choosing the right apprais

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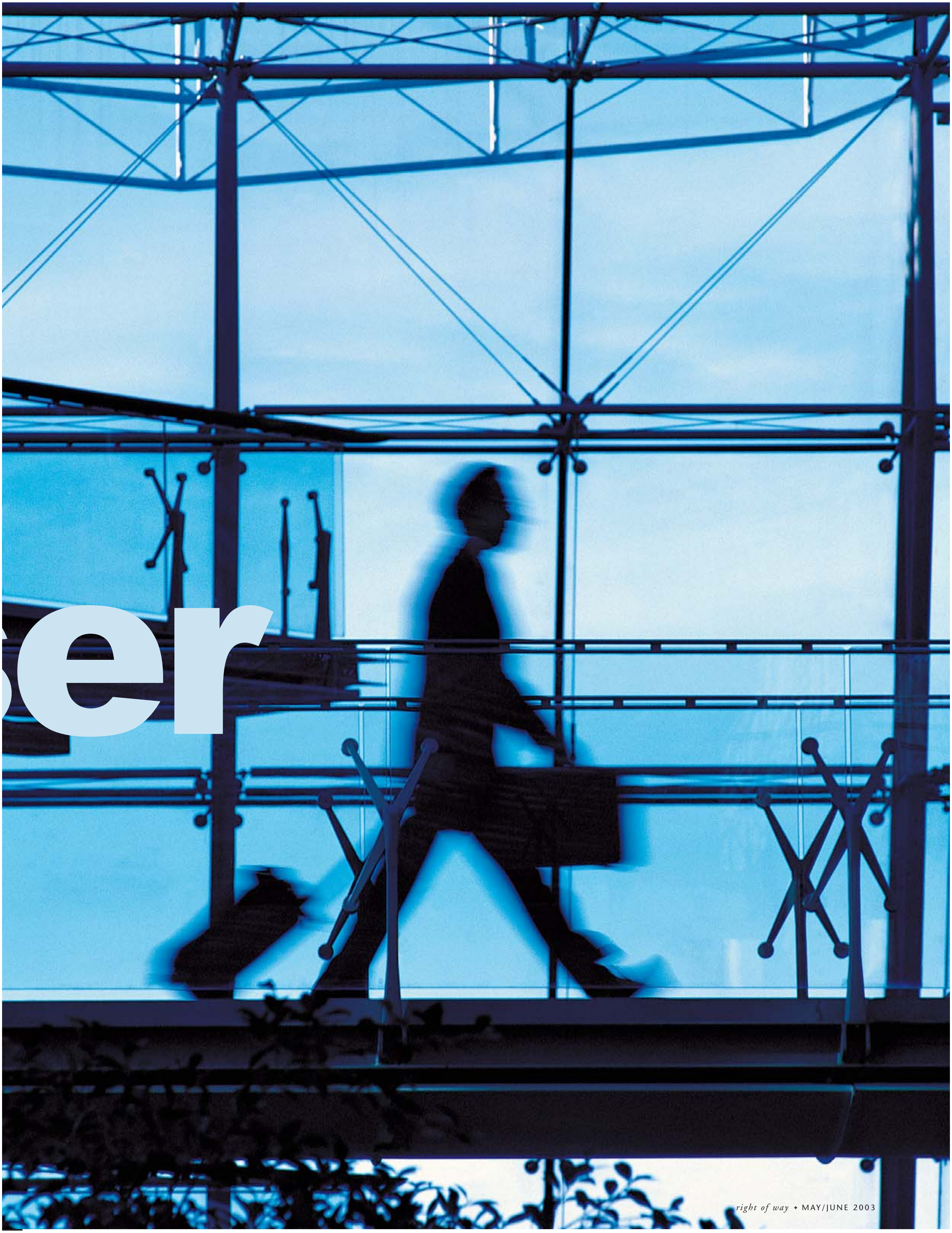
Right of way professionals often require the assistance of business appraisers when planning and implementing acquisitions of properties where businesses are located. Often times, acquisitions require the use of eminent domain, in which litigation cases often ensues. It is important to consider professional background, experience, training and professional accreditations when choosing an appraiser.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Business valuations require a competent, experienced and objective specialist to complete work that will pass muster and withstand scrutiny and criticism. Becoming such a specialist requires dedication to learning, practicing and developing the field of business valuation. Due to inherent conflicts of interest and the time and effort necessary to develop reliable, well-documented appraisals, business valuation is not a field that can be practiced part-time.

Most professional fields face very little confusion. Lawyers are seldom asked to perform surgery and patients typically do not ask physicians to provide legal advice. However, there is often confusion between the accounting and business appraisal fields. Of all professional service businesses, accounting firms are most commonly asked to provide valuation opinions. This article focuses on the differences between accounting firms and business appraisal firms, as well as the importance of choosing the right person for business valuation services.

APPRAISERS AND ACCOUNTANTS – VIVE LA DIFFÉRENCE!

A business appraiser specializes in the analysis of a business from every angle: the appraiser must analyze industry, competitive and economic environments; historical and projected financial performance; business sale information; relevant statutes; and many other areas to perform a thorough business valuation. In contrast, accountants specialize in the preparation, presentation and review of historical financial statements. Just as a business appraiser is not necessarily qualified to audit financial statements, not all certified public accountants (CPAs) are qualified to perform business valuations.

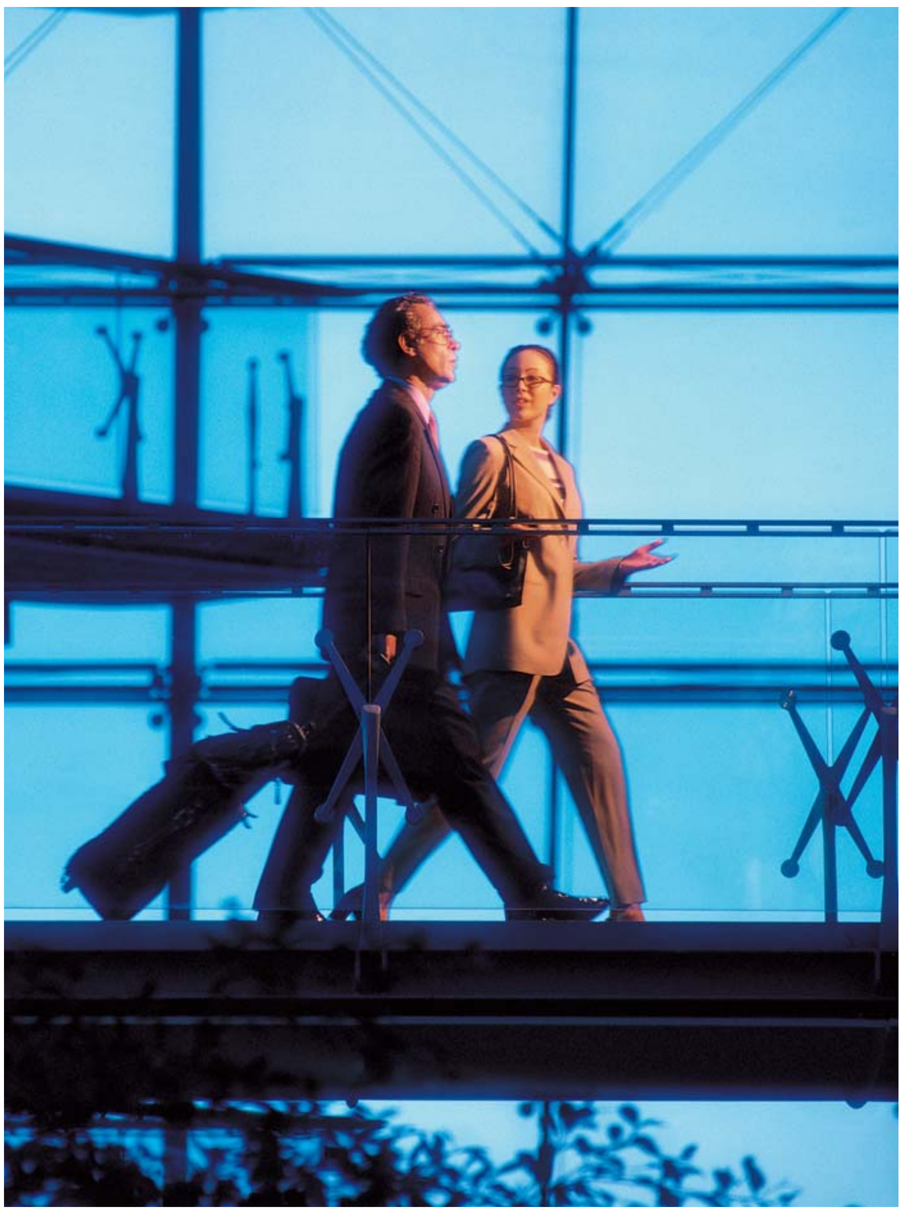
Right of way professionals need to be aware of the potential conflicts that may arise when hiring any firm that does not specialize in business valuation to perform a business appraisal, the different designations available for business valuation professionals, and the benefits of retaining a qualified and experienced business valuation specialist.

CONFLICTS OF INTEREST

Conflicts of interest may arise when firms that offer a variety of services are hired to perform business valuations for current or prospective clients. Typical conflicts include:

• CPAs often face inherent conflicts of interest by offering services that require advocacy (such as tax accounting) in addition to business valuation services, which require independence. Even if the accountant currently has no relationship with the business other than to provide business valuation services, the mere fact that the accountant offers tax, audit and other services that could be used by the business can be considered a conflict of interest. According to business appraisal standards, this relationship between the accountant and the client could be interpreted as "a contemplated future benefit."[1] In a litigation setting, even the appearance of a conflict of interest could

BUSINESS VALUATIONS IS NOT



seriously undermine and/or disqualify the appraisal opinion, leaving the client without adequate support for their position.

• In the article "As Business Valuation Niche Grows Among Firms, So Do Liability Claims," John Rasponte, CPA and manager of Camico's Mutual Insurance Co., points out this conflict of interest that arises when CPAs are hired for business valuation purposes. "We often see practitioners undertake business valuations who rarely do them. The reason they take on the engagement is that they have a long-term relationship with the client. They have no expertise or formal training and this contributes to the risk."[2]

Many valuation engagements are accepted by CPAs because they do not want to send their clients elsewhere, they see an opportunity for additional fees, or they just do not want to say no to a client. This is an alarming motive when the individual should be considering what is best for the client.

• A CPA may be inclined to use inaccurate or controversial methods, assumptions and techniques to manipulate values and create, improve or maintain client relationships. As a result, the validity and reliability of the valuation could be questioned, criticized, and ultimately, disregarded.

• It is very difficult to value a business from a critical perspective when the CPA valuing the business is also responsible for the preparation of the company's financial statements. Simply put, the CPA is not going to analyze the financials and current position of the company in the same objective way that an independent party or buyer would. This could prove to be costly and time consuming to the company, public agencies and their attorneys if a valuation engagement is questioned because of this lack of objectivity.

TRAINING, COMPETENCE AND EXPERIENCE COUNT

Training, competence, experience and the proper professional accreditations in business valuation are central when choosing the right person for business valuation services. Hiring an appraiser without the appropriate training and experience to perform a business valuation poses significant risk to the validity, credibility and reliability of the appraisal. Shannon Pratt, Ph.D., CFA, FASA, MCBA[3], the author of several of the most authoritative and widely referenced textbooks on business valuation, stresses the importance of choosing a competent, experienced and well-trained specialist to conduct business valuation services. "I keep hearing stories about what seems like incredibly bad business valuation practice. If bad appraisals are detected early enough, the client may suffer only the costs and delay of getting a more competent appraisal. If not detected early enough, the client may be disserved to the extent of an unnecessarily unfavorable and irreversible legal determination of value." [4]

A FIELD THAT CAN BE PRACTICED PART-TIME

Business valuations require a significant commitment to business valuation services that most CPAs simply cannot offer. Accounting firms perform so many services for their clients that they are unable to dedicate the time and resources required for sound business valuations that withstand the scrutiny of a courtroom environment. As a result, their opinions lack muster, says CPA Stephan Bravo. "I can tell you, the more I become exposed to the world of business valuations and the wholehearted commitment it takes to excel in this profession, the more I realize most CPAs only understand the tip of the iceberg." [5]

This lack of understanding often leads to simple mistakes that can seriously undermine an appraisal. According to James L. "Butch" Williams, CPAs commonly make business valuation mistakes such as: [6]

- Using an incorrect standard of value;
- Relying only on historical financial results (rather than the future outlook);
- Misapplying discount rates and capitalization rates;
- Making improper financial adjustments;
- Inadequate due diligence; and
- Applying inappropriate discounts and premium.

Pratt's book, "Valuing Small Businesses & Professional Practices – Third Edition," [7] similarly includes a chapter on common errors made by business appraisers that involve basic principles of business valuation and can be attributed to lack of experience and training.

Part-time practitioners of business valuation are much more likely to make such mistakes. In fact, according to deposition testimony, court transcripts and billing records, CPAs that perform business valuations typically spend, at best, one-quarter of their time working on business valuations and, at worst, one-twentieth of their time. This small percentage of time spent on business appraisals typically leads to a qualification issue in court. Judges have a duty to prevent unqualified expert testimony from being presented to a jury and are unlikely to allow CPAs with only a passing familiarity with business valuation to be presented to a jury as an expert in the field. This role as a "gatekeeper" is outlined in various court decisions:

Under the Rules [of Evidence], the trial judge must ensure that any and all scientific testimony or evidence admitted is not only relevant, but reliable. [8]

The initial question before us is whether this basic gatekeeping obligation applies only *to "scientific" testimony or to all expert testimony. We, like the parties, believe that it applies to all expert testimony.* [9]

To rely on the opinion of an appraiser that does not have the proper experience, staffing or research capabilities is highly risky in a courtroom environment. To withstand this scrutiny and thereby establish credibility with judges and jurors, a business appraiser with substantive experience and the proper credentials is absolutely necessary.

"Courts and other evaluators of business appraisal work products are becoming more sophisticated, resulting in growing expectations regarding the level of competence on the part of business valuers," says Pratt. [10]

The nature of accounting training emphasizes the objective historical perspective of compliance reporting. Business valuations, on the other hand, typically involve the analysis of more subjective future projections. Accountants without business valuation training and who do not devote a significant amount of time to valuation engagements may not have the skills and understanding of this type of required analysis. The judge may therefore decide that the CPAs opinion is not relevant or reliable, and exclude his or her testimony.

NOT ALL BUSINESS VALUATION DESIGNATIONS ARE EQUAL

Right of way professionals and their attorneys often look at professional designations in business valuation to ensure that an expert is trained, knowledgeable, experienced, qualified as an expert in court and able to withstand scrutiny. However, the various business valuation professional designations vary significantly in education, experience and performance requirements. Not all designations provide the same level of assurance that the expert is competent to testify in court.

There are four organizations in the United States and one in Canada that offer accreditations in business valuation. These organizations are the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators (CICBV), the Institute of Business Appraisers (IBA), the National Association of Certified Valuations Analysts (NACVA), and the American Institute of Certified Public Accountants (AICPA).

Below is a summary of the different designations:

- Established in 1936, the American Society of Appraisers offers the ASA designation. It requires five years of specific full-time experience in business valuation, submission of two full narrative valuation reports for peer review and approval, completion of four three-day courses and four half-day exams. All applicants must also engage in a thorough interview process, pass an ethics exam, and take a Uniform Standards of Professional Appraisal Practice (USPAP) class with an exam.

USPAP standards are the most widely cited and recognized set of professional standards for appraisals."

- Established in 1971, the CICBV offers the Chartered Business Valuator (CBV) designation. It requires an applicant to have two years of valuation experience followed by successful completion of six courses.
- Established in 1978, the IBA offers the Certified Business Appraiser (CBA) designation, which requires an applicant to complete one-day's equivalent in exams, submit two business appraisals demonstrating a professional level of competence, and complete at least two valuation assignments.
- Established in 1991, the NACVA offers the Certified Valuation Analyst (CVA) designation, which requires two years of valuation experience, an eight-hour pre-qualification exam, a CPA license, and a five-day course that includes one case study. The required two years of valuation experience is not defined.
- Established in 1997, the AICPA offers the Accredited in Business Valuations (ABV). It requires that the appraiser have "substantial involvement," in 10 business valuation engagements. The designation requires the applicant to take two three-day courses and two one-day courses with exams following each. There are no published standards specific to this designation.

The above associations (other than the AICPA) have established standards that are enforced to ensure that the valuation follows at least one set of guidelines. For members, compliance with these standards is mandatory.

BUSINESS VALUATION STANDARDS

Complying with thorough business valuation standards requires access to research and numerous other resources that are very costly. Pratt suggests a minimum library of updated research materials for anyone doing business appraisals. [12] These research materials are of vital importance to substantiate, support and reinforce the opinion of the expert. Inferior quality work that is not in compliance with standards results when business appraisals are done without the necessary research materials.

It is simply not economically feasible for most accounting firms to conduct business valuations that are in compliance with set standards. For example, it costs approximately $100,000 per year to maintain the necessary business valuation research materials and a library that includes:

- A developed reference library
- Subscriptions to numerous publications
- A case law library
- Access to many subscription-based online databases
- Training materials
- Files of reports and deposition transcripts of other experts
- Personnel to maintain and update the library and review the exponentially increasing flow of information on a daily basis

Based upon deposition testimony, transcripts and their own billing records, CPAs generally perform only 10 business

BUSINESS VALUATIONS REQUIRE A COMPETENT,

valuations per year. If a CPA were to perform the valuation engagement in compliance with set standards, they would spend approximately $10,000 per valuation on research and resources.[13] This is not economically feasible in light of the fact that the average valuation report generates approximately $10,000 to $20,000 in revenue. The cost to maintain the necessary resources to complete valuations that comply with set standards is simply too high for the limited number of engagements. As a result, CPAs perform valuations that are not in compliance with standards. Ultimately, the outcome of a case is compromised.

"Worse than bad case law resulting from poor appraisal work products (either written or oral) is that clients are not well served," says Pratt. "On the one hand, the court may not accept an appraiser's testimony that violates basic standards, resulting in a disservice to his or her own client. On the other hand, poor testimony sometimes goes unchallenged, resulting in a disservice to the opposing attorney's client." [14]

A business valuation specialist firm typically engages in over 200 business valuations per year. Therefore, only $500 is required per engagement to maintain the necessary research materials to comply with business valuation standards.[15]

WHAT ARE THE DIFFERENCES BETWEEN HIRING A SPECIALIST IN BUSINESS VALUATION COMPARED TO A CPA FOR BUSINESS APPRAISAL ENGAGEMENTS?[16]

Accredited Specialist in Business Valuation	Certified Public Accountant (CPA)
• 100 percent of time devoted to business valuations	• Only 5 percent to 20 percent of time devoted to business valuations
• Typically performs (certified form) over 50 business valuations per year	• Typically performs (non-certified form) 10 to 20 business valuations per year
• Prepares certified opinion of value in report form per professional standards	• Does not prepare certified reports that comply with any standards
• Maintains extensive resources devoted exclusively for business valuations	• Does not maintain the minimum necessary resources required for business valuations
• Experience in business valuations is guaranteed	• Experience in business valuations is not required
• Tested to guarantee a minimum threshold of knowledge of business valuations	• CPAs not tested to guarantee any minimum knowledge of business appraisals
• No inherent conflict of interest present to perform client business valuations	• Inherent conflict of interest arises from CPA/client relationship
• Extremely effective at advising counsel for cross-examination of opposing expert	• Often ineffective at advising counsel for cross-examination of opposing experts
• Trained in the overall analysis of past, present and future financial, business, industry, competitive and economic conditions	• Trained in preparation, presentation and review of historical financial information

CHOOSING THE RIGHT APPRAISER

Finding the best and most qualified appraisal expert is essential to the successful outcome of any litigation issue involving business valuations.

"We want the best appraiser, and we would not make a decision based on cost. That should not really be a concern," says Ron Aucutt, a leading estate-planning attorney. "I have not seen a good appraisal that didn't have the potential to pay for itself many times over. Clients generally understand this … I think the client is as well off investing in a good appraiser as in a good attorney." [17]

Robust business valuation opinions require the services of a competent, experienced and well-trained specialist. To ensure these qualities, an appraiser with the proper professional designation should be sought. It is also important to find business appraisers who devote themselves entirely to the practice of business valuation and comply with high professional quality standards.

HELPFUL RESOURCES

www.appraisers.org/findappraiser/

The American Society of Appraisers' directory of appraisers. Searchable by discipline/specialty, name, city, state, area code, postal code and country.

www.cicbv.ca/client/cicbv/cicbv.nsf/web/Members+Listing!OpenDocument

The Canadian Institute of Certified Business Valuators' listing of members alphabetically by region.

www.instbusapp.org/directory.asp

The Institute of Business Appraisers' directory of appraisers. Searchable by state, name, area code, zip code, city and expertise.

www.nacva.com/US_guide/US_guide.html

The National Association of Certified

EXPERIENCED AND OBJECTIVE SPECIALIST

Valuation Analysts' directory of appraisers. Searchable by geographical location, and by name.

www.aicpa.org/accredrefweb/abvsearch.asp

The American Institute of Certified Public Accountants' directory of appraisers. Searchable by location, zip code and area code.

www.irwaonline.org

Web site of the International Right of Way Association including news, events, and a membership directory of right of way professionals.

www.eminentdomainonline.com

Web site for right of way professionals including news, message boards, and a consultant directory searchable by type of consultant and state. ❖

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[1] Pratt, Dr. Shannon. The Lawyers Business Valuation Handbook. Chicago, Illinois: ABA Publishing, 2000.

[2] Russell, Roger. "As Business Valuation Niche Grows Among Firms, So Do Liability Claims." *Accounting Today.* September 2001.

[3] Pratt's doctorate is in business administration.

[4] Pratt, Dr. Shannon. "Evaluating Business Valuation Experts."Shannon Pratt's Business Valuation Update. January 2001, p.2.

[5] Bravo, Stephan. "Qualified Business Appraiser Serves Client's Best Interest." Business Valuation Library. June 1996, p.1.

[6] William, James L. "Butch," "Common Mistakes Made by CPAs in Preparing and Reporting Business Values," *Business Valuation Update,* December 1996, Page 1.

[7] Pratt, Dr. Shannon, *Valuing Small Businesses & Professional Practices – Third Edition,* McGraw Hill, 1998, Chapter 29.

[8] *Daubert v Merrell Dow Pharmaceuticals, Inc.,* 509 U.S. 579 (1993).

[9] *Kumho Tire Co. Ltd., et al. v. Carmichael et al.,* 119 S. Ct. 1167 (1999).

[10] Pratt, Dr. Shannon. "Qualified Business Appraiser Serves Client's Best Interest." Shannon Pratt's Business Valuation Update, June 1996.

[11] "Valuations that will withstand Current Challenges." Business Valuation Resources. February 2000.

[12] Pratt, Dr. Shannon."Qualified Business Appraiser Serves Client's Best Interest." Shannon Pratt's Business Valuation Update. June 1996, p.1.

[13] $100,000 per year in research materials and resources divided by 10 valuation engagements per year.

[14] Pratt, Dr. Shannon. "Lawyers Should Have BV Standards Handy For Reference." Business Valuation Library, February 2001.

[15] $100,000 per year in research materials and resources divided by 200 valuation engagements per year.

[16] Based on surveys of CPAs advertising business valuation services as well as users of business appraisal services including attorneys, public agencies, and business owners.

[17] Ronald D. Aucutt. "Criteria Important to Attorneys in Selecting Valuation Experts," Shannon Pratt's Business Valuation Update, February 1997, p.2.