



# Appraisers and Accountants – *Vive la Difference!!*

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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 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, 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:

- ◆ 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.”<sup>1</sup> In a litigation setting, even the appearance of a conflict of interest could seriously undermine and/or disqualify the appraisal opinion, leaving the client without adequate support for their position. This could be very costly to both the attorney and the client.

In an article entitled, “As Business Valuation Niche Grows Among Firms, So Do Liability Claims,” John Rasponde, 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.<sup>2</sup>*

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.

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<sup>1</sup> PRATT, DR. SHANNON. THE LAWYERS BUSINESS VALUATION HANDBOOK. CHICAGO, ILLINOIS: ABA PUBLISHING, 2000.

<sup>2</sup> RUSSELL, ROGER. “AS BUSINESS VALUATION NICHE GROWS AMONG FIRMS, SO DO LIABILITY CLAIMS.” ACCOUNTING TODAY. SEPTEMBER 2001.



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 who is 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 both the company and their attorney 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 a significant risk to the validity, credibility, and reliability of the appraisal. Dr. Shannon Pratt, CFA, FASA, MCBA, 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.<sup>3</sup>*

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 will withstand the scrutiny of a courtroom environment. As a result, their opinions lack muster, says Stephan Bravo, a CPA:

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<sup>3</sup> PRATT, DR. SHANNON. "EVALUATING BUSINESS VALUATION EXPERTS." *SHANNON PRATT'S BUSINESS VALUATION UPDATE*. JANUARY 2001, P.2.



*I am a CPA with 18 years of experience in tax, accounting, and financial planning. 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 CPA's only understand the tip of the iceberg.<sup>4</sup>*

This lack of understanding often 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<sup>5</sup>:

- ◆ 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.

Dr. Shannon Pratt’s book, Valuing Small Businesses & Professional Practices – Third Edition<sup>6</sup>, similarly includes a chapter on common errors made by business appraisers. Like the above list, the common errors described by Dr. Pratt 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 CPA’s 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:

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<sup>4</sup> BRAVO, STEPHAN. “QUALIFIED BUSINESS APPRAISER SERVES CLIENT’S BEST INTEREST.” *BUSINESS VALUATION LIBRARY*. JUNE 1996, P.1.

<sup>5</sup> WILLIAM, JAMES L. “BUTCH”, “COMMON MISTAKES MADE BY CPAS IN PREPARING AND REPORTING BUSINESS VALUES”, BUSINESS VALUATION UPDATE, DECEMBER 1996, PAGE 1.

<sup>6</sup> PRATT, DR. SHANNON, VALUING SMALL BUSINESSES & PROFESSIONAL PRACTICES – THIRD EDITION, MCGRAW HILL, 1998, CHAPTER 29.



*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.<sup>7</sup>*

*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.<sup>8</sup>*

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. Dr. Pratt points out, “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.”<sup>9</sup> 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 CPA’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 accreditations in business valuation. An analysis of these accreditations reveals that all of the

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<sup>7</sup> DAUBERT V MERRELL DOW PHARMACEUTICALS, INC., 509 U.S. 579 (1993).

<sup>8</sup> KUMHO TIRE CO. LTD., ET AL. V. CARMICHAEL ET AL., 119 S. Ct. 1167 (1999).

<sup>9</sup> PRATT, DR. SHANNON. “QUALIFIED BUSINESS APPRAISER SERVES CLIENT’S BEST INTEREST.” SHANNON PRATT’S BUSINESS VALUATION UPDATE, JUNE 1996.



designations attempt to mirror the program 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:

- Established in 1936, the American Society of Appraisers is considered the gold standard of all business valuation credentials. 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, are all required to receive an ASA designation. All applicants must also engage in a thorough interview process, pass an ethics exam, and take a USPAP (Uniform Standards of Professional Appraisal Practice) class with an exam. USPAP standards are the most widely cited and recognized set of professional standards for appraisals.<sup>10</sup> In addition to compliance with USPAP, the ASA publishes business appraisal standards that are more stringent than those promulgated in USPAP.
- Established in 1971, the Canadian Institute of Chartered Business Valuators offers the CBV (Chartered Business Valuator) designation. It requires an applicant to have two years of valuation experience followed by successful completion of six courses. This designation does not have the same rigorous criteria compared to the ASA designation.

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<sup>10</sup> "VALUATIONS THAT WILL WITHSTAND CURRENT CHALLENGES." *BUSINESS VALUATION RESOURCES*. FEBRUARY 2000.



- Established in 1978, the Institute of Business Appraisers requires an applicant to complete one-day's equivalent in exams, submit two business appraisals demonstrating a professional level of competence, and have done at least two valuation assignments to receive the CBA (Certified Business Appraiser) designation. Again, the qualifications for this designation are less stringent than the ASA.
- Established in 1991, the National Association of Certified Valuation Analysts 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 to acquire the CVA (Certified Valuation Analyst) designation. It is important to point out that the required two years of valuation experience is not defined. The criteria for this designation are much less rigid than the ASA's.

The ABV (Accredited in Business Valuations) accreditation of the American Institute of Certified Public Accountants was established in 1997. It requires that the appraiser have "substantial involvement," in ten business valuation engagements. However, the AICPA never defines what "substantial involvement" entails. The AICPA does not require submission of any valuation report for peer review and approval to ensure the quality of the applicant's work. However, the designation does require 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 summary chart below illustrates the designations described above:





	AMERICAN SOCIETY OF APPRAISERS	CHARTERED BUSINESS VALUATORS	OF BUSINESS APPRAISERS	OF CERTIFIED VALUATION ANALYSTS	CERTIFIED PUBLIC ACCOUNTANTS
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 <sup>12</sup>	4 Half-Day Exams + Ethics exam + USPAP exam	6 Exams Following Courses	2 Days of Exams	1 Half Day Exam	1 Day of Exam

The American Society of Appraisers has a much more developed and stringent set of criteria which enables the ASA accredited appraisers to withstand the criticism of opposing counsel and ensures that an experienced, qualified specialist has conducted the business appraisal. Furthermore, an ASA expert will be able to advise attorneys on effective cross-examination of opposing witnesses. This can prove to be a significant factor in the outcome of a case.

Each professional designation besides the AICPA has established standards that are enforced to ensure that the valuation follows at least one set of guidelines. However, only the ASA designation has specific standards related to performance, diligence, and compliance. For ASA members, compliance with these standards is mandatory. It is simply not an option for members of the ASA to not comply with the prescribed standards. The other designations do not have specific standards related to compliance, diligence, and performance.

Complying with thorough business valuation standards requires access to research and numerous other resources that are very costly. In an article published by

<sup>12</sup> THESE EXAMS ARE IN ADDITION TO THE REQUIRED CLASS TIME.



Business Valuation Resources, “Qualified Business Appraiser Serves Client’s Best Interest,” Dr. Pratt points out the importance of maintaining updated research materials, “we suggest a minimum library for anyone doing business valuations.”<sup>13</sup> 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 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.<sup>14</sup> 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, CPA’s perform valuations that are not in compliance with standards. Ultimately, the outcome of a case is compromised. Dr. Shannon Pratt emphasizes:

*Worse than bad case law resulting from poor appraisal work products (either written or oral) is that clients are not well served. On the one hand,*

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<sup>13</sup> PRATT, DR. SHANNON. “QUALIFIED BUSINESS APPRAISER SERVES CLIENT’S BEST INTEREST.” *SHANNON PRATT’S BUSINESS VALUATION UPDATE*. JUNE 1996, P.1.

<sup>14</sup> \$100,000 PER YEAR IN RESEARCH MATERIALS AND RESOURCES DIVIDED BY 10 VALUATION ENGAGEMENTS PER YEAR.



*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.*<sup>15</sup>

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.<sup>16</sup>

What are the differences between hiring an ASA compared to a CPA for business valuation engagements?

**ASA SPECIALIST IN  
BUSINESS VALUATION**

**CERTIFIED PUBLIC ACCOUNTANT  
(CPA)**

◆ 100% of time devoted to business valuations.	◆ Only 5% to 20% 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 ASA standards.	◆ Does not prepare certified reports that comply with any standards.
◆ Opinions and reports follow strict compliance, performance, and diligence standards.	◆ Opinions do not follow any guideline standards.

<sup>15</sup> PRATT, DR. SHANNON. “LAWYERS SHOULD HAVE BV STANDARDS HANDY FOR REFERENCE.” *BUSINESS VALUATION LIBRARY*, FEBRUARY 2001.

<sup>16</sup> \$100,000 PER YEAR IN RESEARCH MATERIALS AND RESOURCES DIVIDED BY 200 VALUATION ENGAGEMENTS PER YEAR.



**ASA SPECIALIST IN  
BUSINESS VALUATION**

**CERTIFIED PUBLIC ACCOUNTANT  
(CPA)**

◆ Maintains extensive resources devoted exclusively for business valuations.	◆ Does not maintain the minimum necessary resources required for business valuations.
◆ Each ASA expert is tested to guarantee a minimum threshold of knowledge of business valuations.	◆ CPA's 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.	◆ Typically 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. As leading estate-planning attorney Ron Aucutt has explained:

*We want the best appraiser, and we would not make a decision based on cost. That should not really be a concern. 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.<sup>17</sup>*

Robust business valuation opinions require the services of a competent, experienced, and well-trained specialist. To ensure these qualities, an appraiser with the Accredited Senior Appraiser designation should be sought. ASAs 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<sup>18</sup>, 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.*

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<sup>17</sup> RONALD D. AUCUTT. "CRITERIA IMPORTANT TO ATTORNEYS IN SELECTING VALUATION EXPERTS," *SHANNON PRATT'S BUSINESS VALUATION UPDATE*, FEBRUARY 1997, P.2.

<sup>18</sup> THIS INDIVIDUAL IS ALSO AN ASA.