

Financial Valuation *and* Litigation Expert

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



Editor's Outlook

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Season's greetings! We bring you some interesting articles to enjoy over what we hope will be your "holiday down time."

Our front-page article takes a look at a recent BV thread from the professional networking site LinkedIn. We hope to set the record straight as we address some inaccuracies in that discussion.

Next up, Steve Bravo takes a look at synergistic attributes in a fair market value case. He looks to *BTR Dunlop* to find answers to some of his questions and shares those with our readers.

Rod Burkert and Bob Dohmeyer provide a look at a new mean reversion model and explain how to use it to adjust excess compensation. A link is also provided to download the complete model.

Darrell Dorrell poses the question "Does 'Offer Price' Equal 'Value?'" He then provides 20 factors to help our readers answer that question.

Rounding out this issue, Steve Babitsky and James Mangraviti offer a concise list of the mistakes most often made by expert witnesses at deposition.

Best wishes to you for a restful, peaceful holiday season. Thank you for your support throughout the year.

'LinkedOut'

A Response to a Business Valuation Standards Discussion

We at VPS and *FVLE* occasionally monitor various LinkedIn discussion groups that pertain to business valuation (BV). Some of these discussions are very informative and professional; others are not. That's where our expression "LinkedOut" comes from. We have been following a recent discussion thread on BV standards, one that has generated great comments and insight but also—well—bad comments and lack of insight. Regardless, this discussion has attracted a lot of activity.

The initial question posted was as follows: "When valuing an operating company, is it necessary to mention *USPAP* in addition to *SSVS 1* when talking about the standards adhered to?" This is a great question, the answer to which can sometimes be confusing. This article will attempt to remove the confusion in a positive way and address this area with balance and

objectivity. You'll see none of what we call the "designation wars" here. We think that the AICPA, ASA, IBA, NACVA and the Appraisal Foundation (*USPAP*) are all fine organizations and do a good job serving their members or constituencies. This will be an unbiased discussion. As Michael Corleone says in *The Godfather*, "It's not personal, Sonny. It's strictly business."

We will answer the original question first and then address various additional questions and comments posted in this discussion group thread. We will then respond to the various questions and comments from this LinkedIn discussion group. We have not attached names to the various comments as that will not serve the purpose here, which is to try to set the record straight. Some of the questions and comments have been edited for clarity.

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The original four-member team that actually wrote the AICPA's BV standards, *SSVS No. 1*, included Ed Dupke, chair; Jim Alerding; Greg Forsythe and Jim Hitchner. It is important to note that Dupke, Alerding and Hitchner are CPA/ABVs. All four former members of the original BV standards task force are ASAs. Alerding is also a CVA. To bolster the accuracy of our discussion here, Dupke and Alerding reviewed this article and agree with all the answers and responses to the questions and comments posted. Here is a LinkedIn question that was recently posted:

“When valuing an operating company, is it necessary to mention USPAP in addition to SSVS 1 when talking about the standards adhered to?”

Only members of the American Society of Appraisers (ASA) are required to adhere to the *Appraisal Foundation's Uniform Standards of Professional Appraisal Practice (USPAP)*. In the U.S., no other BV group is required to follow *USPAP*. This includes the American Institute of Certified Public Accountants (AICPA), the Institute of Business Appraisers (IBA) and the National Association of Certified Valuators and Analysts (NACVA). However, any valuation analyst (analyst) can adhere to *USPAP* if he or she chooses to do so.

If you are a certified public accountant (CPA) and are a member of the AICPA, you must follow the AICPA's *Statement on Standards for Valuation Services No. 1, Valuation of a Business, Business Ownership Interest, Security or Intangible Asset (SSVS)*. If you are a CPA who is not a member of the AICPA, you likely have to follow *SSVS* if your state board of accountancy follows AICPA rules and regulations. For this discussion, we assume the CPA must follow *SSVS*. So, if you are a CPA you must follow *SSVS* but do not have to follow *USPAP*. As such, it is not necessary for a CPA to mention or adhere to *USPAP*. This is also true of certified business appraisers (CBA) from the IBA and certified valuation analysts (CVA) and accredited valuation analysts (AVA) from NACVA.

Let's move on to our responses to the many questions and comments posted on this LinkedIn Group.

Question/Comment 1: *SSVS* is a standard created by and for the accounting community and is limited to financial reporting appraisals only, in my view. *USPAP* is the only standard mentioned by the IRS in its definitions of qualified appraiser and qualified appraisal. Advocates of *SSVS* would like to believe *SSVS* is defacto for the industry, but it is not, regardless of the hype. If it were as ideal as *USPAP* for tax appraisals, the Service would advocate for it as much as they have for *USPAP*. “Pick one and use it” is my advice. If you wish to please the accounting community's insatiable need for consistency... Non-CPA appraisers recognize *SSVS* for what it is: something created by the accounting community to gain appeal and BV mind-share, nothing more.

Response 1: *SSVS* was indeed created by and for the accounting community. It is incorrect that *SSVS* is limited to financial reporting appraisals. While *SSVS* does apply to financial reporting appraisals, it also applies to all other types of valuations including tax, ESOPs, disputes, dissenters' rights, marital and business divorces, etc. While *USPAP* was indeed the only standard mentioned by the IRS in one of its publications, there is absolutely no inference that other standards do not meet the same qualification. In fact, various conversations with current and former IRS employees indicate that *SSVS* would meet the requirements for a qualified appraisal.

It was never the intention of the AICPA to have *SSVS* become the “defacto” standard. It is targeted to members of the AICPA and most CPAs within most state boards of accountancy. It is not required for anyone else and there is no intention that it be any more than what it is— for CPAs. As to any hype, we are not aware of any hype that non-CPAs should comply with *SSVS*. While there has been a great deal of education on *SSVS*, that is not “hype.”

As to which standards to comply

with, we believe you should comply with whatever the standards are of any organizations/groups to which you belong. If you do not want to adhere to an organization's standards, then simply quit that organization. If you do not currently belong to any such organization, then adherence to either *USPAP* or the *SSVS* will enhance the efficacy of your product.

SSVS was not created by the accounting community to gain appeal and BV mind-share. As previously discussed, it was created to give CPAs guidance and to promote good practices. Given that three members of the original AICPA business valuation standards task force reviewed this article, we can assure you that this was the sole intention. Furthermore, to make a global statement that this is the view of non-CPAs is unsupported. The following was a succinct comment about *SSVS* from one of the members of the AICPA BV Standards Writing Task Force.

The *SSVS* was not put together so CPAs could strut around saying, ‘We have a standard.’ They took six years to develop, and a lot of effort went into getting them right. We had the AICPA looking over our shoulder with their over 100 years of standard-writing experience, helping us to get it right. It was needed because we felt that the ABV needed to have a set of standards to provide quality to holding the designation, and we also wanted to corral the CPAs doing valuation work and get them to follow standards to improve the overall quality of work in valuation done by CPAs.

Question/Comment 2: It is my firm belief that *SSVS* has no place in estate/gift tax (EGT) appraisals, but that *USPAP* has a place in financial reporting appraisals.

Response 2: CPAs must conform to *SSVS*, so they must follow *SSVS* in estate/gift appraisals as well as other types of valuations. We agree that if you belong to an organization that

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requires adherence to *USPAP*, that *USPAP* has a place in financial reporting appraisals. As stated previously, analysts may also elect to follow *USPAP* in any type of appraisal, including financial reporting. The following was a succinct comment about *SSVS* and estate and gift tax appraisals.

There are, literally, a few thousand appraisers following *SSVS* when preparing EGT valuations, including myself. And speaking just for myself, I have never run into a problem with that.

Please note that we believe there are many more than just a few thousand appraisers following *SSVS*. CPAs, whether they are accredited in business valuation (ABV) or not, must follow *SSVS*.

Question/Comment 3: I wonder how many CPAs who reference only *SSVS* (and not *USPAP*) in a high profile EGT case would be challenged by opposing counsel— and found to be wanting. I am curious to know, also, if the double-dippers will find themselves in a compromised position when they come under clever challenge. While the standards are not mutually exclusive, they don't appear to be identical either. Making all potential users of our BV work satisfied seems to me to be a path to insufficiency or maybe even failure.

Response 3: A great many CPAs reference only *SSVS* in estate and gift tax, as well as many other appraisal services. The reason is that they *must* adhere to *SSVS*, and many do not belong to any other BV groups that require *USPAP* compliance. Furthermore, there are many CPAs who are members of the ASA. This group is required to follow *SSVS*, *USPAP* and the ASA standards. See the following response from this discussion thread.

There is no requirement to use *USPAP* for EGT valuations. The IRS will accept any reasonable set of standards and the *SSVS* certainly falls in that category. There are thousands of CPAs using *SSVS* and to my knowledge the IRS has not challenged the use of those standards. To say that one cannot

use solely *SSVS* for EGT is simply false.

Question/Comment 4: But be aware that the standards are not as complimentary as some may suggest, as illustrated by the AICPA-based challenges to *USPAP*. It is a power grab of sorts. Be prepared to defend your compliance with *USPAP* and to defend how you can potentially drive on both sides of the road at once.

Response 4: Actually, the standards of the AICPA, ASA, IBA, NACVA and the Appraisal Foundation's *USPAP* are quite complimentary. The original group that wrote the AICPA standards was very careful to review all the other standards and to make them as similar as possible. For example, *SSVS* and *USPAP* are very similar. In the last few years, NACVA and the IBA did an admirable job in revising and merging their standards. That process also made them complimentary to *SSVS*. There are some differences, but the overall standards are very similar. The ASA has more specific requirements than the other three sets of standards but, again, they are generally very similar.

We are not aware of any AICPA-based challenges to *USPAP*. There is no power grab. This is fiction, not fact. As to driving on both sides of the road, which we assume means adhering to multiple standards, see the following responses from this discussion thread.

- Being the conservative accountant that I am, it sounds like there would be no downside to making sure I am in compliance with both *USPAP* and *SSVS*.
- As a non-CPA who has worked inside of a CPA firm and continues to sub-contract with CPA firms, I am required to be in compliance with *SSVS 1*. As an ASA, I am required to be in compliance with *USPAP* for the appraisal services that I perform, and ASA's BV standards. Just to keep things interesting, I am an AVA and therefore required to be in compliance with the NACVA professional standards. I have found nothing that prevents me from being in compli-

ance with these standards at the same time. Sure, there are terminology differences, but I don't think that there are substantive differences between what these standards are trying to accomplish for us professionals...

- I am also subject to all three standards and find they complement each other nicely and actually work to make our work stand out in some respects when we can say we are in compliance with all three.
- I am a full-time ASA appraiser who also happens to be a registered CPA (not licensed and do not perform any attest functions as a CPA) and am a member of the AICPA. So, my understanding is that I must comply with *SSVS* in addition to *USPAP*. My read of the *SSVS*, however, did not reveal serious areas of disagreement with *USPAP*.
- I have studied the standards of all five major credentialing organizations, and I haven't found any significant areas of disagreement or incongruence with *USPAP*.
- If my only designation was the 'AVA,' as issued by NACVA, and the only set of standards that I was subject to was the NACVA professional standards, I personally would have no problem calling myself a 'qualified appraiser,' as required by the Treasury regs. Would the IRS accept my assertion? Given the 'SKEET' test: skills, knowledge, education, experience and training, I think I'd pass the test.

Question/Comment 5: First, only CPAs utilize *SSVS*, non-CPAs do not— nor would many of us want to. That is a point of clarity that I don't think has been made. Again, only CPAs have any requirement to use *SSVS*. The number of non-CPAs in the BV profession is something that should be considered as well.

Response 5: It is not true that only non-CPAs utilize *SSVS*. There are a great many non-CPA analysts who
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work for either a CPA or a CPA firm where they follow SSVS. We have heard very few complaints about this. Non-CPAs who do not work for a CPA or CPA firm may do as they wish. They can follow SSVS or USPAP or any other set of standards. This is really a non-issue.

Question/Comment 6: I am reminded by an email that I just received that I provide "opinions" of value, not "conclusions" of value. The former is an appraiser term; the latter is an accounting term. Subtle perhaps, but telling as well.

Response 6: All appraisers, regardless of their affiliations, prepare *conclusions* of value. The word *opinion* comes up in two well-known contexts: legal and accounting. An appraiser, whether a CPA or not, can offer an opinion of value. There is no prohibition against CPAs offering opinions of value and many do so, particularly in a dispute/legal environment. In a courtroom, the expert must have an opinion. See the following response from this discussion thread concerning the accounting side.

Actually 'opinion' is an accounting term, referring to financial statement auditing, as in an unqualified opinion, qualified opinion, disclaimer opinion, and an adverse opinion. It was precisely for this reason that SSVS instead uses the term 'conclusion.' Similarly, SSVS uses the term 'representation,' rather than 'certification.'

Question/Comment 7: Maybe I'm missing something, but it seems to me the USPAP vs. SSVS vs. other standards "battle" was won/lost/drawn years ago already. We're now in the era of "let's work with what we have and keep going." CPAs will always do valuation work, and ASAs will always include a large constituency of non-CPAs. Okay. Fine. Move on. My understanding is that several organizations continue to look for ways to collaborate on standards writing as well as other opportunities to serve their members. They'll tell us when they have something substantive to share. We all benefit when the sister organi-

zations propel us through competition to continue to learn and serve client needs well.

Response 7: We agree. There is a lot more cooperation among the four U.S. BV groups concerning standards than many members know about. For example, NACVA presented a multi-standards presentation at its 2012 Annual Consultants Conference on June 22. Its title was "Unifying Industry Standards - Bringing Everyone to the Table." There were representatives from NACVA, IBA, ASA, AICPA and the Canadian Institute of Chartered Business Valuators. The panelists agreed that there were a lot more points in common than differences and that complying with multiple standards was not really that difficult.

Another example is when the Appraisal Foundation convened in a meeting in Washington, DC on April 23, 2012. The program title was, "The Business Valuation Profession as it Relates to Financial Reporting: Where Are We Headed?" While this meeting was focused on valuations for financial reporting, the discussion again shows the cooperation among various groups. For example, one of the co-chairs was the managing director in a business valuation firm and the other co-chair was a partner in the valuation group of a Big Four accounting firm. Both co-chairs were ASAs. There were representatives from the Securities & Exchange Commission, the Financial Accounting Standards Board, academia, the Public Company Accounting Oversight Board, the CFA Institute, the Appraisal Foundation, a large international appraisal firm and representatives from the Big Four accounting firms. The discussion addressed BV standards as well as valuation procedures, best practices and quality control and enforcement. It was a very collaborative atmosphere.

Participants at the meeting included representatives from NACVA, the International Association of Consultants, Valuators and Analysts, ASA, the Royal Institution of Chartered Surveyors, the Appraisal Institute, the AICPA, Office of the Comptroller of the Currency, International Valuation Standards Council,

the National Association of Realtors and various appraisal, accounting and investment advisory firms.

You couldn't have gotten a more diverse group to discuss valuation issues. The discussion and question/answer sessions were blunt, professional and enlightening. We hope to hear more from the Appraisal Foundation's efforts to solve some of our professions problems.

Question/Comment 8: As long as SSVS is out there in its current form, the analyst undertakes significant risk in forming an opinion based on a calculation. By definition, a calculation engagement does not lead to an opinion of value. An appraisal does. However, and more importantly, is the scope you have undertaken sufficient to render the opinion you advocate? Again I refer to the USPAP Scope of Work Rule as a great litmus check for this question.

Response 8: First off, all four U.S. BV groups allow calculations. As such, they recognize a need in the BV profession to have a lesser work product. This need also exists for clients and client representatives such as accountants and attorneys. Calculations can be used for such services as preliminary estate planning, preliminary mergers and acquisition analyses and preliminary values for settlement purposes in litigation. Note the word *preliminary* in each of these examples of when calculations can be used. However, it is also true that there is no requirement to have *only* preliminary calculations. CPAs are free to provide calculations any way they see fit as long as it complies with SSVS.

The most important limiting language in SSVS for a calculation is as follows:

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

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limited than those of a valuation engagement)...The valuation analyst expresses the results of these procedures as a calculated value...A calculation engagement does not include all of the procedures required for a valuation engagement... (p. 13, 21.b.)

(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. (p. 34, 76.g.)

Some CPAs are providing calculations, calculated values and calculation reports as their only and final value in a litigation setting. Some are also offering calculated values as their opinion of value. Remember, in a litigation setting an expert opinion must be with "reasonable certainty." While there is no prohibition against this, from a practical perspective, why would you want to? If you are admitting that a calculation engagement does not include all of the procedures required for a valuation engagement and had a valuation engagement been performed, the results may have been different, how can this be with reasonable certainty? Saying that your opinion of the calculated value of XYZ Company is \$4,000,000 is like saying that my opinion (with reasonable certainty) of the calculated value (without reasonable certainty) of XYZ Company is \$4,000,000.

Other comments from this discussion follow:

- And I can see some attorney trying to get some poor hapless 'expert' to state his 'opinion' of the 'calculated value.'
- It [a calculation] is not in conflict with the SSVS to testify as to a calculation. Just making that clear. That is not a violation of the SSVS. However, one would be rather silly to do so. The calculation provisions were put into the SSVS to aid the CPA/ABV in instances where something less than a full valuation was needed. That occurs

in a non-litigation situation. It was wanted by the profession when SSVS was put together and it is a very useful tool in some cases. It is not likely to ever be taken out of the SSVS.

- Unless I am misunderstanding something, when you testify as an expert, you testify as to your opinion. With a calculation, you have not formed an opinion.
- While I agree in part to your assessment of calculation engagements, they do have a place. We use them extensively in a transition planning exercise for business owners. We typically provide a range of value under three scenarios— a value on a minority, non-marketable interest basis, a financial control basis and 'strategic' value basis. The 'report' is not designed to be used for any gifting or, for that matter, to support any filing with any 'authority.' It is in its simplest form a discussion vehicle.
- There is nothing in *SSVS 1* that restricts one from saying their opinion of the calculated value is X, but we made it clear that we would not do it or recommend others using opinion with a calculation level of service. I make it very clear in our calculation reports and our accompanying engagement letter that we will not testify to a calculated value that is provided for planning and settlement purposes only. We have often been engaged to upgrade our calculation to a conclusion when a particular matter does not settle, and for the record, normally do full conclusions at the outset anyway. That said, I find it is a great service to be able to provide calculations based on agreed upon parameters, when the circumstances warrant and most of this calculation work is outside of litigation anyway for tax planning, M&A and the like.
- We are often asked to provide a calculation service when in fact they are asking for an opinion of value to be used either in a litigation

environment or for a gift for example. We always decline— our process tries to ferret out the reasons— the real reasons behind the potential assignment. Calculation engagements are useful when the user understands the limits of the service and we are not trying to provide a 'cheaper' service to suffice for what we should be providing.

- As for the reporting standard for calculations, it is important for the user of a calculation to understand what is being provided. The requirements and suggested wording for a calculation report clearly state what a calculation is and what it is not. As pointed out, feel free to highlight, make bold, or add any other limiting phrases you like to your report. If you are concerned about other calculation reports, they are the responsibility of the preparer and as noted, if anyone uses a calculation in litigation they do so at their own peril.

CONCLUSION

Ed Dupke, former chair of the AICPA BV Standards Writing Task Force, offers a concise summation:

As as ASA, I follow and respect the ASA Standards and *USPAP*. As a CPA and as one of the authors, I follow and respect *SSVS*. I think that the standards committees of NACVA and IBA did an outstanding job in bringing their standards together. I respect the work those talented individuals did. I would hope that in the near future, we could reach a point where we all agree that there is quality in all of these standards and respect each others work conforming to these standards.

We want to thank all the nameless participants who posted in this LinkedIn discussion. While some were more vitriolic than others, it at least got the discussion going. We'll end this article with an appropriate comment from one of the LinkedIn participants. "Only BV appraisers could make over 100 comments on the topic '*USPAP* vs. *SSVS*.'" 