

# BV Standards Applications Update: Six Months Into Compliance

Jim Hitchner's *Financial Valuation and Litigation Expert*, Issue 13, June/July 2008

*You can't always get what you want*

*You can't always get what you want*

*You can't always get what you want*

*But if you try sometime, you just might find*

*You get what you need.*

These lyrics from the song “You Can’t Always Get What You Want,” written by Mick Jagger and Keith Richards of the Rolling Stones, may best describe the most prolific period (2007/2008) ever in business valuation standards. Most likely, nobody is completely happy with all the new standards and revisions to standards, so we may not have gotten what we *want*. However, if you carefully read the standards and view them in a positive manner, we may have gotten what we *need*.

It’s hard to believe that it’s been almost six months since the effective date of three new and/or revised sets of business valuation standards. The American Institute of Certified Public Accountants (AICPA) issued its first- ever standards directly related to business valuation: *Statement on Standards for Valuation Services (SSVS) No. 1, Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*. The National Association of Certified Valuation Analysts (NACVA) issued a major revision to its standards. The Appraisal Foundation also issued the latest version of the Uniform Standards of Professional Appraisal Practice (USPAP). All three sets of standards were effective January 1, 2008. These new standards affect, either directly or indirectly, all valuation analysts.

Obviously, standards have been a hot topic with a lot of debate on the merits of all these changes. There have been venting and anger expressed as well. Well, new things can cause fear, but they also make us take our most precious commodity— time— and apply it to learning and understanding what the standards mean, how to apply them, and also how to avoid any violations.

Valuation Products and Services (VPS), through this and future articles, and the VPS STRAIGHTtalk webinar series will try to efficiently accelerate the learning process.

Jim Alerding, CPA/ABV, ASA, CVA, Ed Dupke, CPA/ABV and Jim Hitchner, CPA/ABV, ASA have been on the speakers’ circuit for several years giving presentations on BV standards. Dupke was the chair of the four-person AICPA Business Valuation Standards Writing Task Force and Alerding and Hitchner were members. All three served for the entire six years prior to the June 2007 release date. All three are very knowledgeable about the NACVA and the USPAP standards as well, having spent a considerable amount of time reviewing them, and other standards, during the actual writing of SSVS.

Dupke, Alerding and Hitchner have been asked hundreds of questions, either live or through emails, about various applications and nuances of these standards. The following questions are a handful of the types of questions they have been asked. They are sharing their knowledge in this article, as they did in a VPS webinar on BV standards on June 17. (For more information on the webinar, see page 6). They are all in agreement with the answers to the following questions.

*Please note that Dupke, Alerding and Hitchner do not represent the AICPA, NACVA or the Appraisal Foundation, and the answers they share here are solely their own and are not the official position of the AICPA, NACVA, or the Appraisal Foundation.*

**Question 1:** Can you prepare a calculation of value for litigation purposes under AICPA SSVS? [Note: For our readers who comply with USPAP, we will answer the following similar question in a future issue of *FVLE*: “Can you prepare a calculation for litigation (or other) purposes under USPAP?”]

**Answer 1:** Yes. There is no prohibition in SSVS against preparing a calculation engagement to estimate value and developing a calculation of value for litigation.<sup>1</sup>

There is a litigation exemption from the reporting section of SSVS for reporting a value, whether within a valuation engagement or a calculation engagement, but there is no exemption from the development section of SSVS for the performance of a valuation engagement and the development of a conclusion of value or the performance of a calculation engagement and the development of a calculated value.

The above answer is a factual one based on the standards. However, there is a practical answer as well. Under a calculation engagement “(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...A calculation engagement does not include all of the procedures required for a valuation engagement...”<sup>2</sup>

Furthermore, in the section of SSVS that discusses what generally goes into a calculation report it says “A general description of a calculation engagement is given, including that (1) a calculation engagement does not include all of the procedures required for a valuation engagement and (2) had a valuation engagement been performed, the results may have

been different.”<sup>3</sup>

Can you imagine the type of deposition and/or cross examination questions that may come up when presenting a calculation of value to a judge or jury?

- “Mr. /Ms. Analyst, what approaches, methods and procedures were omitted?”
- “Who had the final say on what you did?”
- “Is your calculated value your opinion of value?”
- “If it is your opinion of value, is it a reasonably certain opinion of value, since the standards state that the results may have been different had a valuation engagement been performed?”
- “How different would the results have been if you performed a valuation engagement?”

Some analysts are now structuring their engagement letters in two parts. Part one is the development of a calculated value for use by the attorney in planning and settlement. The second part is triggered when that fails and the valuation analyst will be asked to testify. In part two, the engagement letter states that a valuation engagement must be performed if testimony is required of the analyst. The analyst may still have to contend with and explain any differences between the calculated value in part one and the conclusion of value in part two, assuming part one is discoverable.

There may be one other exception to the practical answer given above. In some jurisdictions, the attorneys, analysts and judges may be comfortable with a limited-scope calculated value and the resulting savings in time and money. However, this is definitely not true in many other jurisdictions, and one must still be careful when presenting a calculated value in litigation. The analyst may want to see if the attorney he or she is working with can agree with the other side that a calculation engagement will be prepared by both sides. However, there is wide latitude in what can be done in a calculation engagement, as the standards are minimum requirements.

Analysts preparing a calculation must still be objective per SSVS paragraph 14, which “... imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflict of interest.” Knowingly performing a calculation where a client is directing the process towards a desired result would be a violation of SSVS paragraph 14.

**Question 2:** Can a summary or calculation report under SSVS be used for estate and/or gift tax purposes?

**Answer 2:** Yes. There is no specific prohibition in SSVS against a calculation engagement and calculation report or a valuation engagement and summary report for estate and gift tax purposes.

Again, there is a practical answer as well. Given the limited procedures, do you feel comfortable preparing a calculation and a calculation report, and do you believe you can support a calculated value? Many analysts believe the answer is no. However, remember that a calculation engagement has minimal requirements. If you believe that you can do more work and are able to support the value, this is a risk choice that the analyst must make. Just be sure that the client is aware of the language for a calculation engagement and the possible risks. That would best be done in the engagement letter by quoting SSVS as it pertains to a calculation engagement.

Many analysts feel more comfortable preparing a valuation engagement for tax purposes. Whether that valuation engagement and the resultant conclusion of value are presented in a summary or detailed report is, again, up to the analyst. This should also be discussed with the client and become part of the engagement letter. Again, the summary report section of SSVS contains minimum requirements. There is no prohibition in SSVS in presenting a longer summary report with more information, which is less than what is required in a detailed report. Obviously, if you do so much work that the summary report is now meeting the requirements of a detailed report, why not go with the detailed report?

**Question 3:** If I conform to the NACVA standards, am I automatically in compliance with SSVS?

**Answer 3:** In general, yes; specifically, maybe not. The standards committee of NACVA did a yeoman’s effort in quickly revising the NACVA standards to avoid any conflicts with SSVS and to draw parity between the two. The two sets of standards are very similar and the terms, definitions and concepts are well synced. However, there is much more detail in SSVS. As such, analysts are encouraged to follow both to ensure compliance with the standards.

**Question 4:** How different is USPAP as compared to SSVS?

**Answer 4:** They are very similar. In Issue 10, Dec. 2007/Jan. 2008, of this journal, [www.valuationproducts.com](http://www.valuationproducts.com), the front-page article is titled “BV Standards: The Positive Side.” This article contains a detailed comparison between the two sets of standards. The article concludes as follows: “While there are some differences between SSVS and USPAP, by far, there are many more similarities. As such, for those analysts who need or wish to conform to both standards, it should not be too much of a problem. Also, USPAP and SSVS are minimum requirements, so combining both is acceptable and can actually result in an enhanced analysis and report.”

**Question 5:** Must valuation analysts comply with SSVS when reviewing the work and/or report of another valuation analyst?

**Answer 5:** First off, obviously a “review” of another analyst’s work and/or report is not an attest function. Also, “appraisal review” has a special meaning within USPAP, particularly Standard 3, “Appraisal Review, Development and Reporting.” If you are a CPA and a member of the AICPA and also belong to an organization that requires compliance with USPAP, e.g., ASA, you should follow Standard 3. Also, under Standard 3, if you conclude to a value you are then subject to Standard

9, "Business Appraisal, Development" and Standard 10, "Business Appraisal, Reporting." If you are not required to follow USPAP and are required to follow SSVS, there is no section of SSVS that discusses the review of another analyst's work and/or report. There is nothing to comply with, since SSVS is silent on this area.

However, if you "review" the work and report of another analyst and use that information to estimate your own value, SSVS will apply under the following conditions within para. 4 of SSVS: "In the process of estimating value as part of an engagement, the valuation analyst applies valuation approaches and valuation methods, as described in this Statement, and uses professional judgment. The use of professional judgment is an essential component of estimating value." The bottom line here is if you "review" another analyst's work and/or report and use that information and review process to apply valuation approaches and methods and use professional judgment to conclude to a value, you must comply with SSVS. If you are performing this "review" without those components, then SSVS is silent on the issue.

**Question 6:** Please explain SSVS para. 65.e that requires a reporting disclosure of the analyst's compensation arrangements as to whether it is fee-based or contingent on the outcome of the valuation.

**Answer 6:** SSVS para. 65 is under the heading "Representation of the Valuation Analyst," and is in the "Detailed Report" section of SSVS. Para. 65 states, "Each written report should contain the representation of the valuation analyst." Para. 65.e states "The analyst's compensation is fee-based or is contingent on the outcome of the valuation."

In 1990, the Federal Trade Commission sued the AICPA, claiming that the AICPA's prohibition against commissions and contingent fees was in restraint of trade. As part of the settlement agreement, the AICPA agreed not to prohibit commissions and contingent fees. That consent decree remains in effect.

As a result, this section of SSVS simply directs the analyst to disclose whether he or she was retained on a fee basis, i.e., fixed fee or hourly, or whether the fee was contingent on the result. I suspect few analysts are preparing contingent fee valuations but if you are you must disclose this. Most analysts charge for their time either on a fixed fee basis or on an hourly basis. If that is the case then a simple statement as follows complies with the standards: "My/Our compensation is fee-based and is not contingent on the outcome of the valuation." No further disclosure is required. ☞

Article by James R. Hitchner, CPA/ABV, ASA; reprinted with permission from Issue 13 (June/July 2008) *Financial Valuation and Litigation Expert*

© Copyright 2008, Valuation Products and Services (VPS). All rights reserved. This article may not be reproduced in whole or in part without the express written permission of VPS.