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One question that has been asked of me a number of times is why CPA's and others preparing business damage reports (or business valuations) typically end up with different rather than similar answers. This will be true even if the preparers are equally competent. There are a number of reasons for this.

First, let us realize that if this were not so, then surely many business damage and business valuation assignments could be handled by a simple computer program. Would this not also apply to other professional situations? It would be nice if we had computer programs at home to feed in our symptoms when we are ill. Ideally, it would then print out a correct diagnosis.

Second, we cannot exclude the potential of subjectivity. No matter how professional a person may be, and regardless of his adherence to the ethical standards, we should acknowledge that the business appraiser will tend to give any benefit of doubt or select alternatives that favor the client contracting for this service.

If we are using a simple tape measure then the length of the object should be identical. But when engaged in business appraisals there are so many factors to consider that we should be prepared for these differences. What are some of the basic factors that will cause two equally competent people to achieve different results? Let's call one Robert Green and the other Harold Brown.

Period Selected

If each selects two unidentical periods as the start of their calculations the answer must end up unlike. For example, if Green uses the business' financial statements for the 5 years ended December 31, 1988 and Brown selects the 5 years ended December 31, 1989 the results should differ.

Adjustments

If they were to choose the same financials but make unlike adjustments to them, then the answers should disagree. For example, Green may feel it imperative that additional officers' salaries be shown on the income statements, whereas Brown may feel that the stated salaries are adequate. These are typical of adjustments that may be required to modify submitted financial information so that it represents a fair picture of the business.

Then, there are adjustments that may be appropriate to give effect to a reduced volume. For instance, assume the business is projected to suffer a loss of 20 percent of its volume for two years due to the taking. Brown may believe that it will simultaneously experience a saving of $20 thousand per year in operating expenses during that period (because of the reduced sales) whereas Green may estimate the savings to total $40 thousand each year.

Effect of the Taking

Green and Brown may not agree on the effect of a partial taking on a particular business. Green may believe that the loss will have a permanent drastic effect and Brown may conclude that the taking will result in only a few months of damages.

Evaluation of the Business Type

The overall evaluation of the type of business will obviously affect the conclusion. If Green considers the business is in a stable type of activity and Brown believes the same industry is unsteady and overly competitive, this will influence them materially.

History of the Individual Business

Brown may study the history of the business and conclude that the company is a growing, well-managed concern that was headed towards greater success. Green may take the same information and consider its record to be one portrayed by a marginally operated venture. Obviously, this overall opinion will affect the final calculations they perform in the end.

Customer Loyalty and Competition

Green may reach an opinion that the business has developed substantial goodwill and has achieved a significant number of loyal customers. Brown may believe that the

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business is more like one that is subject to intense competition, whether it be price or service, and therefore more likely to be adversely affected by any moderate inconvenience or change in its operation.

Therefore, any possible change in the parking or other accessibility of the business will have a notable impact in Brown's calculations.

Capitalization Rate

If the professional is preparing a valuation report or computing permanent damages due to a taking he often is faced with selecting a capitalization rate. If Green regards the business as one with higher risk factors he will typically select a larger capitalization rate. Brown may consider the business to be a stable one, and accordingly, warrant the use of a lower capitalization rate.

The earnings involved are divided by the capitalization rate and then multiplied by 100 – resulting in the goodwill or value of the earnings. Therefore, the higher the rate the less value is attributable to the earnings.

Conclusion

Business valuations and business damage appraisals will continue to differ according to the professional judgement of the appraisers. With this involving so many factors that cannot be measured by a scale, the answers will continue to vary when identical facts are provided two professionals.

Those who are overly concerned about this realistic concept should remember that they are dealing with a situation that may be compared with differing opinions offered in other professional matters, such as in the field of medicine. In the same way that we rely on our selected physician, we should be content, with the same degree of comfort, if we carefully choose professionals for appraisals with good reputations and the essential experience.