

It's Still a Matter of Professional Judgment

By Rod P. Burkert, CPA/ABV, CVA

Do you know the difference between a valuation engagement and a calculation engagement? Or do you just think you know? Here's an excerpt of a recent discussion on a LinkedIn valuation group (I've corrected some misspellings to protect the innocent).

Party 1: A Calculation of Value in accordance with SSVS1 should only be utilized *when the appraiser is not making any judgments*, in other words, simply following a formula given to her/him (emphasis added).

Me: I think you are incorrect. A calculation limits which approaches, methods, and procedures are applied. It does not limit the appraiser's judgment in how the selected approaches, methods, and procedures are applied.

Party 1: See Paragraph 21 b of SSVS1. I know I am correct. Have had many discussions with AICPA members on this. A Calculation is not a Conclusion of Value found in the other types of analyses and reports. *It is simply calculating a value in accordance with an agreement, such as a buy-sell* (emphasis added).

Party 2: This could turn into a fun discussion on what a "calculation" really is and what it isn't. I think many BV professionals handle it as Rod suggests, taking a position that there has been an agreement reached between them and the clients as to what methodologies are applied. In my opinion, it does not necessarily mean that the BV professional cannot exercise judgment . . .

Me [to Party 1]: If I was valuing a company in which both a DCF and a completed transaction method would apply, and we limit the engagement to DCF because of time or budget constraints, my judgment is not limited in how I develop the DCF. In the buy-sell situation that you describe above, I am not even sure that it falls within the bounds of SSVS since it sounds like you are describing a "mechanical calculation." And if I am wrong, I will happily 'fess up.

Party 3: [Party 1], the big difference in the calculation and the opinion of value is that the valuator is limiting their choices of methods and procedures to what is agreed upon. The value is then calculated based on that agreement. The valuator's experience and judgment will always come into play in an assignment.

Party 4: I agree with Rod re: the calculation engagement. *It does require professional judgment*, but your scope has been limited in terms of approaches/methodologies used. Once a method is decided upon, the appraiser uses that method just as he/she would in a valuation engagement, *so professional judgment is required*. (emphasis added)

Party 1: Thanks for your input [to Party 4]. But it still is not an Opinion of Value but a calculated amount based on agreed upon procedures. *Still creates confusion*. (emphasis added)

Me [to Party 1]: The only confusion created is if we don't clearly state in the report exactly what we did and what we didn't do. I draw an analogy to an agreed-upon procedures engagement:

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here's what we agreed to do . . . here's what we did . . . and here's the result.

Party 1: Thanks to everyone who contributed to this discussion. I think many more could benefit from it.

You would think, with all the standards interpretations, webinars, and conference presentations discussing the types of engagements and types of reports, that we appraisers would be on the same page when it comes to something as basic as this. And yet . . .

From ¶121b, here is how the SSVS #1 defines a 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. . . .^{1,2}

So let me restate my position from the conversation above. A calculation engagement limits which approaches, methods, and procedures are applied. It does not limit the appraiser's judgment in how the selected approaches, methods, and procedures are applied. For example, if I am valuing a company in which both a DCF and a completed transaction method would apply—and the client and I limit the engagement to a DCF because of time or budget constraints—my

- 1 The IBA and NACVA *Professional Standards* define a calculation engagement as “when the client and member agree to specific valuation approaches, methods, and the extent of selected procedures and results in a Calculated Value.”
- 2 The ASA *Business Valuation Standards* state: “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.”

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professional judgment is not limited in how I develop the DCF.

Further, Party 1's belief that a calculation engagement "is simply calculating a value in accordance with an agreement, such as a buy-sell" is not true. At ¶19(b), SSVS #1 states: "This Statement 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."

So if we are not using our professional judgment, not only are we not performing a calculation engagement, we're also outside the boundaries set by the SSVS.

If you are looking for some language to put in your calculation reports, here's what I use. It's a little more comprehensive than the SSVS-suggested disclosure, but I believe it can serve to eliminate some of the confusion that Party 1 sees with a calculation engagement.

Under the respective standards of the American Institute of Certified Public Accountants and the National Association of Certified Valuation Analysts, the scope of my work constitutes a "Calculation Engagement," whereby I estimated

the fair market value of the Subject Interest using the agreed-upon methodology outlined on page x.

A Calculation Engagement does not include all the steps required for a "Valuation Engagement" as that term is defined by the above-referenced standards. However, the scope of work I performed is intended to produce a credible result in order to estimate the relevant range of the fair market value of the Subject Interest for the purpose and intended use of this report. But the result could change if additional procedures were performed, and the extent of change may be material.³

I hope this proves useful. I welcome feedback. Let me know what you think!

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³ I have very similar language in my engagement letter, except that I also add this: "The scope of work performed and the result reached should not be relied upon for use in any legal proceeding [unless I agreed to do a calculation for a negotiation or non-binding mediation], and I will not testify as to the report's calculated value."