# Calculation Engagement versus Valuation Engagement in a Family Law Context—Can a Valuation Engagement be More Efficient and Effective?

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*Within a family law context, legal counsel ("counsel") to each marital estate party may retain a valuation analyst ("analyst") to assist with certain equitable property settlement aspects associated with the marital dissolution. Namely, the analyst may be retained to estimate the value of certain marital property, such as a family-owned business ownership interest. In such instances, counsel may retain the analyst to perform either (1) a calculation engagement or (2) a valuation engagement. This discussion (1) highlights the differences between a calculation engagement and a valuation engagement within a family law context and (2) explains when each engagement may be most appropriate, efficient, and effective. This discussion also includes a summary of certain business valuation professional standards and practices associated with each type of engagement.*

## Introduction

Over the last several decades, Americans have been getting divorced at an increasing rate. Within these increasing marital dissolutions, both marriage parties are typically represented by family law legal counsel ("counsel").

Similarly, counsel rely on valuation analysts and forensic accountants (collectively, "analysts") in order to assist with certain property settlement aspects associated with the marital dissolution. In particular, analysts assist with estimating the value of certain marital property, and more specifically, assist with estimating the value of certain closely held business ownership interests that may be included in the marital estate.

According to the American Institute of Certified Public Accountants Statement on Standards for Valuation Services No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* ("SSVS"), there are two types of engagements that analysts may perform to estimate the value of a marital estate closely held business interest:

1. A valuation engagement
2. A calculation engagement.[1]

Generally, these are the two types of engagements for which an analyst would be retained by family law legal counsel within a marital dissolution context.

According to SSVS, a calculation engagement is performed when:

1. the analyst and the client (e.g., counsel)[2] agree in writing on the specific valuation approaches and methods the analyst will

use in calculating the value of the closely held business ownership interest and

2. the analyst calculates the value of the closely held business ownership interest according to the written agreement.

Further, according to SSVS, a valuation engagement is performed when:

1. the engagement letter specifically requires the analyst to estimate the value of the closely held business ownership interest(s) and
2. the analyst estimates the value of the closely held business ownership interest(s) and is not required to select certain valuation approaches (i.e., the analyst is permitted to apply the valuation approaches and methods he or she feels is most appropriate for the engagement).

This discussion explains the differences between a calculation engagement and a valuation engagement within a family law context. This discussion considers the appropriateness of each engagement within certain family law frameworks (including which of the two engagements should be utilized when the family law matter will likely end in trial or in arbitration).

Also, this discussion summarizes certain business valuation professional standards associated with the reporting of each engagement (i.e., a calculation report versus a valuation report).

## Calculation Engagement versus Valuation Engagement

When an analyst is retained by counsel to provide services in a family law context, typically the analyst is retained through what is termed an "engagement to estimate value."

While the analyst may be retained to provide other services within a family law context, such as general consulting or forensic accounting services, this discussion will focus on the situation where an analyst is retained to estimate the value of a closely held business ownership interest that is held within a marital estate.

SSVS provides guidance to the valuation profession with regard to the types of services, and more specifically the types of engagements and reports, that the analyst can provide in a family law context.

To avoid any relevant analysis being excluded from the family law proceedings, it is important for the analyst to adhere to relevant business valuation professional standards when being retained to estimate the value of a closely held business ownership interest within the marital estate.

The first procedure is for the analyst to understand what constitutes an engagement to estimate value. As explained in SSVS:

> **Engagement to estimate value**. An engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.[3]

Once it is determined that the analyst will be retained by counsel through an engagement to estimate value, the analyst and counsel should agree on what type of engagement the analyst will perform.

Two common types of potential engagements are described in SSVS:

> There are two types of engagements to estimate value—a **valuation engagement** and a **calculation engagement**. [emphasis added] The valuation engagement requires more procedures than does the calculation

engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client:

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.[4]

The next procedure is for counsel and the analyst to determine whether a calculation engagement or a valuation engagement is more appropriate. This decision will be based on the facts and circumstances of the individual family law matter.

## Is a Calculation Engagement or a Valuation Engagement More Appropriate?

Determining which level of service, that is, which type of engagement, is most appropriate when estimating the value of a closely held business ownership interest within a family law context can be problematic.

It is important that the analyst consider the circumstances surrounding each potential engagement, and discuss with counsel what the ultimate goal, result, and audience will be for the engagement.

A few examples may be helpful in understanding when a calculation engagement or a valuation engagement may be most appropriate.

First, let's assume that the purpose of the valuation is to assist with preliminary management planning associated with the potential sale of the closely held business ownership interest (i.e., not within a family law context).

In this circumstance, a calculation engagement is likely appropriate and acceptable as the goal is to estimate the value of the closely held business ownership interest in order to obtain an idea of what a hypothetical willing buyer may pay for said interest.

The hypothetical willing buyer would likely perform its own due diligence and analysis in order to estimate what it may pay for the closely held business ownership interest as well. Therefore, the result of the calculation engagement may be used as an initial negotiating tool in the up-front discussions with the hypothetical willing buyer.

While updating the calculation engagement to a valuation engagement (once an agreement to sell has been finalized) may be appropriate, a calculation engagement can be a suitable and cost effective option to a valuation engagement when the purpose is for general management planning purposes.

Second, let's assume that the individual with the same closely held business ownership interest is involved in a family law matter. Further, let's assume that the family law matter will require a division of the relevant assets held within the marital estate.

One of the more significant assets in the marital estate may be the closely held business ownership interest. Therefore, a value needs to be estimated in order to equitably divide the value of the closely held business ownership interest between the marital parties.

If the family law matter is in its early stages, then a calculation engagement may be appropriate in order to assist with up-front settlement discussions.

However, it is important for the analyst (and for the counsel) to consider that in proceedings that may end up in a court of law or arbitration, the selected engagement should ultimately adhere to the standards of a valuation engagement, allowing the analyst to opine on an estimated *conclusion of value*.

As mentioned above, a calculation engagement results in a calculated value, not a *conclusion of value*, which provides the analyst's direct opinion or conclusion that can be easily testified to or defended in court or arbitration.


In fact, SSVS explicitly states that in a calculation engagement, the analyst should disclose that the calculation engagement does not include all the procedures required of a valuation engagement.

Further, SSVS requires the analyst to state that if a valuation engagement had been performed, then the resulting indications of value may have been different.[5]

Due to this difference, among others, many analysts will not testify in a court of law or arbitration without having completed a valuation engagement that results in a *conclusion of value*, which, again, represents the analyst's professional opinion or valuation conclusion.

While marital dissolutions have the ability to be settled prior to any formal court or arbitration proceedings, the analyst should be wary of completing calculation engagements within a family law context. This statement is true for several reasons.

The first reason is efficiency. If a valuation engagement is completed as the initial engagement, then there will be no need for counsel to request an update once the family law matter proceeds to court or arbitration.

The valuation engagement can be more efficient by saving additional costs and fees associated with:

1. completing a calculation engagement/report and
2. having to update the calculation engagement/report to a valuation report.

The second reason is: in updating from a calculation report to a valuation report, the value conclusions of the subject business can change significantly. This is because in a calculation engagement, the analyst and the client (i.e., counsel) agree on the valuation approaches and methods the analyst will use, rather than the analyst applying the valuation approaches and methods that he or she deems most appropriate in the circumstances.

Further, the degree of analysis in a valuation engagement is typically more robust than the degree of analysis in a calculation engagement, which can contribute to large discrepancies in value indications between the two reports.

The third reason is: as previously mentioned, analysts will often not testify in a court of law or arbitration without having completed a valuation engagement. This can result in an unsupported analysis, and/or additional expense, for counsel and the marital parties.

This is not to say that each family law engagement should be a valuation engagement. A calculation engagement may be appropriate for purposes of up-front settlement discussions outside a court of law or arbitration.

However, the analyst, and counsel, should both reasonably consider the goals, result, and audience in order to determine which engagement would be most appropriate within a family law context.

## Applicable Standards for a Valuation Engagement or a Calculation Engagement

As mentioned, SSVS is one set of professional standards that provide practitioner guidance to the business valuation profession. While SSVS is promulgated by the American Institute of Certified Public Accountants ("AICPA"), it provides relevant guidance to all analysts (and not just to certified public accountants).

This is because, while different organizations have different business valuation professional standards, there is a relative commonality to the relevant business valuation standards and procedures within each organization that can assist the analyst in performing assignments properly.

> "Regardless of which VPO standards the analyst selects to adhere to, the analyst should ensure that each segment of the valuation complies with all applicable professional standards of the selected VPO."

Some examples of other valuation professional organizations ("VPOs") professional standards include the following:

1. *Uniform Standards of Professional Appraisal Practice* ("USPAP")
2. National Association of Certified Valuators and Analysts ("NACVA") Standards.

For example, if the analyst agrees with counsel to enter into a valuation engagement, the following professional standards from the AICPA, USPAP, and NACVA specific to the valuation engagement may apply:

- NACVA Professional Standards II General and Ethical Standards; Standard III Scope of Services (B)(1) Valuation Engagement; Standard IV Development Standards; and Standard V Reporting Standards (C)(1) Contents of Report for detailed reports and (C)(2) Contents of Report for summary reports
- SSVS No. 1 0.21(a), .23 through .45 for valuation engagements, .48 (a) and (b), .51 through .70 for detailed valuation engagement reports; .71 and .72 for summary valuation engagement reports
- USPAP Standard 9 Business Appraisal, Development and Standard 10 Business Appraisal Reporting; specifically, Standard 10-2(a) for a detailed report and Standard 10-2(b) for a summary/restricted report

Alternatively, if the analyst agrees with counsel to enter into a calculation engagement, the following professional standards from the AICPA and NACVA specific to the calculation engagement may apply:

- NACVA Professional Standards II General and Ethical Standards; Standard III Scope of Services (B)(2) Calculation Engagement; Standard IV Development Standards; and Standard V Reporting Standards (C)(3) Contents of Report for calculation reports
- SSVS No. 1 0.21(b), .46 for calculation engagements, .48(c), .73 through .77 for calculation reports

It is noteworthy that USPAP does not have an alternative to a valuation engagement, such as a calculation engagement as referenced in SSVS and NACVA professional standards.

If an analyst is required to follow USPAP in performing a closely held business valuation, then the analyst should follow all applicable USPAP standards for a valuation engagement (i.e., a full appraisal engagement—as there is no calculation engagement, or calculation report, option within USPAP).

Regardless of which VPO standards the analyst selects to adhere to, the analyst should ensure that each segment of the valuation complies with all applicable professional standards of the selected VPO.

## Calculation Report versus Valuation Report

Once the appropriate type of engagement (i.e., a calculation engagement or a valuation engagement) is determined, the analyst should then prepare a report commensurate with the selected engagement.

If the analyst is required to produce a valuation report (as a result of being retained on a valuation engagement), it is important for the analyst to follow applicable professional standards in completing the valuation report.

The AICPA (and specifically, SSVS), among other professional standard organizations (including the VPOs presented above), provides guidance with regard to the content and presentation of a valuation report.

It is noteworthy that SSVS provides two options with regard to a valuation report:

1. A valuation engagement, detailed report
2. A valuation engagement, summary report

For purposes of this discussion, we present only the structure of a valuation engagement, detailed report.[6]

As described in SSVS:

> The detailed report is structured to provide sufficient information to permit intended users to understand the data, and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement or financial information analysis
- Valuation approaches and methods used
- Valuation adjustments
- Nonoperating assets, nonoperating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendixes and exhibits

> The report sections previously listed and the detailed information within the sections described in the following paragraphs . . . may be positioned in the body of the report or elsewhere in the report at the direction of the valuation analyst.[7]

If the analyst is required to produce a calculation report (as a result of being retained on a calculation engagement), as mentioned above it is important for the analyst to follow applicable professional standards in completing the calculation report.

SSVS also provides guidance with regard to the content and presentation of a calculation report. As presented in SSVS:

> . . . a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst . . . , but adapted for a calculation engagement.[8]

More specifically, SSVS presents a checklist of what should be included in a calculation report. As described in SSVS:

> The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:
>
> a. Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.
>
> b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
>
> c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
>
> d. The calculation engagement was conducted in accordance with the *Statement on Standards for Valuation Services* of the American Institute of Certified Public Accountants.
>
> e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
>
> f. The estimate of value resulting from a calculation is expressed as a calculated value.

g. A general description of a calculation engagement is given, including that

   i. a calculation engagement does not include all of the procedures required for a valuation engagement, and

   ii. had a valuation engagement been performed, the results may have been different.

h. The calculated value, either a single amount or a range, is described.

i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.

j. The date of the valuation report is given.

k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.[9]

It is noteworthy that the above professional standard guidance is only a brief summary of some of the standards presented in SSVS.

It is the responsibility of the analyst to ensure that the presentation of the estimated value indications, as a result of completing a calculation engagement or valuation engagement, adhere to all relevant standards as presented in SSVS (or adhere to all relevant standards as proffered by USPAP and the NACVA).

## Summary and Conclusion

Counsel often have to work with—and rely on—analysts in order to assist with certain property settlement aspects associated with family law matters.

In particular, counsel have to work with—and rely on—analysts to assist with estimating the value of family-owned or other closely held business, business ownership interests, debt and equity securities, or intangible assets owned by the marital estate.

In assisting counsel, the analyst may decide (in conjunction with counsel) whether the engagement should be a calculation engagement or a valuation engagement. The AICPA (through the application of SSVS) and other VPOs provide professional standards guidance with regard to the structure and requirements of a calculation report and a valuation report.

However, regardless of the selected VPO standards to which the analyst will rely on in completing the engagement, it is important to consider the goals, result, and audience for each engagement when determining whether a calculation engagement or a valuation engagement is most appropriate within a family law context.

This is because, depending on the selected engagement, the analysis:

1. may be overly expensive due to having to update from a calculation engagement to a valuation engagement,
2. may not be effective based on potential significant changes in the value indications when having to update from a calculation engagement to a valuation engagement, and
3. may not be property defended at trial or at arbitration, if at all.

Notes:

1. SSVS, .21.
2. It is important to note that the analyst can be directly retained by the husband or wife, rather than by counsel, and may be retained by the husband and wife on a joint basis (or retained by the husband and wife on a joint basis through counsel). A joint retention means that the estimated value concluded by the analyst, as a result of a calculation engagement or a valuation engagement, will be accepted by both parties.
3. SSVS, .82.
4. Ibid, .21.
5. Ibid, .76.
6. As presented in SSVS paragraph .48, "Valuation engagement—summary report. This report may be used to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .71). For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client."
7. SSVS, .51.
8. Ibid., .73.
9. Ibid., .76.

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