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OFFICIAL PUBLICATION

ASA Appraisal Review &
Management Discipline

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Standard of Care for Appraisal Review

By Jack Young, ASA, ARM, CPA

Abstract: A critical responsibility of the reviewer is to ascertain what the standard of care should be for the work under review (WUR) and to assess how well the WUR reflects that necessary standard of care. The Reviewer's competency in understanding and applying the standard(s) of care relevant to the WUR is critical to the review process. This standard of care is established in line with the research, methodology and analysis of an experienced and reasonable appraisal professionals in the community. (All USPAP citations from 2020-2021 Edition)



Origin of Standard of Care Concept

In 1837, the English tort law case *Vaughn v. Menlove* famously

introduced the concept of Standard of Care in the question of whether the defendant had “proceed[ed] with such reasonable caution as a prudent man would have exercised under such circumstances.”

The defendant in *Vaughn v. Menlove*, had been warned more than once that the haystack on his property appeared susceptible to spontaneous ignition. When it did ignite, the out-of-control fire consumed two cottages on an adjoining property. The haystack owner was held accountable not to the question of whether he had acted to the best of his own judgment, but in accordance with a “reasonable person’s universal duty of care.” The concept of standard of care supported by this legal case spread rapidly into the medical and legal fields and thence into other areas of professional practice, such as appraisal.

In appraisal standard of care, this “prudent man” is referenced as a “reasonable” appraisal professional, or, as USPAP references in the Acceptability section of the Scope of Work Rule, “the appraiser’s peers:”

The scope of work must include the research and analyses that are necessary to develop credible assignment results.

Comment: The scope of work is acceptable when it meets or exceeds:

- *the expectations of parties who are regularly intended users for similar assignments; and*
- *what an appraiser’s peers’ actions would be in performing the same or a similar assignment.*

Determining the scope of work is an ongoing process in an assignment. Information or conditions discovered during the course of an assignment might cause the appraiser to reconsider the scope of work.

An appraiser must be prepared to support the decision to exclude any investigation, information, method, or technique that would appear relevant to the client, another intended user, or the appraiser’s peers.

Determining Reasonable Standard of Care

It is important to note that standard of care is not subject to a precise definition and is judged on a case-by-case basis.

A reviewer should use information from the WUR’s scope of work to determine the purview of standard of care. If the WUR under review fails to meet that standard of care, it is most likely to be found invalid. By the same token, a WUR determined not to be credible is unlikely to meet the necessary standard of care.

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USPAP Standards alone often do not provide a complete guide to either an appraiser or a reviewer in developing a full understanding of the purview of a specific assignment's standard of care. Instead, because the standard of care can only be met in the context of each assignment, the reviewer must consider a wide variety of inputs: the intended use for the appraisal, the user and/or client, the asset type, market, analytical procedures, or methodology being performed, and any special or specific assumptions referred to in the assignment agreement or final report. All of this information must then be considered in light of how a "reasonable" appraisal professional would perform the assignment, as discussed in the following *Application* section.

For example, if a machinery & equipment appraisal requires the calculation of an Inutility Discount which uses the cost to capacity formula, a reasonable valuer will perform that calculation and will follow the procedure set forth in the ASA manual *Valuing Machinery and Equipment (VME)*.¹ For appraisers of every discipline, following the guidance of appropriate definitive sources of information, procedures, methodology and analysis is imperative in fulfilling the expected and necessary appraisal standard of care. Similarly, consulting with another competent appraiser or other expert may also be a part of fulfilling standard of care requirements. In certain assignments, particular avenues of research may be necessary to fulfill the standard of care demanded.

In all review situations, the reviewer's responsibility is to determine the steps that a reasonable appraisal professional would perform in the production of the work under review and to ascertain that those steps

were indeed performed in an appropriate, acceptable, accurate, logical, and complete manner. Measuring the work under review against the necessary and appropriate standard of care is as important as writing the review according to the necessary and appropriate standard of care set forth for appraisal review.

Application of Standard of Care for Reviewers

USPAP Standards 3 & 4, which govern appraisal review, can be used to review appraisal reports written under any standard: IVS, USPAP, IRS, or ASA manuals, such as *Valuing Machinery and Equipment (VME)*: *The Fundamentals of Appraising Machinery and Technical Assets* – or no standard at all. USPAP Standards 3 & 4 function as "filters" – one of the 4 types of standards discussed early in *Standards: Recipes for Reality*.²

The metaphor of the filter suggests the key aspect of this type of standard: some people or things can pass through the filter and thereby meet the standard, while others fail in this regard.

In the case of appraisal reports, useful "filters" of appraisal review are found in USPAP Standards Rule 3.3: Consistent with the reviewer's scope of work, the reviewer is required to develop an opinion as to the completeness, accuracy, adequacy, relevance and reasonableness of the analysis in the work under review, given law, regulations, or intended user requirements applicable to the work under review.

¹ *Valuing Machinery and Equipment*, American Society of Appraisers, Fourth Edition, p. 233-234

² Busch, Lawrence, *Standards: Recipes for Reality*, Massachusetts Institute of Technology, 2013, p. 35

Busch's book helped inform the section on standards in appraisal review POV classes and many of his ideas are pertinent to an understanding of how and why standards are important.

The Purpose of Standards

Busch begins by laying out the purpose of standards:

As the title of this book suggests, standards are means by which we construct realities. They are a means of partially ordering people and things so as to produce outcomes desired by someone.³

In the case of USPAP, whose desired outcomes are being produced? We might immediately think that the desires of the appraisal profession drive practice standards and in one way that seems obvious. But USPAP was created by Congressional decree in the wake of a financial disaster to address the concerns of lenders and other financial institutions. From that perspective, USPAP addresses the need of the intended users for appraisal results that are objective, well-researched, and defensible. The other outcome of appraisal standards is to support the public's trust in the appraisal profession, a clearly stated desire of the appraisal profession that is also an important factor for many financial markets.

Are the Standards Principle-based or Rule-based?

Participants in the AR201 class spend some time dissecting the differences between principles and rules. While USPAP is a rules-based system, the American Institute

of Certified Public Accountants' Statement on Standards for Valuation Services (SSVS) is principle-based, including the responsibility principle, the public interest principle, the integrity principle, the objectivity and independence principle, the due care principle, and the scope and nature of services principle. Reviewing that list of principals should remind appraisers of USPAP rule-based standards that support such principles.

The critical difference between the two approaches is that while principles are based on subjective concepts that require professional judgment and can be difficult to enforce, the objectivity of rules that provide a basis for comparability and consistency can be followed while the underlying principles are ignored – like the little boy who climbed out the upstairs window because his parents told him not to go out the door.

Sir David Tweety famously stated that “Europeans have no rules and the Americans have no principles” and yet the truth of the matter is that rules-based systems are inevitably based on principles. Appraisers and reviewers have a responsibility to understand and adhere to the bedrock principles USPAP rules are designed to concertize.

What is Appraisal Standard of Care?

Standard of care in appraisal practice refers to the degree of attentiveness, skill and judgment that a reasonable professional appraiser would exercise in completing an appraisal assignment. This standard of care is established in line with the research, methodology and analysis of an experienced and reasonable appraisal professionals in the community.

³ Busch, p. 13

“Measuring the work under review against the necessary and appropriate standard of care is as important as writing the review....”

Degrees of Tolerance

While most reviewers would agree that an important part of developing a review report is focusing the reader's attention on the most significant issues – considering the intended users' requirements – discussions of appraisal review inevitably include debate regarding the significance of a ponderance of minor errors. When does the level of “minor” become a deterrent to credibility? This is what Busch might discuss as “degrees of tolerance,” an important concern in appraisal review.

Yet another meaning of standards, and one closely related to the notion of average or normal, can be found in the notion of tolerance. ... tolerances are the maximum acceptable degree to which a thing or object may differ from some specified behavior without incurring some kind of negative sanction.⁴

During appraisal review development, an appraisal is analyzed to gauge its alignment with the standard of care quantified in USPAP — or other related standards. The degree to which the work under review aligns with those standards determines its credibility. A report need not be perfect to be credible. Even machine parts manufactured for extremely exact specifications have a narrow range of tolerances within which the part is still viable. So, too, an appraisal might present with a number of imperfections and still meet the required credibility standards, including those of accuracy, reasonableness, relevance, adequacy and completeness. Staying within acceptable tolerances avoids sanctions such as rejection of an appraisal report or review in litigation proceedings or revocation of accreditation or credentialed status.

⁴ Busch, p. 25

Commensurability of Appraisal Standards

One last idea is that of commensurability. Busch offers the examples of temperature measurement, where the formula $F=9/5+32$ calculates the commensurability of Celsius and Fahrenheit; money, which is made commensurate through the standards of currency exchange; and electrical current, which in some cases would be completely incommensurate without the use of specialized transformers and adapters.⁵

So what about appraisal standards? While most US appraisers follow USPAP standards, other appraisers may follow different standards such as International Valuation Standards. ASA's appraisal review classes discuss how these different standards compare and contrast. Are they fully commensurate, partially commensurate, or completely incommensurate, in the manner of American television standards (NTSC) and French television standards (PAL), the examples Busch cites on p35? How much does commensurability even matter?

Busch suggests – and it seems practical in the appraisal profession – that *commensurability of standards is important only when people and things come in contact with one another.*⁶

The most common way for appraisal standards to contact would probably be an appraisal review situation, when a reviewer who works under one standard accepts an assignment to review an appraisal created under different standards. Or when an appraiser who generally operates under USPAP is required to produce an IVS-compliant appraisal. In many cases the

⁵ Busch, p. 34

⁶ Busch, p. 38

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intended use of the assignment causes multiple standard(s) of care to come into effect such as financial accounting standards. A machinery and equipment appraisal for purchase price allocation may likely need to refer to the standards of care found in USPAP, in the ASA's VME manual, and the relevant financial accounting standards for Fair Value. All these standards must be utilized when performing a credible review.

ASA offers the webinar [Simple Keys to Bridging Standards](#), suggesting ways to understand the similarities and differences between USPAP and IVS, including steps to make a USPAP appraisal report compliant with IVS. The Appraisal Foundation's publication addressing the two standards states that "the two standards are already quite similar;" Busch uses the term "partially commensurable" when comparing meat butchered in the US and the UK:

*Meat butchered according to British standards includes only some cuts that are similar to those produced by an American butcher; many cuts commonly available in the United States are simply unavailable in Britain, and vice versa.*⁷

Similarly, the Appraisal Foundation's A Bridge from USPAP to IVS 2018 reports on what is not covered in the guide:⁸

This guide does not focus on all the areas issues in which IVS and USPAP have effectively the same requirements, nor issues in which USPAP has an additional requirement.

This guide does not discuss any topics that the IVS covers but are not currently addressed by USPAP.

Standards and Appraisal Review

Appraisal reviewers using the "filter" of the appraisal review methods required by USPAP Standards 3 & 4, may review any appraisal report, beginning with identifying the problem to be solved and determining the scope of work necessary to solve the review problem. Appraisal reviewers "have broad flexibility and significant responsibility in determining the appropriate scope of work" and that scope of work must include whatever "is necessary to produce credible assignment results." When the assignment includes developing an opinion of the quality of the WUR, many reviewers will find it helpful to consider the filters USPAP provides of completeness, accuracy, adequacy, relevance, and reasonableness of the analysis⁹ and/or the report.¹⁰

About the Author

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⁷ Busch, p. 35

⁸ *A Bridge from USPAP to IVS 2018*, The Appraisal Foundation and the International Valuations Standards Council, 2018, p. 2

⁹ Standards Rule 3-3

¹⁰ Standards Rule 3-4