Analysis Shmalysis

by Shawn Hyde, Executive Director ISBA

Shawn Hyde,
Executive Director ISBA

Some of my best article ideas come from a conversation or a question I get asked during one of my presentations. I don't know if this one will be one of my best ones, but the genesis of this article came from a question I was asked not long ago.

"How can I tell if the appraisal report I am looking at is any good?"

I need to provide a little background on the conversation that engendered the question above. We were discussing the various different business appraisal certifications that exist in the market, the training programs associated with each, and also the results of the several different valuation software packages that are in use today. The point was made that every single appraisal is an expression of the appraiser's opinion and that different appraisers can come up with different values, even using identical data, and each value conclusion can be correct even while they are different. (This last point may be the topic of another article someday.)

In the middle of the conversation, one of the participants asked the question above. I gave a fairly short, and I think very accurate answer then, but I want to expand on my answer here.

I believe there are some very obvious indicators anyone can look at in order to decide if a particular appraisal report is sufficient for their needs. Some of these are listed below:

1. "Garbage in, garbage out"

This is a very well-known adage, that basically says, if one inputs worthless data into a system, the result provided is equally worthless. For a business appraisal, one needs to consider the quality of the data used in the report and see how dependent the appraiser was on that data.

For example, I have appraised businesses where I did not trust the information provided in the tax returns or financial statements. The section where I described the efforts I put into reconciling the business' results with what was reported tends to be more robust in those types of assignments. One of my favorite assignments was where I was handed a check book register and was told to value the business based on that data. A good report can be developed from this type of data, but it takes more analysis from the appraiser.

2. "The devil is in the details"

A business appraisal has lots of moving parts and the narrative aspect of the report is where an appraiser has the opportunity to explain the steps involved in the process one used to analyze a Company and its expected future results. Watch for consistency on the part of the appraiser though. I have seen reports where the appraiser stated that the business was expected to be going through a volatile growth period, yet also stated that the risk of operations was lower than average. Those two points do not typically go together.

If an appraisal report is very thin, there is less room for appraisers to explain their thoughts and analyses that went into the development of the value conclusion. Depending on the purpose of the valuation assignment, this type of assignment may be fine, but if a user of the report has any questions on any aspect of it, it may be very difficult to find an answer.

3. "Cotton candy is fluffy, the appraisal report does not need to be"

On the other end of the scale, are business appraisal reports where the appraiser must have charged a fee per pound of the final report. There are mountains of data that are available for an appraiser to consider, but not all of it may be relevant for a particular assignment.

If the subject of an appraisal report is a boutique nail salon, how pertinent to the value conclusion is a discussion of the trade imbalance with China? Another thing to consider are charts and graphs. They can be pretty to look at, but if the information provided by the graphs is not incorporated into the analysis, there is no reason to include them.

Analysis Shmalysis

by Shawn Hyde, Executive Director ISBA

Just like 'beauty' is in the eye of the beholder, the intended user of an appraisal report is in the best position to decide if a particular report is any good or not. The purpose of an appraisal report is to communicate to the end user what the final conclusion of value is and how the appraiser arrived at that conclusion. That said, there are different formats of appraisal report that are allowed under various sets of appraisal standards, and each has its own niche where it best fits.

Sometimes the client is the owner of the business and the appraiser does not need to do a detailed analysis of the competition in the area because the client already knows that information, or perhaps the valuation is for a purpose involving litigation and the appraiser has been instructed to only provide an oral report on the stand.

Shawn Hyde,
Executive Director ISBA

The key to a good report, is really inside the appraiser's work papers and the analyses performed. A good report will describe the information the appraiser relied on, any adjustments that may have been made and why, and will also explain the steps involved in the appraisal process that led to the value conclusion.

If an appraiser responds to a question asking about details involved in the analysis performed, with something like, "Analysis Schmalysis, I just know what the value is" then the report may not be a high-quality appraisal.