

Common Problems in Business Appraisal Reports

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The value to be determined may not be appropriately defined.

In many appraisal reports, the specification of the value being determined is missing from the report. A particular standard of value such as the fair market value may be eluded to but not accurately defined. The reader must be certain of its meaning. Different jurisdictions have used varying definitions of fair market value, and the exact nature of this value must be specified in the report.

There may be inconsistencies between the value specified and the value utilized.

Sometimes an appraiser may define the standard of value that was supposed to be used in the assignment. During the actual appraisal process, however, the appraiser may erroneously apply a different standard of value.

There may be appropriate valuation methods left out.

Appraisers may rely on only one or two “favorite” methods of appraisal. Yet, there may be other appropriate methodologies left out. A full appraisal should consider all of the appropriate appraisal methods in order to provide a system of checks and balances on the individual methods used. Inexperienced appraisers may continually use a particular method, but this may not be the most appropriate or versatile method. The excess earnings method seems to be a favorite of many appraisers but biased selection of methods should be avoided. The availability of information and the circumstances surrounding the appraisal should determine the correct appraisal method, rather than the preferences of the appraiser.

Contradictory methods of appraisal may be utilized.

The use of methods that contradict each other is another common error. The facts of the appraisal should lead the selection on the method in a particular direction. Different methods are used in different circumstances. For example, it does not make sense to apply both the Capitalization Method and the Discounted Cash Flow Method, as the former assumes stable income streams, while the latter assumes unstable income streams.

The market data may be missing from the report.

Some appraisers may leave out market data that they believe is not locatable. This leads to a major flaw in many appraisals. Market data can actually be found in most situations. At the very least, market data should always be looked for.

The Guideline Companies may be poor comparables.

The companies chosen as guideline companies to compare with the appraisal subject must be similar and relevant. Poor comparables make for problematic reports. A typical mistake is when the appraiser selects guideline companies that are too large to be comparable. But note: A company does not have to be in the same line of business. Revenue Ruling 59-60 suggests “same or similar”.

Summary

In summary, a number of common errors can and do occur in appraisal reports. The onus rests with the client to engage the most appropriate appraiser for the specified appraisal.