

# The Case of a Qualified Second Opinion



### **Problem:**

#### Review of Non-Conforming Appraisal Reports

We were recently contacted by counsel and the local Superior Court in two different cases to review the report and valuation calculations of another appraiser. Regrettably, in both instances neither appraisal report conformed to the Uniform Standards of Professional Appraisal Practice (USPAP) and were not prepared by certified or credentialed appraisers.

While it is not a given that a credentialed appraiser will provide an appropriate opinion and also not a certainty that an uncredentialed appraiser cannot provide an appropriate and supported appraisal opinion, it is our experience that, more often than not, certified and credentialed appraisers do provide better supported and technically correct opinions.

### **Clients' Situations**

While it is reasonable to expect as much as a 15% difference in opinion simply due to different judgement, clients and courts should not have to experience (as they did in these two cases) common errors in business appraisals:

- Mismatched benefit stream and capitalization rate. That is, a pre-tax benefit stream (net income before taxes) capitalized by an after-tax capitalization rate. The resulting answer was significantly overstated.
- The use of an asset-based method (Excess Earnings) to an operating company where cash flows and income streams were pre-eminent. The company was labor-intensive rather than asset-based and did not even prepare balance sheets (they were estimated by the appraiser).
- The calculation of net cash flow applicable to equity did not respect the mandatory relationships in the single period capitalization model. That is, in the perpetual model, (i) capital expenditures should be equal to or greater than depreciation and (ii) new borrowing should exceed debt repayments.
- The use of an incorrect risk-free rate in the Capital Asset Pricing Model (CAPM).
- Failure to account for the excess risk in applying the Excess Earnings Capitalization Rate.

### **ABA Solution**

In each case we issued a review report that demonstrated the technical errors supported by references to technical literature. In each case, the court did not consider the original appraiser report but, rather, relied on the ABA technical guidance to assist the court in its decision.