MPJ BUSINESS VALUATIONS

Oil and Gas Appraisals - Not Knowing Can Cost Your Client Millions

When requesting an oil and gas appraisal, knowing the difference between a financial reporting value and market value is essential.

A financial reporting value is based on SEC guidelines that oil and gas reserves be valued for financial reporting purposes using a discount rate (i.e., rate of return) of 10%, referenced as the "PV10 value." This is done for standardization purposes and is not reflective of market value.

A market value is used for gift and estate tax purposes and is usually determined using a rate of return between 14% and 20%, or higher, and represents the return that would be required by an investor based on the risk of the investment.

A financial reporting value derived using a return of 10% can be millions of dollars higher than a market value derived using a return of 15%. When requesting an appraisal report from an oil and gas appraiser, be sure to follow these guidelines:

Specifically request the market value, not a financial reporting value (PV10), and make sure the appraiser knows the difference.

Make sure they are using a rate of return that represents the risk of the investment. The typical rate of return on volatile or speculative oil and gas investments is higher than 10%.

Discussing these issues with the mineral appraiser prior to the engagement is highly recommended. Once the report is issued, it may be too late.

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