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VALOREM PRINCIPIA

The Principles of Value   Volume 11 Issue 1 February 2003

Appraisers and Accountants - Vive la Différence!!

Nevin Sanli, ASA, Thomas Pastore, ASA, CFA and Adam Smith

Business valuations require a competent, experienced, and objective specialist to complete work that will pass muster and withstand close 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 profession 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, therefore, focuses on the differences between accounting firms and business appraisal firms. The same observations would be true, however, of any professional service firm that does not specialize in business valuation.

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.

Attorneys 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:

- Offering services that require advocacy (such as tax accounting) in addition to business valuation services, which require independence.
- Acceptance of valuation engagements to avoid sending clients elsewhere. This is an alarming motive when the individual should be considering what is best for the client.
- Use of inaccurate or controversial methods, assumptions, and techniques to manipulate values and create, improve, or maintain client relationships.
- Preparing financial statements and providing a business valuation for the same company. It is very difficult to value a business from a critical perspective when the person valuing the business is also responsible for the preparation of the company's financial statements.

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 a significant risk to the validity, credibility, and reliability of the appraisal.

Lack of training and experience leads to simple mistakes that can seriously undermine an appraisal. According to Mr. James L. "Butch" Williams, CPAs commonly make business valuation mistakes such as[1] :

- 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 premia.

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Part-time practitioners of business valuation are much more likely to make such mistakes. In addition, appraisers that spend only a small percentage of time on business appraisals may not be qualified to testify in court. Judges have a duty to prevent unqualified expert testimony from being presented to a jury and are unlikely to allow accountants 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.*[2]

> *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.*[3]

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 close scrutiny and thereby establish credibility with judges and jurors, a business appraiser with substantive experience and the proper credentials is absolutely necessary.

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 accountant's opinion is not relevant or reliable, and exclude his or her testimony.

Not All Business Valuation Designations are Equal

Lawyers 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 associations in the U.S. and one in Canada that offer various accreditations in business valuation. An analysis of these accreditations reveals that all of the designations attempt to mirror their programs on the American Society of Appraisers (ASA), which is the oldest and most authoritative source of business valuation accreditations and which offers the most difficult to obtain designation of Accredited Senior Appraiser. Other professional associations that offer credentials are 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).

The American Society of Appraisers' Accredited Senior Appraiser designation is unmatched against any other designation. This is evidenced by the organization's longevity, reputation within the business valuation industry, and, most importantly, by the stricter prerequisites and experience guidelines set forth in the ASA's professional accreditation criteria. The table below shows a comparison of the different designations:

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Association	**American Society of Appraisers**	**Canadian Institute of Chartered Business Valuators**	**Institute of Business Appraisers**	**National Association of Certified Valuation Analysts**	**American Institute of Certified Public Accountants**
Designation	**ASA**	**CBV**	**IBA**	**CVA**	**ABV**
Year Commenced	1936	1971	1978	1991	1997
Required Experience	Mandatory 12,000 Hours or 5 Years (Full Time)	2 Years Full-Time (4,000 hours)	Complete at Least 2 Valuations - No Yearly or Hourly Requirement	No Experience in Business Valuation Required	Substantial involvement in 10 valuations - No Yearly or Hourly requirement
Experience Defined	Yes	No	No	No	No
Verification of Experience	Yes	Yes	No	No	No
Submission of Report(s)	2 for peer review and approval	0	2 (not reviewed)	40 hour case study[4]	No
General Appraisal Standards	Yes	Yes	Yes	Yes	No - General Standards for Consulting Practice

General Business Valuation Standards	Yes	No	Yes	Yes	No
Performance/ Reporting Standards	Yes	No	No	No	No
Diligence Standards	Yes	No	No	No	No
Compliance Standards	Yes	No	No	No	No
Total Required Courses	12 Days	6 Days	N/A	5 Days	8 Days
Examinations[5]	4 Half-Day Exams + Ethics exam + USPAP exam	6 Exams Following Courses	2 Days of Exam	1 Half Day Exam	1 Day of Exam

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. Robust business valuation opinions require the services of an independent, competent, experienced, and well-trained specialist. To ensure these qualities, an appraiser with the Accredited Senior Appraiser designation should be sought. ASA's devote themselves entirely to the practice of business valuation and they must comply with high professional quality standards.

Attorneys can best serve the interests of their clients by choosing a business appraiser with the ASA designation who practices valuation full-time and who does not have conflicts of interest.

Sanli Pastore & Hill has established an impeccable reputation in the business valuation industry by providing the highest quality work with the accreditations and credentials to reinforce and sustain our opinions. We have 4 ASAs, 2 CFAs, 1 CPA[6], and several MBAs strictly engaged in the performance of business valuation. Since our employees devote all of their time to business valuations, we do not have the distractions of auditing, giving tax advice, tax planning, bookkeeping, or other services that could hinder our ability to perform unbiased, competent, accurate, and sustainable work. Our valuations withstand the scrutiny and criticism that arise from being in a sometimes subjective and arbitrary environment. We understand that extensive research tools, appropriate staffing requirements, comprehensive training materials, and entrenched business valuation experience is mandatory to give accurate and credible valuation opinions.

[1]Williams, James L. "Butch", *"Common Mistakes Made by CPAs in Preparing and Reporting Business Values"*, Business Valuation Update, December 1996, Page 1.
[2]Daubert v Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993).
[3]Kumho Tire Co. Ltd., et al. v. Carmichael et al., 119 S. Ct. 1167 (1999).
[4]This case study is a take-home examination that requires the candidate to perform a valuation of a hypothetical business.
[5]These exams are in addition to the required class time.
[6]This individual is also an ASA.

"Court Denies Review and Affirms Decisions in Emeryville Redevelopment Agency v. Harcros Pigments, Inc."

by Thomas A. Douvan and Kevin D. Siegel of McDonough, Holland & Allen

On November 13, 2002, the California Supreme Court denied the condemnee's petition for the Supreme Court to review the recent decision of the Court of Appeal. The Supreme Court also refused to de-publish any portion of the Court of Appeal's decision[1]. This Supreme Court ruling leaves standing the Court of Appeal's August 9, 2002 decision in this case as important precedent for public agencies, especially redevelopment agencies involved in exercising the power of eminent domain.

As stated in the prior issue of *Valorem Principia*[2], the Court of Appeal's decision decided many issues of concern for public agencies in Emeryville's favor. In particular, the Court of Appeal clarified that the trial judge, not the jury, must determine the threshold issue of whether a condemnee is entitled to make a claim for loss of goodwill. The jury's only function is to determine the amount of the loss, if the trial court first determines

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the condemnee has a viable claim. In this case, Elementis[3] could not claim loss of goodwill since its real estate appraisers had appraised the property assuming a higher and better use that was inconsistent with continued operation of the business on the property.

The Court of Appeal also held that normally the jury should not be permitted to consider sales of properties involving a condemning agency as comparable sales in determining the value of the property taken. Moreover, it held that in analyzing a comparable sale of a property, an appraiser could not rely on a provision in the purchase contract, which apportioned a higher purchase price to one of the zones of the property, in order to assign a different value per square foot to the property taken[4]. This appraisal evidence ran afoul of the prohibition against offering "an opinion as to the value of any property or property interest other than that being valued[5]." The Court of Appeal further ruled that it was improper to introduce evidence of the Agency's redevelopment plans in front of the jury where the highest and best use of the property was not in dispute.

In its Supreme Court petition, Elementis did not challenge the Court of Appeal's holding that it was improper to introduce evidence of other sales to the Agency as comparables. Instead, it challenged the Court of Appeal's holdings regarding the Evidence Code[6] prohibition on opinion evidence as applied to the different "zones of value" of a comparable property. It also challenged the decision to hold evidence of the Agency's redevelopment plans inadmissible to the jury. Elementis also claimed that the Court of Appeal had changed the standard of review on appeal, making it easier to upset a jury verdict. Finally, it claimed that the jury, not the judge, should determine entitlement to loss of goodwill.

[1]See Emeryville Redevelopment Agency v. Harcros Pigments, Inc. (2002) 101 Cal.App.4th 1083
[2]"Court of Appeal Determines Entitlement to Compensation Must be Decided by Judge, not Jury," beginning on page 3.
[3]Harcros Pigments, Inc. conducted business as "Elementis" on the condemned property.
[4]In this case, the property straddled Oakland and Emeryville; the higher price per square foot was assigned to the Emeryville portion.
[5]California Evidence Code §822(a)(4)
[6]Evidence Code §822(a)(4)

For more information, telephone the authors at MH&A's Oakland office (510/273-8780) or David Beatty at the firm's Sacramento office (916/444-3900). For information regarding goodwill valuation analysis, contact Sanli Pastore & Hill, Inc.

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NEWSFLASH

December 7th - Beverly Hills
28th Annual Family Law Symposium - Beverly Hills Bar Association
SP&H was an exhibitor

January 15rd - Sacramento
Lorman Educational Services - Eminent Domain Seminar
Thomas Pastore and Forrest Vickery presented *"Eminent Domain in California - Goodwill Loss Valuations"*

February 19th - San Diego
International Right of Way Association - Chapter 11 San Diego
Nevin Sanli presented *"The Entitlement Battle: Case Studies of Successful Challenges to Large Goodwill Claims"*

March 5th - 7th - Palm Springs
California Redevelopment Association Conference & Expo
SP&H will be a Presidential Exhibitor

"With ordinary talent and extraordinary perseverance, all things are attainable."
-- Sir Thomas F. Buxton

Published by SANLI PASTORE & HILL, INC.
1990 S. Bundy Drive, Suite 800, Los Angeles, CA 90025

Telephone:	**Los Angeles**	**310/571-3400**	**Fax: 310/571-3420**
	San Francisco	**415/955-2699**	
	San Diego	**619/233-1801**	
	Sacramento	**916/614-0530**	
E-mail:	**bizval@sphvalue.com**		

Articles, letters, comments and suggestions are welcome. ***Please contact Christine Albino at 310/571-3400 or calbino@sphvalue.com***

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SANLI PASTORE & HILL
1990 S. Bundy Drive, Suite 800
Los Angeles, California 90025
www.sphvalue.com