MAXIMIZING VALUE THROUGH KNOWLEDGE

Engaging Accountants, Bankers, and Lawyers in the Valuation Process

ADAMS CAPITAL INC.
BUSINESS VALUATION SERVICES

600 Galleria Parkway
Suite 1850
Atlanta, Georgia 30339
770-432-0308 | www.adamscapital.com

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By

David P. Adams III
CPA, ABV, ASA
david@adamscapital.com

Executive Summary

Appraisers do not operate in a vacuum. Virtually every appraisal is used by a team of professional advisors including accountants, bankers, and lawyers. They are the real users of our reports. Working with these professionals is important for appraisal success.

Our industry has appropriately focused on implementing needed minimum standards. This presentation is about exceeding those minimum appraisal requirements. An appraisal report thoughtfully completed will address not only USPAP rules but also the accounting, banking, and legal rules. Implementation of higher standards in an appraisal practice takes a focused, long term effort.

This paper explores specific ways an appraiser can improve project interaction to be a trusted advisor and yield better overall client solutions. To become a trusted adviser, be dependable, be timely, be professional, be consultative, and be a team player. Look at the broader problem. What is the overall objective? Clients seldom initiate appraisals. Another professional compelled the client to obtain an appraisal. Understand these dynamics and tailor the appraisal to suit the objective.

Walking around is important; share your impressions from walking around with clients, other professionals, and in the appraisal report. You may be appraising a single asset but your tour of the decrepit plant suggests there may be deferred maintenance, OSHA violations, environmental challenges, and operating inefficiency. While sharing your observations with the team, ask these talented professionals to reciprocate. What did they notice and how is it addressed in the appraisal?

Advisors want the team to be successful and will likely respond positively to any request to coordinate services. Pay attention, listen carefully, and work with the client's team. Stay engaged. Be prepared to add additional material and explanations to the appraisal to better support team requirements. The appraisal process should support the team, and never delay the team. When the team finishes, the appraisal process is still not complete. Follow up, get feedback, and improve the next appraisal. By doing these things consistently over years, you will become not just an appraiser but a trusted advisor.

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1. ABOUT THE AUTHOR

David Adams, CPA, ABV, ASA is president of Adams Capital, Inc. He is an expert in the valuation of businesses, business interests, and tangible and intangible property for mergers and acquisitions, corporate recapitalization, privatization, gift and estate tax planning, bankruptcy proceedings, dissenting shareholders, Employee Stock Ownership Plans, and financial and tax reporting. Prior to forming Adams Capital, Inc., Mr. Adams practiced business valuation services with Coopers & Lybrand LLP and KPMG Peat Marwick LLP, two of the international "Big Four" accounting and consulting firms.

Mr. Adams' extensive corporate finance background includes sellside and buyside advisory, divestitures, private placements, transaction negotiation, structure, and strategy. Mr. Adams has experience with over 2,000 transactions Transaction advisory experience includes fairness opinions, due diligence, equity structuring, debt structuring, recapitalizations, solvency opinions, acquisition consulting, board presentations, going public, going private, shareholder stock repurchases, and business planning in support of financing. Clients include Fortune 10 to small cap public companies, private companies, and government entities including the Internal Revenue Service, Department of Defense, and the General Services Administration.

Mr. Adams routinely counsels and quantifies clients on complex shareholder matters. He frequently works to resolve shareholder disputes related to valuation and governance rights stipulated by shareholder agreements. These complex matters involve multiple classes of stock, warrants, and preference rights, including different vesting, performance, or performance characteristics.

Mr. Adams has managed major international acquisition engagements in Australia, Belgium, Canada, China, France, Germany, Hong Kong, Italy, Japan, Mexico, Norway, Spain, Sweden, the United Kingdom, the United States, and Uruguay.

Mr. Adams is a CPA, member of the American Institute of Certified Public Accountants (AICPA), member of the Georgia Society of Certified Public Accountants (GSCPA) where he previously served on the board and as president of the Buckhead chapter. He is a senior member of the American Society of Appraisers (ASA) where he served as president of the Atlanta Chapter. Mr. Adams is currently treasurer and past board member of the Atlanta Estate Planning Council (AEPC).

A Georgia Tech Mechanical Engineering graduate, he currently serves on the School of Mechanical Engineering Advisory Board. Mr. Adams has an MBA from Georgia State University.

2. BEGIN AT THE BEGINNING

Knowing where to begin and end a project is critical to an appraiser's success, and therefore, to the client's success. Unfortunately in today's complex world just determining where to begin and end is not simple. We need to understand who, what, when, where, why, and how. Who will hire us is no longer simple. Our client may pay the bills but does not understand the required scope of work necessary to satisfy the requirements of the lawyer, banker, accountant, IRS, State, foreign government, or any other demanding entity. What are we to appraise and under what standard? We know we need to define the assets to be appraised but are we doing it in a language that will satisfy the ultimate user? Clients should ask the lawyer, banker, or accountant to offer an opinion. If you follow your client's wishes, you may fail to meet your client's true needs. You may even open yourself and your client up to draconian financial penalties like earnings restatements.

How draconian are restatements? If a public company relies on your appraisal and the appraisal is material to earnings, restatement potential exists. Should a new auditor later determine that the appraised value was misstated; the public company must then refile its prior SEC statements. Not only does refilling have a direct cost in legal, accounting, and appraisal fees, it also opens the company and its officers to shareholder liability lawsuits, and probably causes an immediate violation of all bank loan covenants. Now, thanks to a failed appraisal, the company has shareholder lawsuits, loan defaults, and a public relations nightmare that competitors will likely explore. Now that the Company has been publically humiliated after essentially admitted lying to the SEC who will buy from them? So what happens to sales? Lower sales and higher costs are not the best formula for business success.

When will the work be done? What will be the valuation date? Is the date prospective now but will be historic by the time the transaction closes? Does the date need to be consistent with prior years' work? Does it need to be consistent with work conducted by other appraisers?

Where is the equipment? Will the appraiser personally inspect it? Does standing by the tracks while the train rolls by count as a personal inspection? Does a personal inspection matter to the client who already knows what it has? An appraiser is personally inspecting for the user of the appraisal report. The appraiser should know who the user is and ask what they want.

Why is an appraisal being done? Business owners usually do not want an appraisal. Someone compelled them to get an appraisal in order to accomplish some other goal. That goal is important to the ultimate objective. Is the component material? Who is deciding materiality? Many of our appraisals are now used for multiple purposes regardless of how the report is caveated or limited. Be aware of the obvious uses and make sure that the report is sufficient. Obvious uses include audit (US and international), tax (federal income, federal transfer, state income, state ad valorem, local, and international), finance (lending and collateral), and transaction pricing. It is foreseeable that a single valuation could be used for audit, tax, finance, and transaction pricing.

How will the work be performed? How may be the most important question to ask and answer in the report? When things go bad, documentation of the scope of work, assumptions used, support for those assumptions, facts relied upon, and documentation of those facts will make the difference between a quick resolution or lingering doubt. If you support and document well, neither you nor your client needs to worry. Should you fail to explain clearly and accurately support the appraisal process, adoption of results may take a long and inefficient path.

At the beginning of every project, an opportunity exists to do the appraisal without outside interference. On draft delivery the accountant, banker, and lawyer get involved in the process. Do you really work more effectively with an accountant, banker, and lawyer helping? Are there ways to recognize the challenges in advance?

How can we organize our approach to valuation to readily address these important questions?

Core Planning Issues

a) Be on High Alert in “Red Flag” Situations

Look down the road. Anticipate problems. An example of a red flag situation is when a client has used multiple appraisal firms, is in or nearing bankruptcy, or is leaning toward or involved in litigation.

Focus on issues that will become big problems if not addressed properly. Proactively resolving problem issues is much easier prior to issuing the report.

In difficult or uncooperative client situations, realize that other appraisers have probably tried previously. Why were they not successful? Why does a new appraiser think he will succeed?

Emphasize spotting problems and minimizing risk – both for the appraiser and the client.

In Red Flag situations, present options and document in writing. The client, with the assistance of their legal and financial advisors, makes the final decision. Have the client communicate its decision in writing or send them a confirming email stating “based on our discussions, you advise….”

Do not allow the client to take control of the project scope or analysis. Do not lose control of the conclusion. The appraiser is hired to be independent. Ceding any assumptions to a client may embolden the client to seize the process. The client is after all paying for the appraisal. Why not help the appraiser? A fine line exists between balanced review and stepping on the scale.

Be careful before accepting difficult client situations. Think about the arrangements. Use engagement letters that clearly specify the project scope. Consider using a flat fee arrangement with time frame limitations to eliminate client foot dragging.

b) Fact Gathering

Use a detailed checklist to assist in identifying issues. For example, at how many physical locations are assets located? Are any of the assets leased? Who will be using this appraisal? For what purpose will the appraisal results be used? When are results expected? Is financing or a transaction dependent on timely results?

c) The Ultimate Goal

If a client is led to the right decision while believing it was his idea – the appraiser has achieved the ultimate goal. Focus on the client and their unique situation. How can their actual facts better support their goal?

d) Litigator Input

Have a litigator on call as an advisor. Document clearly what they advise you to do and do it in the report. Have another person read the report to make sure there is no misunderstanding. We complete all reports in anticipation of litigation. The upside is that our clear documentation has prevented our inclusion in many lawsuits over the years.

e) Short Meetings

Educate clients over time. Short meetings are best. Set priorities. Realize that every problem will not be solved.

f) Team Approach

Bring in the accountants, bankers, and lawyers so that an agreement can be reached on any outstanding issues. Other advisors may be helpful in getting a client to agree to an expanded project scope.

g) Unique Assets

Unique assets always have valuation issues. Consider structuring a transaction so that valuation issues are eliminated. For example, if a valuation is required prior to liquidation, consider structuring an agreement to share in liquidation proceeds. A valuation may no longer be required, or a valuation could be used to document the assets available for liquidation but results would just be for planning purposes.

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Atlanta, Georgia 30339
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h) Flexibility

Be prepared to deal with changing circumstances. Sometimes data is not available in the right format, the right person is not available, the facility is closed, the power is off, the air conditioning is off, etc.

3. AUDITORS HAVE SPECIAL REQUIREMENTS

As an appraiser and CPA I have had a unique opportunity to understand the needs and requirements of both the appraisal and audit professions. Our goals and objectives are similar but our professional guidelines can at times conflict. The first thing an appraiser needs to understand about an auditor is that when the auditor adopts your appraisal report and opinion, they make it their own including essentially accepting liability for an erroneous result. So when an auditor questions your appraisal report they have every right to require answers and documentation. You should anticipate this additional review as a normal part of working with an auditor.

Take a look at the rules an auditor must comply with. I believe you will see that an auditor is held to a higher standard than an appraiser and therefore an appraisal for audit purposes must meet these audit requirements in addition to USPAP. When the requirements conflict with USPAP, the audit requirement must prevail in an audit oriented valuation. USPAP anticipates and allows for these specific audit departures.

Internal controls as you will see below are an important part of the audit process. Strict interpretation of internal controls will require all appraiser to auditor communication be handled through the client. Yes this is inefficient but direct appraiser-auditor communication is a violation of internal controls. So to do our job well we need to communicate with the auditor but internal controls prevent direct communication. By explaining this to our client up front, we are able to schedule conference calls where our clients are merely facilitating a discussion about scope of work and consistency of assumptions. We find that our clients better understand the unique challenges of coordinating appraisal and audit reporting after “eavesdropping” on these auditor calls.

4. LAWYERS HAVE SPECIAL NEEDS

Think about the job a lawyer needs to do. Lawyers must be advocates for their innocent until PROVEN guilty clients. As appraisers, we are trained to be independent. Therefore we begin our relationship with lawyers in conflict. We can and should advocate for our opinion so we do have some common ground.

Hired Late – Lawyers are frequently hired late in the controversy. Then it takes them time to assess the situation and to build a case. At some point, they may determine an appraisal is required. The lawyer must then convince the client that this appraisal expenditure is necessary. Now time is limited but it is not an excuse to cut corners. Being hired late is a situation an appraiser must either accept and manage, or decline the engagement. Poor appraisal performance makes the appraiser, the lawyer, and the client look bad and probably has negative financial consequences for everyone.

Deep Thought in Story Line – A numerical answer is just the beginning. When lawyers are involved, they need the appraiser to back up the appraisal conclusion. The appraiser needs to tell the story because no other witness may be as qualified. Appraisers are well positioned to describe fully the specific situation related to assets. For example, the installation cost is probably higher than the value of the equipment value. For this reason, the industry prefers to purchase new equipment. Therefore the equipment has value but only at this specific location. Now if we also know (because we are diligent) that the cost of power at this location is triple the cost of power of competitors and cost of power is the most significant cost of operation, we should discuss not only the clear economic impairment of the assets at this location but also the implication for financial success of operations at this location.

Direct and Cross Examination Assistance – Prepare questions for the lawyer to ask so that appraisal findings are presented clearly and convincingly. Also prepare the questions that demonstrate the shortcomings of the opposing party's expert opinions. Review the questions and expected answers with counsel multiple times. Do not expect lawyers to become appraisal experts. The appraiser needs to educate the lawyers. The appraiser also must anticipate being shown information not previously seen. Be prepared to answer the question "How did that affect your opinion?"

Be Competent in Your Presentation – Do not be blindsided in a deposition. One important step to avoid being blindsided is to read all case documents, particularly the complaint. Have an opinion and back it up with data and industry information. The opinion should directly address all relevant allegations. Avoid "because I said so" you may be right but you should then back it up with reason, data, and industry practice. You may help the attorney identify additional experts who can make specific points. For example, the equipment broker who would not buy the subject equipment because it would cost too much to remove could be a great witness. The banker who would not make a loan secured by the equipment could also be a great witness.

Draft Report Management – Everything written is part of the record. If you are ever identified as an expert, plan on all written communication and every draft report being discovered. Do you want to spend your time and everybody else's time explaining the differences among the 8 draft reports you sent? How about explaining the material change after the client emailed you additional data? No matter how independent you are, draft reports can make you look biased, poorly prepared, and unprofessional. Avoid this unnecessary risk by being thorough. Coordinate with the client to ensure you begin with an accurate list of assets. Even if you create the list, share it with the client without numbers to make sure all the assets are reflected. Refer to

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Suite 1850
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legal documents and make sure that descriptions are aligned. Clarify when multiple descriptions are used for similar or identical assets. Many attorneys will provide specific edits. Providing a redlined comparison to the prior document could be a particular time saver for the team.

Bolster the Appraisal – Interview essential people inside and outside the company; talk to key customers and employees. Fortify your report with reviews of documents. Use footnotes and references to supporting documents. To the extent possible, shift from “your opinion” to “the data leads a reasonable person to this opinion”. Demonstrate why a reasonable person would not reach another opinion. Nothing is better than highlighting unreasonable outcomes to focus attention on the reasonable conclusion. You will make a much more compelling witness if you can explain the negatives and positives from a personal perspective. Walk the property, being there is just about impossible for the opposing expert to overcome (unless of course they were there in the same time frame). For example, I walked on ground so contaminated that my feet would sink if I stopped for too long.

Understand the Business, the Risks, and Opportunities – Without an understanding of the business, an expert can be made to appear unreliable and incompetent. Just a little background research can make conclusions far more persuasive. Be a true expert and demonstrate preparedness by understanding business economics. Demonstrate how economics impacts value. Who are the customers? Are the customers financially healthy? Is the business growing? Is the industry growing? Will there be continued demand for the product? What about price competition? Are there alternatives? Is there a key person? Is management at risk of leaving for a competitor?

Graphics in the Report – Think about the courtroom. Plan the direct and cross examination testimony. Develop compelling graphics that present the issue in a lasting and simple way. Use color – green is good, red is bad, etc. Keep it simple; the graphics should support your conclusion and maybe 3 supporting points (all the other supporting points are part of the 3 included in the graphic).

Be a Problem Solver – Be part of a client support team engaged to accomplish a task. Help the team succeed by not only doing the appraisal well but by identifying areas of weakness in the overall strategy and approach. You may not be the one to fill the gap or solve the problem but do you want to sail on a leaky ship? Once the problems are identified, we find that our clients are talented and resourceful. Clients appreciate being informed and hate to be blindsided. Recall that written communication is discoverable so more delicate matters might be best handled by telephone or in person.

Explain Verbally – In addition to your numerical approach, describe in words what you are doing and why.

Headings – Use clear headings to orient the reader of your report. If sections go for pages, consider headings on every page. Make it easy for the reader to stay on point.

Communication – Constantly communicate your progress. Without communication, the team will get nervous. Nervousness detracts from your credibility.

5. BANKING

Banking rules continue to tighten. Real Estate rules seem to be the better documented but we should anticipate similar attention for any other asset class. If we know a bank is relying on our appraisal should we not assist in making sure that regulation compliance is integrated into our work product? If we better understand the bank lending policies and approval process could we coach the banker into making a better loan? We frequently appraise complex companies like chemical plants and oil refineries. Does it make sense to make an equipment-only loan if another lender has a secured interest in the real estate? What about the real value of operating permits, environmental permits, assembled workforce, and other site specific intangibles? Do any of these assets have value without the right to use the patents required to run the processes used to make a product? We frequently find bankers so focused on making a loan they neglect some of these critical lending issues.

6. CHARACTERISTICS OF A WELL-SUPPORTED VALUATION

A well-supported valuation helps reduce the risk of adjustment and if audited, helps the client achieve a smooth audit process. Aside from USPAP guidance, there are additional characteristics of a well-supported valuation report:

1. The inputs to the valuation agree to source documentation. A valuation specialist does not opine to the accuracy and completeness to data received but it is important that all information is documented and supportable. The starting point of any well-supported valuation starts with the source company documents.
2. Calculations are easily understood by the reader. There should not be complex calculations buried in any Excel file. The reader should be able to easily follow any adjustment made from source documentation all the way to the concluded fair market value. This ensures ease of review from the client, accountant, banker, or lawyer.
3. All assumptions are clearly supported. Any assumptions need to be clearly stated and explained in the report. All sources to support assumptions needs to be appropriately cited. Valuation assumptions typically have a significant impact on fair value and the appraiser needs to show sufficient and supportable analysis.
4. The subject interest agrees to the tax return or financial statement. The subject interest needs to be defined and clear to the reader. The concluded fair value of the subject interest should agree to the financial statement.

7. FILLING IN THE BLANKS – DISCRETIONARY FACTORS

Businesses typically do not have written plans for a wide array of issues that may arise. An appraiser must frequently make assumptions about how prudent management will respond to future market challenges. Below are several discretionary factors that have a significant impact on value:

1. Actual distributions: A distributing entity is more marketable than one that is non-distributing. The prior five years of distributions indicate whether or not the entity regularly distributes. If there have been past distributions but no intent in the future, this needs to be clearly understood and explained by the appraiser.
2. Investment decisions: Future business plans may for example turn perfectly good cash into less liquid acquired assets. How should this cash be accounted for? The intent to sell real estate and hold marketable securities (or sell marketable securities and buy real estate) can and should flip an owner's opinion and therefore the appraiser's opinion.
3. Early liquidation: If the intent is to liquidate in the near future, marketability increases. This needs to be understood by the appraiser in order to appropriately assign discounts. Uncertainty in liquidation and uncertainty regarding the receipt of cash leads to a higher discount.

8. IN CASE OF IRS AUDIT – CONTACT YOUR APPRAISER

Be sure clients and their advisors understand that an appraiser can and should assist with an IRS audit. In an audit, it is important that the appraiser participate in any response to questions in regards to the appraisal. Appraiser experience working with the IRS will assist in responses to IRS requests. Early appraiser involvement can prevent significant effort in the later stages of an audit. It is always important to maintain a good working relationship with the IRS during an audit. IRS and appraiser communication will facilitate an efficient resolution.

9. IRS REVIEWS

The IRS uses these guidelines in their reviews: "Discount for Lack of Marketability Job Aid for IRS Valuation Professionals", September 25, 2009, developed by Engineering/Valuation Program DLOM Team.

http://www.irs.gov/pub/irs-utl/dlom.pdf

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10. CALL ME, MAYBE

Complex matters benefit from multiple perspectives. If in doubt, call for help. We maintain contacts with the IRS and the SEC, and have years of experience managing the valuation process required to resolve successfully disputes with the IRS.

Adams Capital works with appraisers across the country and around the world. We believe that all ships rise on a rising tide. We believe that the poor performance of any appraiser reflects badly on all of us. We stand ready to assist those appraisers who ask. We are good at what we do and we have fun every day doing valuation. If you read this far, you are the kind of person with whom we want to work. Thank you for your time.

11. GAAP/GAAS SUMMARY

Sample Audit Report and the Responsibility of Management

The following is an excerpt taken from the 2012 Annual Report on Form 10-K for The Coca-Cola Company explaining why an audit is necessary in a corporation:

Report of Management[1]

Management's Responsibility for the Financial Statements

Management of the Company is responsible for the preparation and integrity of the consolidated financial statements appearing in our annual report on Form 10-K. The financial statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances and, accordingly, include certain amounts based on our best judgments and estimates. Financial information in this annual report on Form 10-K is consistent with that in the financial statements.

Management of the Company is responsible for establishing and maintaining a system of internal controls and procedures to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements. Our internal control system is supported by a program of internal audits and appropriate reviews by management, written policies and guidelines, careful selection and training of qualified personnel, and a written Code of Business Conduct adopted by our Company's Board of Directors, applicable to all officers and employees of our Company and subsidiaries. In addition, our Company's Board of Directors adopted a written Code of Business Conduct for Non-Employee Directors which

[1] 2012 Annual Report on Form 10-K for The Coca-Cola Company, page 150.

reflects the same principles and values as our Code of Business Conduct for officers and employees but focuses on matters of relevance to non-employee Directors.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and, even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934 (''Exchange Act''). Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2012. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (''COSO'') in *Internal Control — Integrated Framework*. Based on this assessment, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2012.

The Company's independent auditors, Ernst & Young LLP, a registered public accounting firm, are appointed by the Audit Committee of the Company's Board of Directors, subject to ratification by our Company's shareowners. Ernst & Young LLP has audited and reported on the consolidated financial statements of The Coca-Cola Company and subsidiaries and the Company's internal control over financial reporting. The reports of the independent auditors are contained in this annual report.

Audit Committee's Responsibility

The Audit Committee of our Company's Board of Directors, composed solely of Directors who are independent in accordance with the requirements of the New York Stock Exchange listing standards, the Exchange Act, and the Company's Corporate Governance Guidelines, meets with the independent auditors, management, and internal auditors periodically to discuss internal controls and auditing and financial reporting matters. The Audit Committee reviews with the independent auditors the scope and results of the audit effort. The Audit Committee also meets periodically with the independent auditors and the chief internal auditor without management present to ensure that the independent auditors and the chief internal auditor have free access to the Audit Committee. Our Audit Committee's Report can be found in the Company's 2013 Proxy Statement.

The following is an excerpt taken from the audit report provided by Ernst & Young, LLP in the 2012 Annual Report on Form 10-K for The Coca-Cola Company:

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareowners
The Coca-Cola Company

We have audited the accompanying consolidated balance sheets of The Coca-Cola Company and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Coca-Cola Company and subsidiaries at December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, The Coca-Cola Company has elected to change its method of calculating the market-related value of plan assets related to certain of its pension plans in 2012.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), The Coca-Cola Company and subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2013 expressed an unqualified opinion thereon.

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600 Galleria Parkway
Suite 1850
Atlanta, Georgia 30339
770-432-0308 | www.adamscapital.com

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors and Shareowners
The Coca-Cola Company

We have audited The Coca-Cola Company and subsidiaries' internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Coca-Cola Company and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, The Coca-Cola Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of The Coca-Cola Company and subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2012, and our report dated February 27, 2013 expressed an unqualified opinion thereon.

12. AU SECTION 336 – USING THE WORK OF A SPECIALIST[2]

Introduction and Applicability

.01
The purpose of this section is to provide guidance to the auditor who uses the work of a specialist in performing an audit in accordance with generally accepted auditing standards. For purposes of this section, <u>a specialist is a person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing.</u>[3]

.02
Specialists to which this section applies include, but are not limited to, actuaries, <u>appraisers,</u> engineers, environmental consultants, and geologists. This section also applies to attorneys engaged as specialists in situations other than to provide services to a client concerning litigation, claims, or assessments to which section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, applies. For example, attorneys may be engaged by a client or by the auditor as specialists in a variety of other circumstances, including interpreting the provisions of a contractual agreement.

.03
The guidance in this section is applicable when—

[2] Source: SAS No. 73. A PDF copy of Section 336 may be obtained from the American Institute of CPAs at http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00336.pdf
[3] Because income taxes and information technology are specialized areas of accounting and auditing, this section does not apply to situations in which an income tax specialist or information technology specialist participates in the audit. Auditing Standard No. 10, *Supervision of the Audit Engagement*, applies in those situations.

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a) Management engages or employs a specialist and the auditor uses that specialist's work as evidential matter in performing substantive tests to evaluate material financial statement assertions.
b) Management engages a specialist employed by the auditor's firm to provide advisory services[4] and the auditor uses that specialist's work as evidential matter in performing substantive tests to evaluate material financial statement assertions.
c) The auditor engages a specialist and uses that specialist's work as evidential matter in performing substantive tests to evaluate material financial statement assertions.

.04
The guidance provided in this section applies to audits of financial statements prepared in conformity with generally accepted accounting principles ("GAAP")[5] and to engagements performed under section 623, *Special Reports*, including a comprehensive basis of accounting other than GAAP.

.05
The following paragraph is effective for audits of fiscal years beginning on or after December 15, 2010. See PCAOB Release No. 2010-004:

This section does not apply to situations in which a specialist employed by the auditor's firm participates in the audit. Auditing Standard No. 10, *Supervision of the Audit Engagement*, applies in those situations.

13. DECISION TO USE THE WORK OF A SPECIALIST

.06
The following paragraph is effective for audits of fiscal years beginning on or after December 15, 2010. See PCAOB Release No. 2010-004:

The auditor's education and experience enable him or her to be knowledgeable about business matters in general, but the auditor is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. During the audit, however, an auditor may encounter complex or subjective matters potentially material to the financial statements. Such matters may require special skill or knowledge and in the auditor's judgment require using the work of a specialist to obtain appropriate evidential matter.

.07

[4] The auditor should consider the effect, if any, that using the work of a specialist employed by the auditor's firm has on independence.
[5] References in this section to "financial statements" and to "generally accepted accounting principles" include special reports covered under section 623, *Special Reports*.

Examples of the types of matters that the auditor may decide require him or her to consider using the work of a specialist include, but are not limited to, the following:

a) Valuation (for example, special-purpose inventories, high-technology materials or equipment, pharmaceutical products, complex financial instruments, real estate, restricted securities, works of art, and environmental contingencies)

b) Determination of physical characteristics relating to quantity on hand or condition (for example, quantity or condition of minerals, mineral reserves, or materials stored in stockpiles)

c) Determination of amounts derived by using specialized techniques or methods (for example, actuarial determinations for employee benefits obligations and disclosures, and determinations for insurance loss reserves[6])

d) Interpretation of technical requirements, regulations, or agreements (for example, the potential significance of contracts or other legal documents or legal title to property)

14. QUALIFICATIONS AND WORK OF A SPECIALIST

.08

The auditor should consider the following to evaluate the professional qualifications of the specialist in determining that the specialist possesses the necessary skill or knowledge in the particular field:

a) The professional certification, license, or other recognition of the competence of the specialist in his or her field, as appropriate

b) The reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance

c) The specialist's experience in the type of work under consideration

.09

The auditor should obtain an understanding of the nature of the work performed or to be performed by the specialist. This understanding should cover the following:

a) The objectives and scope of the specialist's work

b) The specialist's relationship to the client (see paragraphs .10 and .11)

c) The methods or assumptions used

d) A comparison of the methods or assumptions used with those used in the preceding period

e) The appropriateness of using the specialist's work for the intended purpose[7]

f) The form and content of the specialist's findings that will enable the auditor to make the evaluation described in paragraph .12

[6] In the specific situation involving the audit of an insurance entity's loss reserves, an outside loss reserve specialist—that is, one who is not an employee or officer of the insurance entity—should be used. When the auditor has the requisite knowledge and experience, the auditor may serve as the loss reserve specialist. (See Statement of Position 92-4, *Auditing Insurance Entities' Loss Reserves).*

[7] In some cases, the auditor may decide it is necessary to contact the specialist to determine that the specialist is aware that his or her work will be used for evaluating the assertions in the financial statements.

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15. RELATIONSHIP OF THE SPECIALIST TO THE CLIENT

.10

The auditor should evaluate the relationship[8] of the specialist to the client, including circumstances that might impair the specialist's objectivity. Such circumstances include situations in which the client has the ability—through employment, ownership, contractual right, family relationship, or otherwise—to directly or indirectly control or significantly influence the specialist.

.11

When a specialist does not have a relationship with the client, the specialist's work usually will provide the auditor with greater assurance of reliability. However, the work of a specialist who has a relationship with the client may be acceptable under certain circumstances. If the specialist has a relationship with the client, the auditor should assess the risk that the specialist's objectivity might be impaired. If the auditor believes the relationship might impair the specialist's objectivity, the auditor should perform additional procedures with respect to some or all of the specialist's assumptions, methods, or findings to determine that the findings are not unreasonable or should engage another specialist for that purpose.

16. USING THE FINDINGS OF THE SPECIALIST

.12

The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (*a*) obtain an understanding of the methods and assumptions used by the specialist, (*b*) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (*c*) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the opinion of another specialist.

17. EFFECT OF THE SPECIALIST'S WORK ON THE AUDITOR'S REPORT

.13

The following paragraph is effective for audits of fiscal years beginning on or after December 15, 2010. See PCAOB Release No. 2010-004:

If the auditor determines that the specialist's findings support the related assertions in the financial statements, he or she reasonably may conclude that sufficient appropriate evidential matter has been obtained. If there is a material difference between the specialist's findings and

[8] The term *relationship* includes, but is not limited to, those situations discussed in section 334, *Related Parties*, footnote 1.

the assertions in the financial statements, he or she should apply additional procedures. If after applying any additional procedures that might be appropriate the auditor is unable to resolve the matter, the auditor should obtain the opinion of another specialist, unless it appears to the auditor that the matter cannot be resolved. A matter that has not been resolved ordinarily will cause the auditor to conclude that he or she should qualify the opinion or disclaim an opinion because the inability to obtain sufficient appropriate evidential matter as to an assertion of material significance in the financial statements constitutes a scope limitation. (See section 508, *Reports on Audited Financial Statements*, paragraphs .22 and .23.)

.14
The auditor may conclude after performing additional procedures, including possibly obtaining the opinion of another specialist, that the assertions in the financial statements are not in conformity with GAAP. In that event, the auditor should express a qualified or adverse opinion. (See section 508.35, .36, and .41.)

18. REFERENCE TO THE SPECIALIST IN THE AUDITOR'S REPORT

.15
Except as discussed in paragraph .16, the auditor should not refer to the work or findings of the specialist. Such a reference might be misunderstood to be a qualification of the auditor's opinion or a division of responsibility, neither of which is intended. Further, there may be an inference that the auditor making such reference performed a more thorough audit than an auditor not making such reference.

.16
The auditor may, as a result of the report or findings of the specialist, decide to add explanatory language to his or her standard report or depart from an unqualified opinion. Reference to and identification of the specialist may be made in the auditor's report if the auditor believes such reference will facilitate an understanding of the reason for the explanatory paragraph or the departure from the unqualified opinion.

19. THE AUDIT PROCESS

Valuation work typically falls under management's use of estimates on the Company's balance sheet. Goodwill and intangible assets are estimated using the work of a specialist as defined in the section above. Stock option valuation may have an impact on the income statement as well. Typically, all intangible assets are audited as part of any auditor's procedures. Below are audit steps taken when a valuation report is handed over to the auditors:

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AU Section 328 – Auditing Fair Value Measurements and Disclosures[9]

Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data

.23

Based on the auditor's assessment of the risk of material misstatement, the auditor should test the entity's fair value measurements and disclosures. Because of the wide range of possible fair value measurements, from relatively simple to complex, and the varying levels of risk of material misstatement associated with the process for determining fair values, the auditor's planned audit procedures can vary significantly in nature, timing, and extent. For example, substantive tests of the fair value measurements may involve (a) testing management's significant assumptions, the valuation model, and the underlying data (see paragraphs .26 through .39), (b) developing independent fair value estimates for corroborative purposes (see paragraph .40), or (c) reviewing subsequent events and transactions (see paragraphs .41 and .42).

.24

Some fair value measurements are inherently more complex than others. This complexity arises either because of the nature of the item being measured at fair value or because of the valuation method used to determine fair value. For example, in the absence of quoted prices in an active market, an estimate of a security's fair value may be based on valuation methods such as the discounted cash flow method or the transactions method. Complex fair value measurements normally are characterized by greater uncertainty regarding the reliability of the measurement process. This greater uncertainty may be a result of:

- The length of the forecast period
- The number of significant and complex assumptions associated with the process
- A higher degree of subjectivity associated with the assumptions and factors used in the process
- A higher degree of uncertainty associated with the future occurrence or outcome of events underlying the assumptions used
- Lack of objective data when highly subjective factors are used

.25

The auditor uses both the understanding of management's process for determining fair value measurements and his or her assessment of the risk of material misstatement to determine the nature, timing, and extent of the audit procedures. The following are examples of considerations in the development of audit procedures:

- The fair value measurement (for example, a valuation by an independent appraiser) may be made at a date that does not coincide with the date at which the entity is required to measure and report that information in its financial

[9] Source: SAS No. 101; SAS No. 113. A PDF copy of Section 328 may be obtained from the American Institute of CPAs at http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00328.pdf

statements. In such cases, the auditor obtains evidence that management has taken into account the effect of events, transactions, and changes in circumstances occurring between the date of the fair value measurement and the reporting date.

- Collateral often is assigned for certain types of investments in debt instruments that either are required to be measured at fair value or are evaluated for possible impairment. If the collateral is an important factor in measuring the fair value of the investment or evaluating its carrying amount, the auditor obtains sufficient appropriate audit evidence regarding the existence, value, rights, and access to or transferability of such collateral, including consideration of whether all appropriate liens have been filed, and considers whether appropriate disclosures about the collateral have been made.
- In some situations, additional procedures, such as the inspection of an asset by the auditor, may be necessary to obtain sufficient appropriate audit evidence about the appropriateness of a fair value measurement. For example, inspection of the asset may be necessary to obtain information about the current physical condition of the asset relevant to its fair value, or inspection of a security may reveal a restriction on its marketability that may affect its value.

[Revised, March 2008, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.26

The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether:

a) Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06).

b) The fair value measurement was determined using an appropriate model, if applicable.

c) Management used relevant information that was reasonably available at the time.

.27

Estimation methods and assumptions, and the auditor's consideration and comparison of fair value measurements determined in prior periods, if any, to results obtained in the current period, may provide evidence of the reliability of management's processes. However, the auditor also considers whether variances from the prior-period fair value measurements result from changes in market or economic circumstances.

.28

Where applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.

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.29

Assumptions are integral components of more complex valuation methods, for example, valuation methods that employ a combination of estimates of expected future cash flows together with estimates of the values of assets or liabilities in the future, discounted to the present. Auditors pay particular attention to the significant assumptions underlying a valuation method and evaluate whether such assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06).

.30

Specific assumptions will vary with the characteristics of the item being valued and the valuation approach used (for example, cost, market, or income). For example, where the discounted cash flows method (a method under the income approach) is used, there will be assumptions about the level of cash flows, the period of time used in the analysis, and the discount rate.

.31

Assumptions ordinarily are supported by differing types of evidence from internal and external sources that provide objective support for the assumptions used. The auditor evaluates the source and reliability of evidence supporting management's assumptions, including consideration of the assumptions in light of historical and market information.

.32

Audit procedures dealing with management's assumptions are performed in the context of the audit of the entity's financial statements. The objective of the audit procedures is therefore not intended to obtain sufficient appropriate audit evidence to provide an opinion on the assumptions themselves. Rather, the auditor performs procedures to evaluate whether the assumptions provide a reasonable basis for measuring fair values in the context of an audit of the financial statements taken as a whole.
[Revised, March 2008, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 105.]

.33

Identifying those assumptions that appear to be significant to the fair value measurement requires the exercise of judgment by management. The auditor focuses attention on the significant assumptions that management has identified. Generally, significant assumptions cover matters that materially affect the fair value measurement and may include those that are:

a) Sensitive to variation or uncertainty in amount or nature. For example, assumptions about short-term interest rates may be less susceptible to significant variation compared to assumptions about long-term interest rates.

b) Susceptible to misapplication or bias.

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.34

The auditor considers the sensitivity of the valuation to changes in significant assumptions, including market conditions that may affect the value. Where applicable, the auditor encourages management to use techniques such as sensitivity analysis to help identify particularly sensitive assumptions. If management has not identified particularly sensitive assumptions, the auditor considers whether to employ techniques to identify those assumptions.

.35

The evaluation of whether the assumptions provide a reasonable basis for the fair value measurements relates to the whole set of assumptions as well as to each assumption individually. Assumptions are frequently interdependent and therefore need to be internally consistent. A particular assumption that may appear reasonable when taken in isolation may not be reasonable when used in conjunction with other assumptions. The auditor considers whether management has identified the significant assumptions and factors influencing the measurement of fair value.

.36

To be reasonable, the assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows),[10] individually and taken as a whole, need to be realistic and consistent with:

a. The general economic environment, the economic environment of the specific industry, and the entity's economic circumstances;
b. Existing market information;
c. The plans of the entity, including what management expects will be the outcome of specific objectives and strategies;
d. Assumptions made in prior periods, if appropriate;
e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable;
f. Other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts other than those relating to fair value measurements and disclosures; and
g. The risk associated with cash flows, if applicable, including the potential variability in the amount and timing of the cash flows and the related effect on the discount rate.

Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience.

[10] The auditor also should consider requirements of FASB ASC 820, *Fair Value Measurements and Disclosures*. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote renumbered, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16.]

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.37
If management relies on historical financial information in the development of assumptions, the auditor considers the extent to which such reliance is justified. However, historical information might not be representative of future conditions or events, for example, if management intends to engage in new activities or circumstances change.

.38
For items valued by the entity using a valuation model, the auditor does not function as an appraiser and is not expected to substitute his or her judgment for that of the entity's management. Rather, the auditor reviews the model and evaluates whether the assumptions used are reasonable and the model is appropriate considering the entity's circumstances. For example, it may be inappropriate to use discounted cash flows for valuing an equity investment in a start-up enterprise if there are no current revenues on which to base the forecast of future earnings or cash flows.

.39
The auditor should test the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions. Specifically, the auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of a specialist, is accurate, complete, and relevant; and whether fair value measurements have been properly determined using such data and management's assumptions. The auditor's tests also may include, for example, procedures such as verifying the source of the data, mathematical recomputation of inputs, and reviewing of information for internal consistency, including whether such information is consistent with management's intent and ability to carry out specific courses of action discussed in paragraph .17.

20. EXPLORING SOME FDIC RULES AND REGULATIONS[11]:

§ 365.2 Real estate lending standards.
(a) Each insured state nonmember bank shall adopt and maintain written policies that establish appropriate limits and standards for extensions of credit that are secured by liens on or interests in real estate, or that are made for the purpose of financing permanent improvements to real estate.
(b)(1) Real estate lending policies adopted pursuant to this section must:
  (i) Be consistent with safe and sound banking practices;
  (ii) Be appropriate to the size of the institution and the nature and scope of its operations; and
  (iii) Be reviewed and approved by the bank's board of directors at least annually.
(2) The lending policies must establish:

[11] FDIC Law, Regulations, Related Acts, 2000 – Rules and Regulations, Part 365 – Real Estate Lending Standards. http://www.fdic.gov/regulations/laws/rules/2000-8700.html

(i) Loan portfolio diversification standards;
(ii) Prudent underwriting standards, including loan-to-value limits, that are clear and measurable;
(iii) Loan administration procedures for the bank's real estate portfolio; and
(iv) Documentation, approval, and reporting requirements to monitor compliance with the bank's real estate lending policies.

(c) Each insured state nonmember bank must monitor conditions in the real estate market in its lending area to ensure that its real estate lending policies continue to be appropriate for current market conditions.

(d) The real estate lending policies adopted pursuant to this section should reflect consideration of the Interagency Guidelines for Real Estate Lending Policies established by the federal bank and thrift supervisory agencies.

[Codified to 12 C.F.R. § 365.2]

Appendix A to Subpart A of Part 365—Interagency Guidelines for Real Estate Lending Policies

The agencies' regulations require that each insured depository institution adopt and maintain a written policy that establishes appropriate limits and standards for all extensions of credit that are secured by liens on or interests in real estate or made for the purpose of financing the construction of a building or other improvements.[12] These guidelines are intended to assist institutions in the formulation and maintenance of a real estate lending policy that is appropriate to the size of the institution and the nature and scope of its individual operations, as well as satisfies the requirements of the regulation.

Each institution's policies must be comprehensive, and consistent with safe and sound lending practices, and must ensure that the institution operates within limits and according to standards that are reviewed and approved at least annually by the board of directors. Real estate lending is an integral part of many institutions' business plans and, when undertaken in a prudent manner, will not be subject to examiner criticism.

Loan Portfolio Management Considerations

The lending policy should contain a general outline of the scope and distribution of the institution's credit facilities and the manner in which real estate loans are made, serviced, and collected. In particular, the institution's policies on real estate lending should:

- Identify the geographic areas in which the institution will consider lending.
- Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market (e.g., limits on higher risk loans).
- Identify appropriate terms and conditions by type of real estate loan.
- Establish loan origination and approval procedures, both generally and by size and type of loan.

[12] http://www.fdic.gov/regulations/laws/rules/2000-8700.html#fdicfoot1_1

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- Establish prudent underwriting standards that are clear and measurable, including loan-to-value limits, that are consistent with these supervisory guidelines.
- Establish review and approval procedures for exception loans, including loans with loan-to-value percentages in excess of supervisory limits.
- Establish loan administration procedures, including documentation, disbursement, collateral inspection, collection, and loan review.
- Establish real estate appraisal and evaluation programs.
- Require that management monitor the loan portfolio and provide timely and adequate reports to the board of directors.
- The institution should consider both internal and external factors in the formulation of its loan policies and strategic plan. Factors that should be considered include:
  - The size and financial condition of the institution.
  - The expertise and size of the lending staff.
  - The need to avoid undue concentrations of risk.
  - Compliance with all real estate related laws and regulations, including the Community Reinvestment Act, anti-discrimination laws, and for savings associations, the Qualified Thrift Lender test.
  - Market conditions.
- The institution should monitor conditions in the real estate markets in its lending area so that it can react quickly to changes in market conditions that are relevant to its lending decisions. Market supply and demand factors that should be considered include:
  - Demographic indicators, including population and employment trends.
  - Zoning requirements.
  - Current and projected vacancy, construction, and absorption rates.
  - Current and projected lease terms, rental rates, and sales prices, including concessions.
  - Current and projected operating expenses for different types of projects.
  - Economic indicators, including trends and diversification of the lending area.
  - Valuation trends, including discount and direct capitalization rates.

Underwriting Standards

Prudently underwritten real estate loans should reflect all relevant credit factors, including:

- The capacity of the borrower, or income from the underlying property, to adequately service the debt.
- The value of the mortgaged property.
- The overall creditworthiness of the borrower.
- The level of equity invested in the property.
- Any secondary sources of repayment.
- Any additional collateral or credit enhancements (such as guarantees, mortgage insurance, or takeout commitments).

- The lending policies should reflect the level of risk that is acceptable to the board of directors and provide clear and measurable underwriting standards that enable the institution's lending staff to evaluate these credit factors. The underwriting standards should address:
    - The maximum loan amount by type of property.
    - Maximum loan maturities by type of property.
    - Amortization schedules.
    - Pricing structure for different types of real estate loans.
    - Loan-to-value limits by type of property.
- For development and construction projects, and completed commercial properties, the policy should also establish, commensurate with the size and type of the project or property:
    - Requirements for feasibility studies and sensitivity and risk analyses (*e.g.*, sensitivity of income projections to changes in economic variables such as interest rates, vacancy rates, or operating expenses).
    - Minimum requirements for initial investment and maintenance of hard equity by the borrower (*e.g.*, cash or unencumbered investment in the underlying property).
    - Minimum standards for net worth, cash flow, and debt service coverage of the borrower or underlying property.
    - Standards for the acceptability of and limits on non-amortizing loans.
    - Standards for the acceptability of and limits on the use of interest reserves.
    - Pre-leasing and pre-sale requirements for income-producing property.
    - Pre-sale and minimum unit release requirements for non-income-producing property loans.
    - Limits on partial recourse or nonrecourse loans and requirements for guarantor support.
    - Requirements for takeout commitments.
    - Minimum covenants for loan agreements.

Loan Administration

The institution should also establish loan administration procedures for its real estate portfolio that address:

- Documentation, including:
    - Type and frequency of financial statements, including requirements for verification of information provided by the borrower.
    - Type and frequency of collateral evaluations (appraisals and other estimates of value).
    - Loan closing and disbursement.
    - Payment processing.
    - Escrow administration.
    - Collateral administration.
    - Loan payoffs.

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- Collections and foreclosure, including:
- Delinquency follow-up procedures.
- Foreclosure timing.
- Extensions and other forms of forbearance.
- Acceptance of deeds in lieu of foreclosure.
- Claims processing (*e.g.*, seeking recovery on a defaulted loan covered by a government guaranty or insurance program).
- Servicing and participation agreements.

21. USPAP STANDARD 7 AND 8 EXCERPTS

When we review the USPAP standards in conjunction with Audit standards, SEC standards, FDIC practice, and effective legal practice, we quickly find many conflicts. Below we excerpt relevant rules and discuss appraiser challenges. Our task is to provide credible appraisal results. We want to avoid restatements. The repercussions of an appraisal restatement can have a significant impact.

Standard 7: Personal Property Appraisal, Development

<u>Standards Rule 7-1</u>

In developing a personal property appraisal, an appraiser must:

(a) be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal;

<u>Comment</u>: This Standards Rule recognizes that changes continue to affect the manner in which appraisers perform appraisal services. Changes and developments in personal property practice have a substantial impact on the appraisal profession. Important changes in the cost and manner of acquiring, producing, and marketing personal property and changes in the legal framework in which appraisers perform their assignments result in the need for corresponding changes in personal property appraisal theory and practice. Social change has also had an effect on appraisal theory and practice. The appraisal profession responds to changing circumstances with revised and new appraisal methods and techniques. Therefore, it is not sufficient for appraisers to maintain the skills and the knowledge they possess when they become appraisers. Each appraiser must improve and update his or her skills and knowledge to remain proficient in the appraisal of personal property.

(b) not commit a substantial error of omission or commission that significantly affects an appraisal; and

Comment: An appraiser must use sufficient care to avoid errors that would significantly affect his or her opinions and conclusions. Diligence is required to identify and analyze the factors, conditions, data, and other information that would have a significant effect on the credibility of the assignment results.

(c) not render appraisal services in a careless or negligent manner, such as by making a series of errors that, although individually might not significantly affect the results of an appraisal, in the aggregate affect the credibility of those results.

Comment: Perfection is impossible to attain, and competence does not require perfection. However, an appraiser must not render appraisal services in a careless or negligent manner. This Standards Rule requires an appraiser to use due diligence and care.

Standards Rule 7-3

In developing a personal property appraisal, when necessary for credible assignment results, an appraiser must:

(a) analyze the property's current use and alternative uses as relevant to the type and definition of value and intended use of the appraisal;

Comment: In the context of personal property, value can be a function of the choice of the appropriate market or, in some cases, market level for the type of item, the type and definition of value, and the intended use of the appraisal.

The appraiser must consider the various uses of the property when viable alternative uses exist and when those alternative uses may result in a different value.

(b) define and analyze the appropriate market consistent with the type and definition of value; and

Comment: The appraiser must recognize that there are distinct levels of trade (measurable marketplaces) and each may generate its own data. For example, a property may have a different value at a wholesale level of trade, retail level of trade, or under various auction conditions. Therefore, the appraiser must analyze the subject property within the correct market context.

(c) analyze the relevant economic conditions that exist on the effective date of the valuation, including market acceptability of the property and supply, demand, scarcity, or rarity.

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Standards Rule 7-4

In developing a personal property appraisal, an appraiser must collect, verify, and analyze all information necessary for credible assignment results.

(a) When a sales comparison approach is necessary for credible assignment results, an appraiser must analyze such comparable sales data as are available to indicate a value conclusion.

(b) When a cost approach is necessary for credible assignment results, an appraiser must:

(i) analyze such comparable cost data as are available to estimate the cost new of the property; and
(ii) analyze such comparable data as are available to estimate the difference between cost new and the present worth of the property (accrued depreciation).

(c) When an income approach is necessary for credible assignment results, an appraiser must:

(i) analyze such comparable data as are available to estimate the market income of the property;
(ii) analyze such comparable operating expense data as are available to estimate the operating expenses of the property;
(iii) analyze such comparable data as are available to estimate rates of capitalization and/or rates of discount; and
(iv) base projections of future income and expenses on reasonably clear and appropriate evidence.

Comment: An appraiser must, in developing income and expense statements and cash flow projections, weigh historical information and trends, current supply and demand factors affecting such trends, and competition.

(d) When developing an opinion of the value of a lease, leased, or encumbered property, an appraiser must analyze the effect on value, if any, of the terms and conditions of the lease(s) or encumbrances.

(e) When appraising multiple objects, the appraiser must consider the significance of the value of the individual assets to the assignment results. Those objects which are more significant to the assignment results should be the focus of the analysis and analyzed in appropriate detail.

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Comment: A group of objects may have a mix of high and low value items. Those objects that are more significant to the assignment results should be subject to a greater and appropriate depth of analysis.

(f) When analyzing the assemblage of the various component parts of a property, an appraiser must analyze the effect on value, if any, of the assemblage. An appraiser must refrain from valuing the whole solely by adding together the individual values of the various component parts.

Comment: Although the value of the whole may be equal to the sum of the separate parts, it also may be greater than or less than the sum of such parts. Therefore, the value of the whole must be tested by reference to appropriate data and supported by an appropriate analysis of such data.

A similar procedure must be followed when the value of the whole has been established and the appraiser seeks to value a part. The value of any such part must be tested by reference to appropriate data and supported by an appropriate analysis of such data.

(g) When analyzing anticipated modifications to the subject property, an appraiser must analyze the effect on value, if any, of such modifications to the extent they are reflected in market actions.

(h) When real property or intangible items are included in the appraisal, the appraiser must analyze the effect on value of such non-personal property items.

Comment: When the scope of work includes an appraisal of real property or intangible items, competency in real property appraisal (see STANDARD 1) or business appraisal (see STANDARD 9) is required. In addition, competency in other types of personal property outside of the appraiser's specialty area may be necessary (see STANDARD 7 and the COMPETENCY RULE).

Standard 8: Personal Property Appraisal, Reporting

Standards Rule 8-2

Each written personal property appraisal report must be prepared under one of the following three options and prominently state which option is used: Self-Contained Appraisal Report, Summary Appraisal Report, or Restricted Use Appraisal Report.[13]

[13] See Advisory Opinion 11, *Content of the Appraisal Report Options of Standards Rules 2-2 and 8-2*, and Advisory Opinion 12, *Use of the Appraisal Report Options of Standards Rules 2-2 and 8-2.*

Comment: When the intended users include parties other than the client, either a Self-Contained Appraisal Report or a Summary Appraisal Report must be provided. When the intended users do not include parties other than the client, a Restricted Use Appraisal Report may be provided.

The essential difference among these three options is in the content and level of information provided. The appropriate reporting option and the level of information necessary in the report are dependent on the intended use and intended users.

An appraiser must use care when characterizing the type of report and level of information communicated upon completion of an assignment. An appraiser may use any other label in addition to, but not in place of, the label set forth in this Standard for the type of report provided.

The report content and level of information requirements set forth in this Standard are minimums for each type of report. An appraiser must supplement a report form, when necessary, to ensure that any intended user of the appraisal is not misled and that the report complies with the applicable content requirements set forth in this Standards Rule.

A party receiving a copy of a Self-Contained Appraisal Report, Summary Appraisal Report, or Restricted Use Appraisal Report in order to satisfy disclosure requirements does not become an intended user of the appraisal unless the appraiser identifies such party as an intended user as part of the assignment.

(a) The content of a Self-Contained Appraisal Report must be consistent with the intended use of the appraisal and, at a minimum:

(i) state the identity of the client and any intended users, by name or type;[14]

Comment: An appraiser must use care when identifying the client to ensure a clear understanding and to avoid violations of the Confidentiality section of the ETHICS RULE. In those rare instances where the client wishes to remain anonymous, an appraiser must still document the identity of the client in the workfile but may omit the client's identity in the report.

(ii) state the intended use of the appraisal,[15]

(iii) describe information sufficient to identify the property involved in the appraisal, including the physical and economic property characteristics relevant to the assignment;

(iv) state the property interest appraised;

[14] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*
[15] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*

(v) state the type and definition of value and cite the source of the definition;

Comment: Stating the definition of value also requires any comments needed to clearly indicate to the intended users how the definition is being applied.
When reporting an opinion of market value, state whether the opinion of value is:

- in terms of cash or of financing terms equivalent to cash, or
- based on non-market financing or financing with unusual conditions or incentives.

When an opinion of market value is not in terms of cash or based on financing terms equivalent to cash, summarize the terms of such financing and explain their contributions to or negative influence on value.

When an opinion of reasonable exposure time has been developed in compliance with Standards Rule 7-2(c), the opinion must be stated in the report.[16]

(vi) state the effective date of the appraisal and the date of the report;[17]

Comment: The effective date of the appraisal establishes the context for the value opinion, while the date of the report indicates whether the perspective of the appraiser on the market and property as of the effective date of the appraisal was prospective, current, or retrospective.

(vii) describe the scope of work used to develop the appraisal;[18]

Comment: Because intended users' reliance on an appraisal may be affected by the scope of work, the report must enable them to be properly informed and not misled. Sufficient information includes disclosure of research and analyses performed and might also include disclosure of research and analyses not performed.

When any portion of the work involves significant personal property appraisal assistance, the appraiser must describe the extent of that assistance. The signing appraiser must also state the name(s) of those providing the significant personal property appraisal assistance in the certification, in accordance with Standards Rule 8-3.[19]

(viii) describe the information analyzed, the appraisal methods and techniques employed, and the reasoning that supports the analyses, opinions, and conclusions;

[16] See Statement on Appraisal Standards No. 6, *Reasonable Exposure Time in Real Property and Personal Property Opinions of Value.* See also Advisory Opinion 7 *Marketing Time Opinions.*
[17] See Statement on Appraisal Standards No. 3, *Retrospective Value Opinions*, and Statement on Appraisal Standards No. 4, *Prospective Value Opinions.*
[18] See Advisory Opinion 28, *Scope of Work Decision, Performance, and Disclosure* and Advisory Opinion 29, *An Acceptable Scope of Work.*
[19] See Advisory Opinion 31, *Assignments Involving More than One Appraiser.*

exclusion of the sales comparison approach, cost approach, or income approach must be explained,[20]

Comment: A Self-Contained Appraisal Report must include sufficient information to indicate that the appraiser complied with the requirements of STANDARD 7. The amount of detail required will vary with the significance of the information to the appraisal.

The appraiser must provide sufficient information to enable the client and intended users to understand the rationale for the opinions and conclusions, including reconciliation of the data and approaches, in accordance with Standards Rule 7-6.

When reporting an opinion of market value, a summary of the results of analyzing the subject sales, offers, options, and listings in accordance with Standards Rule 7-5 is required. If such information was unobtainable, a statement on the efforts undertaken by the appraiser to obtain the information is required. If such information is irrelevant, a statement acknowledging the existence of the information and citing its lack of relevance is required.

(ix) state, as appropriate to the class of personal property involved, the use of the property existing as of the date of value and the use of the property reflected in the appraisal; and, when an opinion of the appropriate market or market level was developed by the appraiser, describe the support and rationale for that opinion;

Comment: In the context of personal property, value can be a function of the current and alternative use of the subject property, the choice of the appropriate market or market level for the type of item, the type and definition of value, and intended use of the report.

(x) clearly and conspicuously:

- **state all extraordinary assumptions and hypothetical conditions; and**
- **state that their use might have affected the assignment results; and**

(xi) **include a signed certification in accordance with Standards Rule 8-3.**

(b) The content of a Summary Appraisal Report must be consistent with the intended use of the appraisal and, at a minimum:

Comment: The essential difference between the Self-Contained Appraisal Report and the Summary Appraisal Report is the level of detail of presentation.

(i) state the identity of the client and any intended users, by name or type,[21]

[20] See Advisory Opinion 2, *Inspection of Subject Property*.
[21] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*

Comment: An appraiser must use care when identifying the client to ensure a clear understanding and to avoid violations of the Confidentiality section of the ETHICS RULE. In those rare instances where the client wishes to remain anonymous, an appraiser must still document the identity of the client in the workfile but may omit the client's identity in the report.

(ii) state the intended use of the appraisal;[22]

(iii) summarize information sufficient to identify the property involved in the appraisal, including the physical and economic property characteristics relevant to the assignment;

(iv) state the property interest appraised;

(v) state the type and definition of value and cite the source of the definition;

Comment: Stating the definition of value also requires any comments needed to clearly indicate to the intended users how the definition is being applied.

When reporting an opinion of market value, state whether the opinion of value is:

- in terms of cash or of financing terms equivalent to cash, or
- based on non-market financing or financing with unusual conditions or incentives.

When an opinion of market value is not in terms of cash or based on financing terms equivalent to cash, summarize the terms of such financing and explain their contributions to or negative influence on value.

When an opinion of reasonable exposure time has been developed in compliance with Standards Rule 7-2(c), the opinion must be stated in the report.[23]

(vi) state the effective date of the appraisal and the date of the report;[24]

Comment: The effective date of the appraisal establishes the context for the value opinion, while the date of the report indicates whether the perspective of the appraiser on the market and property as of the effective date of the appraisal was prospective, current, or retrospective.

(vii) summarize the scope of work used to develop the appraisal;[25]

[22] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*

[23] See Statement on Appraisal Standards No. 6, *Reasonable Exposure Time in Real Property and Personal Property Opinions of Value*. See also Advisory Opinion 7, *Marketing Time Opinions*.

[24] See Statement on Appraisal Standards No. 3, *Retrospective Value Opinions*, and Statement on Appraisal Standards No. 4, *Prospective Value Opinions.*

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Comment: Because intended users' reliance on an appraisal may be affected by the scope of work, the report must enable them to be properly informed and not misled. Sufficient information includes disclosure of research and analyses performed and might also include disclosure of research and analyses not performed.

When any portion of the work involves significant personal property appraisal assistance, the appraiser must summarize the extent of that assistance. The signing appraiser must also state the name(s) of those providing the significant personal property appraisal assistance in the certification, in accordance with Standards Rule 8-3.[26]

(viii) summarize the information analyzed, the appraisal methods and techniques employed, and the reasoning that supports the analyses, opinions, and conclusions; exclusion of the sales comparison approach, cost approach, or income approach must be explained;[27]

Comment: A Summary Appraisal Report must include sufficient information to indicate that the appraiser complied with the requirements of STANDARD 7. The amount of detail required will vary with the significance of the information to the appraisal.

The appraiser must provide sufficient information to enable the client and intended users to understand the rationale for the opinion and conclusions, including reconciliation of the data and approaches, in accordance with Standards Rule 7-6.

When reporting an opinion of market value, a summary of the results of the analysis of the subject sales, offers, options, and listings in accordance with Standards Rule 7-5 is necessary. If such information was unobtainable, a statement on the efforts undertaken by the appraiser to obtain the information is required. If such information is irrelevant, a statement acknowledging the existence of the information and citing its lack of relevance is required.

(ix) state, as appropriate to the class of personal property involved, the use of the property existing as of the date of value and the use of the property reflected in the appraisal; and, when an opinion of the appropriate market or market level was developed by the appraiser, summarize the support and rationale for that opinion;

Comment: In the context of personal property, highest and best use may equate to the choice of the appropriate market or market level for the type of item, the type and definition of value, and intended use of the report.

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[25] See Advisory Opinion 28, *Scope of Work Decision, Performance, and Disclosure* and Advisory Opinion 29, *An Acceptable Scope of Work.*
[26] See Advisory Opinion 31, *Assignments Involving More than One Appraiser.*
[27] See Advisory Opinion 2, *Inspection of Subject Property.*

(x) clearly and conspicuously:

- **state all extraordinary assumptions and hypothetical conditions; and**
- **state that their use might have affected the assignment results; and**

(xi) include a signed certification in accordance with Standards Rule 8-3.

(c) The content of a Restricted Use Appraisal Report must be consistent with the intended use of the appraisal and, at a minimum:

(i) state the identity of the client, by name or type;[28] and state a prominent use restriction that limits use of the report to the client and warns that the appraiser's opinions and conclusions set forth in the report may not be understood properly without additional information in the appraiser's workfile;

Comment: An appraiser must use care when identifying the client to ensure a clear understanding and to avoid violations of the Confidentiality section of the ETHICS RULE. In those rare instances when the client wishes to remain anonymous, an appraiser must still document the identity of the client in the workfile but may omit the client's identity in the report.

The Restricted Use Appraisal Report is for client use only. Before entering into an agreement, the appraiser should establish with the client the situations where this type of report is to be used and should ensure that the client understands the restricted utility of the Restricted Use Appraisal Report.

(ii) state the intended use of the appraisal;[29]

Comment: The intended use of the appraisal must be consistent with the limitation on use of the Restricted Use Appraisal Report option in this Standards Rule (i.e., client use only).

(iii)state information sufficient to identify the property involved in the appraisal;

(iv)state the property interest appraised;

(v) state the type of value, and cite the source of its definition;[30]

Comment: When an opinion of reasonable exposure time has been developed in compliance with Standards Rule 7-2(c), the opinion must be stated in the report.

[28] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*
[29] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*
[30] See Statement on Appraisal Standards No. 6, *Reasonable Exposure Time in Real Property and Personal Property Opinions of Value*. See also Advisory Opinion 7, *Marketing Time Opinions*.

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(vi) state the effective date of the appraisal and the date of the report;[31]

Comment: The effective date of the appraisal establishes the context for the value opinion, while the date of the report indicates whether the perspective of the appraiser on the market and property as of the effective date of the appraisal was prospective, current, or retrospective.

(vii) state the scope of work used to develop the appraisal;[32]

Comment: Because the client's reliance on an appraisal may be affected by the scope of work, the report must enable them to be properly informed and not misled. Sufficient information includes disclosure of research and analyses performed and might also include disclosure of research and analyses not performed.

When any portion of the work involves significant personal property appraisal assistance, the appraiser must state the extent of that assistance. The signing appraiser must also state the name(s) of those providing the significant personal property appraisal assistance in the certification, in accordance with Standards Rule 8-3.[33]

(viii) state the appraisal methods and techniques employed, state the value opinion(s) and conclusion(s) reached, and reference the workfile; exclusion of the sales comparison approach, cost approach, or income approach must be explained;[34]

Comment: An appraiser must maintain a specific, coherent workfile in support of a Restricted Use Appraisal Report. The contents of the workfile must include sufficient information to indicate that the appraiser complied with the requirements of STANDARD 7 and for the appraiser to produce a Summary Appraisal Report.

When reporting an opinion of market value, information analyzed in compliance with Standards Rule 7-5 is significant information that must be disclosed in a Restricted Use Appraisal Report. If such information was unobtainable, a statement on the efforts undertaken by the appraiser to obtain the information is required. If such information is irrelevant, a statement acknowledging the existence of the information and citing its lack of relevance is required.

(ix) state, as appropriate to the class of personal property involved, the use of the property existing as of the date of value and the use of the property reflected in the

[31] See Statement on Appraisal Standards No. 3, *Retrospective Value Opinions*, and Statement on Appraisal Standards No. 4, *Prospective Value Opinions*.
[32] See Advisory Opinion 28, *Scope of Work Decision, Performance, and Disclosure* and Advisory Opinion 29, *An Acceptable Scope of Work.*
[33] See Advisory Opinion 31, *Assignments Involving More than One Appraiser.*
[34] See Advisory Opinion 2, *Inspection of Subject Property.*

appraisal; and, when an opinion of the appropriate market or market level was developed by the appraiser, state that opinion;

Comment: In the context of personal property, value can be a function of the current and alternative use of the subject property, the choice of the appropriate market or market level for the type of item, the type and definition of value, and intended use of the report.

(x) clearly and conspicuously:

- **state all extraordinary assumptions and hypothetical conditions; and**
- **state that their use might have affected the assignment results; and**

(xi) include a signed certification in accordance with Standards Rule 8-3.

Standard 10: Business Appraisal, Reporting

Standards Rule 10-2

Each written appraisal report for an interest in a business enterprise or intangible asset must be prepared in accordance with one of the following options and prominently state which option is used: Appraisal Report or Restricted Use Appraisal Report.

Comment: When the intended users include parties other than the client, an Appraisal Report must be provided. When the intended users do not include parties other than the client, a Restricted Use Appraisal Report may be provided.

The essential difference between these options is in the content and level of information provided. The appropriate reporting option and the level of information necessary in the report are dependent on the intended use and intended users.

An appraiser must use care when characterizing the type of report and level of information communicated upon completion of an assignment. An appraiser may use any other label in addition to, but not in place of, the label set forth in this Standard for the type of report provided.

The report content and level of information requirements set forth in this Standard are minimums for both types of report.

A party receiving a copy of an Appraisal Report or Restricted Use Appraisal Report does not become an intended user of the appraisal unless the appraiser identifies such party as an intended user as part of the assignment.

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(b) The content of an Appraisal Report must be consistent with the intended use of the appraisal and, at a minimum:

(i) state the identity of the client and any other intended users, by name or type;[35]

Comment: An appraiser must use care when identifying the client to ensure a clear understanding and to avoid violations of the Confidentiality section of the ETHICS RULE. In those rare instances when the client wishes to remain anonymous, an appraiser must still document the identity of the client in the workfile but may omit the client's identity in the report.

(ii) state the intended use of the appraisal;[36]

(iii) summarize information sufficient to identify the business or intangible asset and the interest appraised;

Comment: The identification information must include property characteristics relevant to the type and definition of value and intended use of the appraisal.

(iv) state the extent to which the interest appraised contains elements of ownership control, including the basis for that determination;

(v) state the extent to which the interest appraised lacks elements of marketability and/or liquidity, including the basis for that determination;

(vi) state the standard (type) and definition of value and the premise of value and cite the source of the definition;

Comment: Stating the definition of value also requires any comments needed to clearly indicate to the intended users how the definition is being applied.

(vii) state the effective date of the appraisal and the date of the report;

Comment: The effective date of the appraisal establishes the context for the value opinion, while the date of the report indicates whether the perspective of the appraiser on the market or property as of the effective date of the appraisal was prospective, current, or retrospective.

(viii) summarize the scope of work used to develop the appraisal;[37]

Comment: Because intended users' reliance on an appraisal may be affected by the scope of work, the report must enable them to be properly informed and not misled. Sufficient

[35] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*
[36] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*
[37] See Advisory Opinion 28, *Scope of Work Decision, Performance, and Disclosure*, and Advisory Opinion 29, *An Acceptable Scope of Work.*

information includes disclosure of research and analyses performed and might also include disclosure of research and analyses not performed.

When any portion of the work involves significant business and/or intangible asset appraisal assistance, the appraiser must summarize the extent of that assistance. The signing appraiser must also state the name(s) of those providing the significant business and/or intangible asset appraisal assistance in the certification, in accordance with Standards Rule 10-3.[38]

(ix) summarize the information analyzed, the appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions; exclusion of the market approach, asset-based (cost) approach, or income approach must be explained;

Comment: An Appraisal Report must include sufficient information to indicate that the appraiser complied with the requirements of STANDARD 9. The amount of detail required will vary with the significance of the information to the appraisal.

The appraiser must provide sufficient information to enable the client and intended users to understand the rationale for the opinions and conclusions, including reconciliation in accordance with Standards Rule 9-5.

(x) clearly and conspicuously:

- **state all extraordinary assumptions and hypothetical conditions; and**
- **state that their use might have affected the assignment results; and**

(xi) include a signed certification in accordance with Standards Rule 10-3.

(c) The content of a Restricted Use Appraisal Report must be consistent with the intended use of the appraisal and, at a minimum:

(i) state the identity of the client, by name or type;[39] and state a prominent use restriction that limits use of the report to the client and warns that the appraiser's opinions and conclusions set forth in the report may not be understood properly without additional information in the appraiser's workfile;

Comment: An appraiser must use care when identifying the client to ensure a clear understanding and to avoid violations of the Confidentiality section of the ETHICS RULE. In those rare instances when the client wishes to remain anonymous, an appraiser must still document the identity of the client in the workfile but may omit the client's identity in the report.

[38] See Advisory Opinion 31, *Assignments Involving More than One Appraiser*.
[39] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*

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The Restricted Use Appraisal Report is for client use only. Before entering into an agreement, the appraiser should establish with the client the situations where this type of report is to be used and should ensure that the client understands the restricted utility of the Restricted Use Appraisal Report.

(ii) state the intended use of the appraisal;[40]

Comment: The intended use of the appraisal must be consistent with the limitation on use of the Restricted Use Appraisal Report option in this Standards Rule (i.e. client use only).

(iii) state information sufficient to identify the business or intangible asset and the interest appraised;

Comment: The identification information must include property characteristics relevant to the type and definition of value and intended use of the appraisal.

(iv) state the extent to which the interest appraised contains elements of ownership control, including the basis for that determination;

(v) state the extent to which the interest appraised lacks elements of marketability and/or liquidity, including the basis for that determination;

(vi) state the standard (type) of value and the premise of value, and cite the source of its definition;

(vii) state the effective date of the appraisal and the date of the report;

Comment: The effective date of the appraisal establishes the context for the value opinion, while the date of the report indicates whether the perspective of the appraiser on the market or property as of the effective date of the appraisal was prospective, current, or retrospective.

(viii) state the scope of work used to develop the appraisal;[41]

Comment: Because the client's reliance on an appraisal may be affected by the scope of work, the report must enable them to be properly informed and not misled. Sufficient information includes disclosure of research and analyses performed and might also include disclosure of research and analyses not performed.

[40] See Statement on Appraisal Standards No. 9, *Identification of Intended Use and Intended Users.*
[41] See Advisory Opinion 28, *Scope of Work Decision, Performance, and Disclosure* and Advisory Opinion 29, *An Acceptable Scope of Work.*

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When any portion of the work involves significant business and/or intangible asset appraisal assistance, the appraiser must state the extent of that assistance. The signing appraiser must also state the name(s) of those providing the significant business and/or intangible asset appraisal assistance in the certification, in accordance with Standards Rule 10-3.[42]

(ix) state the appraisal procedures followed, state the value opinion(s) and conclusion(s) reached, and reference the workfile; exclusion of the market approach, asset-based (cost) approach, or income approach must be explained;

Comment: An appraiser must maintain a specific, coherent workfile in support of a Restricted Use Appraisal Report. The contents of the workfile must include sufficient information to indicate that the appraiser complied with the requirements of STANDARD 9 and for the appraiser to produce an Appraisal Report.

(x) clearly and conspicuously:

- **state all extraordinary assumptions and hypothetical conditions; and**
- **state that their use might have affected the assignment results; and**

(xi) include a signed certification in accordance with Standards Rule 10-3.

[42] See Advisory Opinion 31, *Assignments Involving More than One Appraiser*.

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