I Need a Valuation, But Do I Need a 'Valuation'?

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Owners of privately-held businesses may wonder from time to time what the business is worth. Unlike a public company where its stock is traded and the value of shares is easily determined, the value of an ownership interest in a privately-held business is not so easy to determine. Certain situations such as federal tax reporting call for a "qualified appraisal" to be performed. This requirement aligns with what valuation professional standards refer to as a "valuation engagement". Other situations, such as personal financial planning or establishment of a business value enhancement program, are less formal and allow for more flexibility in the type of analysis and work product. In these situations, we have found that a "calculation of value" can be the right mix of diligence, time and cost to achieve the purpose. The AICPA valuation standards refer to a "calculation engagement" as follows:

"An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range."

Calculations of value can provide a business owner with an estimate of value (or a range of value) that can allow for personal or business planning decisions to be made with a reasonable degree of confidence. Depending on the plan that is implemented and the resulting transactions, a more formal valuation may be needed. In this case, the work performed for the calculation is usually not lost, but rather updated and supplemented with additional procedures and reporting to elevate the calculation to a valuation.

Another good use of a calculation of value is as part of a business value enhancement program. This type of program combines business reporting (key performance metrics) and periodic updates to a business value estimate. The business reporting scorecard gives owners and managers a frequent (i.e., monthly or quarterly) update on the critical metrics that indicate a positive or negative impact on business value. Then the periodic (i.e., semi-annual or annual) business value update confirms what the key performance indicators have signaled in the interim. Again, this is not a situation where the procedures and expense of a valuation engagement are needed. A calculation can be efficiently updated to provide a reasonable estimate of value at any given point in time, and to demonstrate the trend in value from prior periods resulting from various management and operating strategies and tactics implemented along the way.

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