Monthly Memo

The Family Law Section of the County Bar meets the first Tuesday of every month at the Dante Club, 2330 Fair Oaks Blvd., Sacramento. May's luncheon is on Tuesday, May 6, 2014. Cost is $25.00 per person for section members and $35.00 for non-members. Cost for walk-ins (*without reservation*) is $35.00 and subject to availability. The luncheon this month will be **buffet** style. It will consist of: Chicken Marsala, Rigatoni Pasta with Marinara, Seasonal Vegetables, Salad and Dessert.

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For pre-registration and reservations, send an email to: *Lindie@DivorceWithRespect.com* or mail your reservation and check to: Lindie Newlin, c/o Bartholomew & Wasznicky LLP, 4740 Folsom Blvd., Sacramento, CA 95819.

Note: All reservations and checks received after the deadline date will be charged the walk-in rate of $35.00. Cancellations must be made 24 hours in advance or you will be charged for each reservation.

THE Family Law Counselor

May 2014 Issue 252

THE BASICS OF EQUIPMENT APPRAISALS

By Jack Young ASA CPA, NorCal Valuation, Inc.

EarlierTo determine values for any equipment appraisal, the appraiser always begins with the purpose of an equipment appraisal. The reason for an equipment appraisal always drives the definition of value. For instance, when a bank requests an appraisal of restaurant owned by a construction business for the purposes of a collateral loan, we are likely to use Orderly Liquidation Value because that would give the lender the most accurate value on what the equipment might bring should the loan experience default.

On the other hand, when appraising restaurant equipment for the purposes of due diligence, the value of choice is usually Fair Market Value in Continued Use, as this gives the most appropriate value of the equipment that is expected to continue in use, in place, as part of an income-producing business.

This dependence on the appraisal purpose explains why an appraisal prepared for a collateral loan, for example, would be inappropriate for an equitable distribution of assets related to marital dissolution.

One case study we often use to illustrate this point is the instructive story of Pat & Toby and their Happy Burger restaurants:

Married couple Pat and Toby have owned a chain of Happy Burger restaurants since 1990. They now have 5 restaurants: 3 in leased space in shopping centers and 2 on property that they own. A month ago they got an equipment appraisal for a commercial bank loan to buy new equipment and the loan was funded. Pat recently learned about Toby's extramarital affair, a divorce is pending, and Pat will take over the entire business. They want to use the existing appraisal for the determination of the value of equitable distribution of community property pursuant to the divorce.

That old appraisal, however, is not appropriate for their new situation -- not only does it have the wrong effective date and the wrong intended user but also the wrong intended use and the wrong definition of value. Oh, and neither does it include the new equipment they bought with the loan they received on the strength of that old appraisal! Pat and Toby will need to order a new appraisal for their new circumstance.

MAY SPEAKER
CLAY ARNOLD, ATTORNEY AT LAW

HIS TOPIC IS:

"INS AND OUTS OF DIRECT AND CROSS EXAMINATION: MAKING YOUR POINT SO IT'S REMEMBERED"

Ordering an appraisal requires a few crucial pieces of information, beginning, as you might suspect, with be the intended use of the appraisal and the intended user, as well as the effective date of the report if the valuation is linked to some point in the past such as a date of death or separation. From that information, the appraiser will determine the appropriate Definition of Value for the appraisal. And, of course, the appraiser will need information regarding the assets to be appraised and their location. Asset description is often the point where the wheels fall off.

Often, an equipment appraiser receives a depreciation schedule masquerading as an equipment list. Using a depreciation schedule as an equipment list, however, invokes a host of inherent problems:

- Ghost assets are on the depreciation schedule but have been disposed of. Often these have been fully depreciated and removed from on-going operation.
- Zombie assets exist and are part of on-going operations but aren't on the depreciation schedule for one reason or another:
- Corpse assets are fully depreciated, still on the depreciation schedule, and not being used in the company's on-going operations. Many corpse assets are in the boneyard and being used only for parts ... or nests for hornets.
- Item descriptions on the depreciation schedule often lack sufficient detail. Imagine attempting to value an asset described as "Ford truck!"
- Capital improvements to existing items are listed as separate line items, giving the appearance of more items than actually exist.
- Certain items of Real Property are often included with Personal Property, but these two categories are not interchangeable in appraisals.

While most of these problems become obvious during an inspection, that's not always the case with the distinction between Real Property and Personal Property, which comes up most regularly in manufacturing facilities and restaurants, where some pieces of equipment are physically installed — attached to the building.

In every circumstance where equipment is installed, an appraiser must investigate to determine if the installed equipment should be considered Personal Property — which would be valued for the purposes of the appraisal — or Real Property — which would be considered part of the building and not valued as equipment. Installed equipment of this sort is most obvious in restaurants and generally includes ventilation and fire suppression systems, refrigeration systems, and other attached items, the removal of which may cause damage to the property or create health code violations.

Determining whether to include installed equipment as Personal Property or exclude it as Real Property depends, as many equipment appraisal questions do, on the appraisal premise of value. When appraising under an in-continued use scenario, for instance, the assumption is that assets will remain in-use at their current location as part of a going concern. In this case, it may be appropriate to include the installed items and their related installation costs. If, on the other hand, the appraisal is being done for a liquidation scenario with the assumption of a piecemeal sale, such as for a collateral loan, the installed items are more likely to be considered real estate and less likely to be included in the equipment appraisal.

Once these questions have all been answered to the equipment appraiser's satisfaction and the appraisal report has been submitted, it's your turn to do some investigation as you review the report you've received. The first step is to ensure that you can understand the report. Is it clear what the appraiser has done, who did they contact, what equipment has been valued, and for what purpose? Is there a table of contents? Are terms with which the average reader might not be familiar explained in a clear and concise way? Are headings (& sub-headings if needed) used to guide the reader to important points and concepts in the report?

You might use a checklist like this one during your review to confirm that the appraisal report conforms to USPAP guidelines (Uniform Standards of Professional Appraisal Practice) and contains all salient points of the appraisal process:

- Clear Intended Use and Intended User consistent with purpose
- Premise of Value and Level of Trade relevant to purpose
- Reasonable Effective Date consistent with purpose
- Explanation of appraisal methodology used and limiting conditions
- Discussion of market conditions
- Signed certification and appraiser's CV
- Subject Assets adequately identified
  - Description of the subject assets (make, model, serial #, hours/miles, etc.)
  - Condition rating or other remarks upon equipment condition
  - Photos of Subject Assets
  - Notation as to whether or not Subject Assets were inspected
- Research sources listed and appropriate to Subject Assets

Taking the time to review an equipment appraisal report ensures that you have the appraisal you expect, suitable and supportive of your appraisal needs, and will make the rest of the process — whether a marital dissolution or an estate process — move ahead more efficiently.

Jack Young ASA, CPA, http://www.norcalvaluation.com. Experience includes the KPMG audit department in Sacramento, management of an auction firm specializing in commercial equipment and is an expert in equipment valuation. Jack is also the American Society of Appraisers, Northern California Chapter President. Please give Jack a call at (530) 795-5536 with your valuation questions or visit his website and extensive blog.