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# Business Appraisal Practice

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## Editor's Column – Why Do We Include an Economic and Industry Section in Our Appraisal Reports?

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*Paul R. Hyde, EA, MCBA, ASA, BVAL*

Often, when reviewing another appraiser's work product for some reason, I encounter a detailed description of the world economy and the national economy and a generic report dealing with some industry category. The appraiser then proceeds to the discussion of the subject company and the various valuation methods without ever referencing the economic or industry section. In these instances, I cannot help wondering what the appraiser was thinking when he or she wrote these sections and included them in the report. I wonder if perhaps the appraiser simply purchased these sections from one of a number of vendors and tossed them into the report.

The major reason that I believe appraisers include economic and industry sections in appraisal reports is to comply with the requirements of Revenue Ruling 59-60 which tells us to consider "the economic outlook in general and the condition and outlook of the specific industry in particular."<sup>1</sup> USPAP also tells us to include "financial and economic conditions affecting the business enterprise, its industry, and the general economy."<sup>2</sup> Some appraisers fail to understand that Revenue Ruling 59-60 states just prior to listing its often quoted eight factors, "The following factors, although not all-inclusive, are fundamental and require careful analysis in each case."<sup>3</sup> USPAP tells us to "...study it [the subject business] in terms of the economic and industry environment within which it operates."<sup>4</sup>

I believe that appraisers must explain how what is going on in the economy affects the industry and the subject business and how the economic outlook affects the risk of the subject company achieving its forecasted net cash flow. Simply including an economic section without using it and explaining its impact is insufficient. Also, the industry section including the industry outlook must be explained and used to illustrate how it affects the subject company. In order to do this, the economic section of the report must include specific references to the industry in which the company operates and explain its impact on the value of the subject company. Both the economic analysis and the industry analysis must fit and be appropriate for the subject company. The type and degree of analysis should change depending on the size and the nature of the business being appraised.

When I read an appraisal of a local hot dog stand and it includes a detailed description of the world economic status and nothing about the local economy, I cannot help but wonder what the appraiser was thinking. Certainly, what is happening in the

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1. *IRS Revenue Ruling 59-60*, Sec. 4. Factors to Consider. .01 b.

2. *Uniform Standards of Professional Appraisal Practice*, 2004 Edition, Standards Rule 9-4 (b) (ii).

3. *IRS Revenue Ruling 59-60*, Sec. 4. Factors to Consider. .01.

4. *Uniform Standards of Professional Appraisal Practice*, 2004 Edition, Standards Rule 9-4 (b) Comment.

## Why Do We Include an Economic and Industry Section in Our Appraisal Reports?

worldwide economy appears to be much less relevant to the local hot dog stand than what is happening in the state, city or town, and neighborhood in which the local hot dog stand is located. Also, trends in the fast food sector of the restaurant industry are relevant but again, what is happening in the local area of the hot dog stand is the most important.

Many commercial real estate appraisers do a very successful job in describing how the economy directly affects the value of the property they are appraising. We, as business appraisers, collectively need to do a better job of analyzing and explaining just how the economic and industry outlook affects the businesses we appraise.

For a discussion of one way to describe the effect on risk of the economic and industry outlook sections in a report, please see the article entitled "Practical Risk Assessment" by Rand M. Curtiss in this issue of *Business Appraisal Practice*.

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