

The Valuation Analyst—An Independent Expert or a Client Advocate?

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A valuation analyst may be retained to provide a variety of professional services for a number of different purposes. These professional services are intended to achieve the purpose and objective of the particular engagement to which the analyst was retained. However, regardless of the purpose and objective of the assignment, one responsibility for an individual acting as an independent valuation analyst is to remain independent, objective, and unbiased. This statement is true even if the engagement involves a forensic analysis performed within a litigation support or dispute resolution environment.

INTRODUCTION

A fundamental professional standard for an individual acting as an independent valuation analyst (“analyst”) is the responsibility to maintain independence. This standard involves the obligation to avoid bias or advocacy in the development of—or the reporting of—a value opinion.

However, in the course of a valuation engagement performed within a litigation or other controversy environment, the analyst may encounter challenges or pressure to blur the line between an independent expert and an advocate for the client.

Professional standards related to independent analysts emphasize the need for independence and the avoidance of bias. The Internal Revenue Service (“Service”) often alleges that analysts merely perform as an advocate for their clients instead of providing an independent value opinion.

Similarly, in non-Service-related disputes, it is common for one litigant party to contend that the analyst working for the other litigant party has become an advocate.

This discussion (1) identifies specific standards of selected valuation governing bodies, (2) summarizes common precedent in Service-related court cases, (3) summarizes examples from recent litigation where analysts have appeared to be an advocate rather than an independent analyst, and (4) identi-

fies analyst caveats for avoiding the appearance of advocacy.

Additionally, in a litigation or dispute setting, it is common for the analyst to not only render an independent opinion of his or her own analysis, but to also review or rebut the analyses or opinions of an opposing analyst. In preparing an appraisal review or rebuttal report, it is appropriate for the analyst to prepare an independent analysis and to not become an advocate for his or her client.

STANDARDS OF SELECTED PROFESSIONAL ORGANIZATIONS

Valuation analysts are subject to the professional standards and codes of ethics of the valuation professional organizations (“VPOs”) of which they are members. This section identifies certain standards promulgated by the American Society of Appraisers (“ASA”), the American Institute of Certified Public Accountants (“AICPA”), and the Appraisal Foundation.

American Society of Appraisers

The ASA has promulgated its Principles of Appraisal Practice and Code of Ethics (“ASA Code of Ethics”). The following excerpts describe certain relevant sections of the ASA Code of Ethics regarding the valuation analyst and advocacy.

Section 2.2 (Objective Character of the Results of an Appraisal Undertaking) of the ASA Code of Ethics establishes that, when performing a monetary appraisal, the “numerical result must be developed objectively and without bias. It is unrelated to the desires, wishes, or needs of the client who engages the appraiser to perform the work.”

Section 4.3 (Appraiser’s Obligation of Giving Testimony) specifies that when engaged in a controversy, “It is the appraiser’s obligation to present the data, analysis, and value without bias, regardless of the effect of such unbiased presentation on his/her client’s case.” This section also provides a comment regarding the appraisal expert providing rebuttal services in a litigation assignment.

The comment in Section 4.3 states, “It is perfectly acceptable for the appraiser to rebut the work product of another appraiser, as long as it is done in a manner that is objective, honest, and supported. It is not acceptable to comment about the appraiser, only the work product.”

Section 7.5 (Advocacy) states, “It is unethical for an appraiser to act as an advocate for anything or anyone other than his/her own value conclusion, regardless of the circumstance or situation as the appraiser and the appraisal will lack credibility.”

American Institute of Certified Public Accountants

The AICPA has promulgated the Statement on Standards for Valuation Services (“SSVS”) and the Statement on Standards for Consulting Services (“SSCS”).

SSVS Section 100.14 (Objectivity and Conflict of Interest) recognizes that “objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest.”

Section 100 of SSCS presents similar language and interpretation.

The Appraisal Foundation

The Appraisal Standards Board of the Appraisal Foundation develops, interprets, and amends the Uniform Standards of Professional Appraisal Practice (“USPAP”) which was adopted by Congress in 1989 as a source of appraisal standards and qualifications. These standards cover multiple types of appraisal services including real estate appraisals, personal property appraisals, and business appraisals.

Certain VPOs, including the ASA for example, require their members to adhere to the provisions of USPAP.

As part of the conduct provision under the ethics rule of USPAP, “An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests.” The conduct provision specifically identifies that an appraiser “must not perform an assignment with bias,” and “must not advocate the cause or interest of any party or issue.”

Under the management provision of the ethics rule, “an appraiser must not accept an assignment, or have a compensation arrangement for an assignment, that is contingent on . . . a direction in assignment results that favors the cause of the client.”

Summary of Selected Standards

As identified in the above-listed standards of certain VPOs, the analysis and work product of an independent valuation analyst should be:

- free of bias,
- untainted by a client’s requests,
- objective and free from a conflict of interest,
- supported by facts, and
- honest and impartial.

SUMMARY OF SELECTED TAX-RELATED JUDICIAL PRECEDENT

This section identifies selected citations which have been noted in U.S. Tax Court (the “Tax Court”) cases related to the issues of advocacy and independence.

Rule 702 of the Federal Rules of Evidence (“FRE”) dictates that an expert witness may testify if:

1. the expert’s knowledge will help the trier of fact to understand the evidence or to determine a fact in issue,
2. the testimony is based on sufficient facts or data,
3. the testimony is the product of reliable principles and methods; and,
4. the expert has reliably applied the principles and methods to the facts of the case.

Under this rule, the Tax Court has the discretion to determine whether an expert is assisting the trier of fact or merely acting as an advocate of a party. FRE Rule 702 also requires the use of sufficient facts and the reliable application of appropriate principles and methods. The lack of adherence to

the requirements of Rule 702 may result in a determination by the Tax Court that a valuation analyst is an advocate resulting in an expert opinion that is not admissible as evidence .

In the *Estate of Halas v. Commissioner*,¹ the Tax Court opinion included recognition under the ASA Code of Ethics that, “An expert has a duty to the Court that exceeds his duty to his client; the expert is obligated to present data, analysis, and opinions with detached neutrality and without bias.”

The Tax Court historically has cited multiple precedents in the context of valuation cases where experts lose their credibility (and usefulness) when they become advocates for the position argued by a particular party.

Consequently, it is important for the analyst to perform an analysis and render a conclusion or opinion that is based on the relevant facts, resulting in reliable results and a credible opinion, rather than completing an analysis intended to primarily support a client’s desires.

SUMMARY OF EXAMPLES FROM NONTAX LITIGATION

In 2012, in the bankruptcy matter of *Bachrach Clothing, Inc. v. Edgar H. Bachrach*,² one expert’s opinions were described as walking a thin line between expert and advocate. The court concluded that the expert’s analysis was based too much on questionable assessments and hindsight analysis and “often failed to explain the logic behind his choices, ignored actual market conditions and shifted his trial testimony away from some of the positions taken in his deposition.”

In the end, the court determined that the expert was trying too hard to get the conclusions necessary to benefit the client’s case.

The examples cited in the above matter provide insight into potential areas of advocacy and bias including the following:

- Questionable assessments
- Contradiction or changing of opinions between deposition and trial
- Use of hindsight in place of foreseeable events

One area of analysis often subject to professional judgment is the application of the discounted cash flow valuation method. In the previous case, the court noted that although both analysts relied on the same projection and cash flow data, disparate valuations were concluded. The court conceded



that each expert was at times inconsistent by criticizing the other for what each had done as well. Nevertheless, one expert’s explanations were determined to be better reasoned and “aligned with real world events or contemporaneous market data.”

One analyst testified that the significant disparity in conclusions was a result of the following three areas:

1. The weighting of debt versus equity
2. The estimated equity risk premium
3. The estimated size premium

The differences resulted in estimates for the weighted average cost of capital (“WACC”) for the two experts of 11.0 percent and 19.5 percent. The magnitude of the difference in the WACC estimates between the two analysts clearly resulted in the disparate value conclusions.

As a result, from the court’s perspective, the testimony of the analyst with the better reasoned explanations and supported independent data was considered more relevant and appropriate. On the other hand, the testimony of the analyst with assumptions that lacked independent support or basis was considered to favor a particular client and approach an advocacy position rather than unbiased opinion.

Another area of questionable assumptions revolved around hindsight (what actually happened) versus foreseeability (what was known or knowable

at the valuation date). The court was clear in its disfavor of the use of hindsight in this instance when there was no apparent evidence of the future event being foreseeable at the valuation date.

ANALYST CAVEATS FOR AVOIDING ADVOCACY

As discussed previously, it is necessary for an individual acting as an independent valuation analyst to avoid advocacy or bias in the development of an analysis and conclusion of results. A common description regarding the role of the analyst is that the analyst should only be “an advocate for his or her own opinion.”

In order to accomplish such an objective and limit the potential for bias or appearance of advocating a client’s position, there are certain elements of an analysis that generally assist the analyst in the appearance of independence.

Verifiable Data and Supportable Assumptions

An analysis should be clear with regard to the important facts and assumptions that were used and relied upon during the course of the assignment. Not only should the analysis be straightforward and transparent, but the report or other work product should be complete and provide sufficient detail regarding information relied upon and data sources.

Additionally, assumptions used in an analysis should be verifiable as to accuracy and/or appropriateness as of the date of the analysis. Assumptions that rely on facts not in existence as of the date of the analysis (i.e., hindsight or hypothetical conditions) may result in a analyst being considered an advocate. The use of data that cannot be verified or independently gathered may also lead to questions regarding the analyst’s conclusions and independence.

Credible Assignment Results

A specific analysis may enable an analyst to check off all the relevant boxes in terms of verifiable data, supportable assumptions, professional qualifications, and other issues that have the potential to jeopardize the independence of the valuation analyst. However, the failure to produce credible assignment results may still appear to result in advocacy of a client’s position, contradicting an otherwise thorough and complete valuation process.

In the previously identified litigation, two analysts using the same company projections concluded estimates for the company’s WACC of 11.0

percent and 19.5 percent (a nearly 80 percent difference between the low and the high).

It may be reasonable to accept that each analyst will have his or her own professional judgments regarding the WACC development. However, it is also reasonable to conclude that a difference of this magnitude is likely the result of one or both of the analysts blurring the line between independent expert and client advocate.

The credibility of the final assignment results cannot be overlooked simply because the individual steps along the way appear reasonable.

USPAP Standard 9 requires that the development of a business appraisal includes the necessary steps and research to produce a credible appraisal. USPAP Standard 10 requires the reporting of a business appraisal analysis to be communicated in a manner that is not misleading.

Although not all analysts are required to follow the standards developed by USPAP, adherence to such standards may reduce the potential for, and the appearance of, client advocacy when preparing a valuation analysis.

SUMMARY

It is a simple truth that in most litigation involving valuation disputes, the analyst is retained by one side or the other in the dispute. This fact naturally creates a challenge for the analyst to remain an independent party rather than become part of the team of advocates representing the client.

Still, in order for the analyst to protect his or her reputation, it is important for the analyst to adhere to any relevant VPO professional standards and requirements in order to maintain independence and produce a credible analysis that lacks bias. Although the value conclusion reached may not exclusively favor the client’s position, the analyst should always remain an advocate—but only for his or her own opinion.

Notes:

1. Estate of Halas v. Commissioner, 94 T.C. 570, 577–578 (1990).
2. In re Bachrach Clothing, Inc., Debtor, 480 B.R. 820 (N.D. Ill., E. Div., 2012).

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