuation process. Also, that expert's work product (file) must support same.

In contrast is the calculation of value. Perhaps it's easiest to describe this (in comparing it to a conclusion of value) as a valuation concept that starts out with certain scope limitations with the understanding that steps will be intentionally omitted, shortcuts taken, in arriving at the determination of value. Typically this is done to save on fees – for instance, by agreeing that the market approach won't be considered, or that there will be no economic and industry analysis (perfectly acceptable within the context of a calculation of value). These scope limitations, these steps to shorten the valuation process, have nothing directly to do with the generally preceding step of forensic or investigative accounting. That is, unless there is a similar agreement in some fashion to restrict the forensic accounting element of the assignment, what was described is limited only to a reduction in the work effort in the valuation phase. The ultimate result is an expression/determination of value by the expert based on his/her work being subjected to various scope limitations. Whether or not, and to what extent, a written report is issued is a separate issue – though generally, when we are dealing with a calculation of value, not only is the work effort truncated, but so is the report, sometimes being as simple/abbreviated as a relatively short letter summarizing what was done.

The wiggle room is in the writing of the report when we are involved in litigation. That is, while SSVS-1 lays out various requirements of what must be included in a business valuation report done in a non-litigation environment (for instance for estates or gifting), it allows the expert (and thus indirectly counsel) total flexibility in terms of the extent of what must be included in a report prepared for litigation. That does not alter the work that needs to be done (that is the analysis and what would be expected to be in the CPA's files) – it only allows complete flexibility as to what must be published in a report.

Some of our readers may ask along the lines of why bother with a conclusion of value when you can get a result/product from the expert with simply a calculation. The answer is multifaceted. It relates to the quality and depth of the work, the reliance that can be placed upon same, and to no small measure, in a litigated matter, what is the other side doing? To paraphrase a well-known line from a movie, "Doing a calculation of value in a litigation matter is like bringing a knife to a gunfight". If an expert is directed to do only a calculation of value in a litigated matter, and the expert on the other side was authorized to proceed with a conclusion of value, the expert issuing a calculation of value report (and by extension that expert's clients and counsel) are at a distinct disadvantage – to the extent that might constitute a critical shortcoming, even one fatal, to that side's position. Thus, one must tread very carefully in a litigation matter as to considering using a calculation of value rather than a conclusion of value approach to valuation. On the other hand, where the expert is a neutral expert, or where the expert is working in a mediation or collaborative law

environment, then a calculation of value might serve everyone well – as long as the extent of scope limitations are not such that they truly impair the ability of the expert to do a professional job, and where the non business spouse (in a divorce) is not placed at a disadvantage by the use of a calculation.

Even in a non-litigation environment, a calculation of value may be the wrong way to proceed. As referenced above, by definition it lacks addressing the full complement of issues involved in a valuation. As a result, through no fault of the expert, a calculation of value may result in a number that is wrong – and you may never know it until perhaps it is too late, if you ever know it at all. Further, when it comes to valuations for gifts and estates, the IRS has effectively mandated that it will only accept a conclusion of value as sufficiently professional and adequate for the expression of the value for a Form 709 for gifting or Form 706 for estates. Shortcutting that process through the use of a calculation of value may wind up being a total waste of money and time.

Thus, while some amount of fees can be saved through the use of a calculation rather than a conclusion of value, the professionals and clients involved in the process must give serious consideration to whether they will be well-served with only a calculation of value, and even if the answer then is yes, to what extent is the valuation process to be truncated – how far is it prudent to go in this shortcutting process before you cut into muscle?