Certified in Entity and Intangible Valuations™ (CEIV™)[i] Credential

Mandatory Performance Framework (MPF) and Application of the MPF (AMPF)

Frequently Asked Questions

Members of the Performance Workstream and the MPF's Technical Authors convened to review the submissions and compiled Frequently Asked Questions ("FAQs") and answers. *The FAQs follow the order of the contents covered in the MPF and the AMPF to the extent it was possible to do so.*

The FAQs are intended to be interpretive and not intended to revise or replace the original MPF and AMPF. For brevity, within the context of the FAQs and answers, "MPF" or "the MPF documents" refers to both the MPF and AMPF. The expression *financial reporting purposes* is a shortened form of the purpose to which the MPF and FAQs apply.

The MPF and AMPF were developed for all valuation professionals and provide guidance about *how much* support, in terms of scope of work delineation and documentation, to prepare or obtain when designing, implementing, and conducting *valuations* of businesses, business interests, intangible assets, certain liabilities, and inventory used as a basis for management assertions made in financial statements issued for financial reporting purposes.

The overarching themes that underscore the MPF are disclosure and transparency, and this is achieved with documentation that is sufficient, supportable and auditable. Whether the valuation is subject to auditor review or not, the level of documentation must be at a level that *could* be readily audited. In other words, sufficient documentation is such that an experienced professional[1] (defined in the MPF) who is not involved in the valuation engagement could review and understand the significant inputs, analyses, and outputs and how they support the conclusion of value. Such documentation may exist within the valuation report, working papers or both. While the valuation report's content may vary based on agreement between the valuation professional and the client (as is the case for an abbreviated report), in all instances the valuation itself must include a complete valuation analysis as defined in MPF section 2.20.

The MPF pertains to *valuations* where the *purpose is fair value measurement* (regardless of the premise of value) *for financial reporting matters generally in accordance with ASC 820, for U.S. (SEC and U.S. GAAP) reporting requirements*. In addition to the ASC topics covered by

[1] **Experienced professional.** A professional who has sufficient experience in preparing, reviewing, or auditing valuation reports issued for financial reporting purposes (for example, valuation professionals, management, auditors, attorneys, and so forth).

the Application of the MPF, valuation professionals may need to apply the MPF to valuations that integrate ASC 820 with other sections of U.S. GAAP (for example, ASC 718 – Compensation – Stock Compensation; ASC 470 – Debt, etc.). The Performance Workstream believes the MPF documents represent necessary best practice pertaining to transparency, disclosure and documentation for valuations prepared for the above stated purpose, and they *may* also be useful to other similar valuations but are not intended to be specifically applicable.

The MPF and AMPF are mandatory for CEIV credential holders and their work will be subject to valuation professional organization (VPO) quality control and compliance requirements. In addition, the Performance Workstream believes they are best practice guidance for all others that perform valuations for the previously stated purpose, whether done as an external practitioner or as an employee of an entity making use of the valuation for its financial reporting requirements.

As is the case with most aspects of valuation, the use of professional judgment is critical. The Performance Workstream has designed the MPF documents to require valuation professionals to apply and document professional judgment. To further the cause of applying professional judgment, the Performance Workstream elected not to include examples of:

- Valuation reports and supporting working papers
- Disclosures for departures from the MPF documents
- Extraordinary and hypothetical assumptions

Examples of any kind might be interpreted as "how to" instructions. Rather, it is up to the valuation professional and his or her firm to decide how to best integrate the MPF documents into the firm's practice to ensure consistent interpretation, application and documentation on each engagement.

Mandatory Performance Framework Questions

Scope

Management/Internal Valuation Professionals

18. How does the MPF apply to employees or members of management of companies that perform internal valuations that will be used for financial reporting purposes?
19. If a financial statement preparer (management) uses a valuation professional to measure fair value, and the resulting fair value measurements are used by management as the basis for material financial statement assertions, does this circumstance decrease the risk associated with auditing the financial statements, and therefore the cost and time associated with performing the audit?
20. Does the MPF apply to valuation reviews?
21. How does the MPF apply to private equity firms for their holdings?

Professional Summary / Curriculum Vitae

22. Are CEIV credential holders required to include a curriculum vitae (CV) or professional summary in the final valuation report?

Application of the Mandatory Performance Framework Questions

AMPF Requirements

23. Is the Application of the MPF intended to be treated as a checklist or should it be interpreted as best practices that should be applied when they are appropriate, reasonable, or necessary?
24. AMPF section A1.2 discusses the concept of calibration. Is the AMPF saying that if a transaction price is at fair value at the initial recognition, then the assumptions and other inputs I used to determine fair value need to be evaluated and updated at all subsequent measurement dates?

Prospective Financial Information (PFI)

25. What is the valuation professional's responsibility with regards to the PFI? What does 'reasonable' mean in the context of evaluating PFI for use in a valuation?
26. A1.4 refers to 'expected cash flows'. What is the meaning of 'expected cash flows' in the context of the MPF guidance?
27. In A1.4.3, A.1.4.7, and A.1.4.8, the valuation professional is required to compare PFI to the 'expected cash flows' of the subject interest or entity. What does 'compare' imply in this context?
28. What is the underlying guidance driving the PFI discussion in the MPF? Is there an overarching principle?
29. How should a valuation professional proceed when he or she has applied the steps in AMPF section 1.4.1 (a), (b), and (c) and still believes management's PFI is unsuitable for use in the valuation analysis?
30. AMPF section A1.4.8(g) requires that the valuation professional provides evidence in the work file that a 'mathematical and logic check' was performed when evaluating management's PFI. Does this mean the valuation professional needs to validate or check PFI models in order to be in compliance with the MPF?

Tax Amortization Benefit

General Questions

External Subcontractors and Internal SMEs

Minority Interests

Non-Valuation Engagements

For purposes of this FAQ, 'valuation professionals' are deemed either to i) have earned the CEIV credential or ii) are valuation professionals who represent they have complied with the MPF documents as a best practice in accordance with MPF section 2.27.21. Furthermore, where there are requirements specific to CEIV credential holders (for example, complying with VPO ethics), these requirements will also be clearly identified.

Mandatory Performance Framework Questions

Scope

1. If a company retains a valuation professional, will my audit procedures be impacted?

It is the understanding of the Performance Workstream that audit risk is made up of three components, each of which is carefully considered when the auditor is planning and executing an audit. Those three components are:

a. Inherent risk – this is the risk that is the result of an error or omission that is due to factors other than the failure of the company's internal controls
b. Control risk – is the risk that is caused by the failure or absence of internal controls
c. Detection risk – is the risk that is caused by the auditor's failure to discover a material misstatement in the financial statements

Regardless of whether a company retains a valuation professional to assist with or fully prepare a valuation, the inherent risk and detection risk of an audit will remain the same. The Performance Workstream believes, however, when auditors assess control risk, they may consider the retention of properly trained and experienced professionals as an input into their control risk assessment. This, in turn, could reduce the nature, timing, and scope of the audit procedures.

Return to Top

2. Should a valuation professional use the MPF and AMPF for international financial reporting?

While the initial scope of the MPF and AMPF is focused on financial reporting purposes in the United States as defined in MPF section 1.1 and 1.2, these documents can apply to valuations performed for international reporting purposes. The MPF and AMPF:

- *Must be applied and are mandatory* for valuations that will be used by a foreign entity that files its financial statements with the SEC (for example, SEC Form F filings), as they fall within the scope of MPF section 1.2.1, which includes companies reporting under IFRS
- *'May'*[2] be applied in valuations that will be used by a foreign entity that does not file its financial statements with the SEC. However, care should be taken as there could be local or jurisdictional requirements that take precedence over the MPF requirements

[2] Within the context of the MPF documents and when used in conjunction with identified tasks, techniques, or procedures, the word 'may' indicates that the valuation professional is required to consider performing the indicated task, technique, or procedure, but the action itself is not required. Facts and circumstances will affect the valuation professional's decision as to how to proceed.

If a valuation professional is engaged to provide valuation services for a client that is a foreign entity that does not follow US GAAP as its basis of accounting and does not file its financial statements with the SEC, then the engagement is considered outside the scope of the MPF documents. And as a result, the valuation professional is not required to adhere to the MPF documents and does not have to disclose in the report or supporting working papers that the valuation is not in compliance with the MPF documents.

Return to Top

3. What is covered by MPF section 1.2.3?

It was the intent of the Performance Workstream to have MPF section 1.2.3 address US based financial reporting that for one reason or another did not meet the criteria established in MPF section 1.2.1 or 1.2.2. This section was not intended to cover international financial reporting engagements (where the reporting entity is not required to file with the SEC), engagements where the subject matter is out of scope of the MPF documents, or engagements where the client prepares financial statements in accordance with a special purpose frameworks (see FAQs #2, #4, and #10, respectively).

Return to Top

4. If I am engaged to conduct a valuation that is outside the scope of the MPF, in terms of subject matter or level of service, do I need to disclose in my valuation report that I am not in compliance with the MPF documents as stated in the 'important' note in MPF section 1.2?

No. The 'important' note in MPF section 1.2 and its disclosure requirements were put in place to address circumstances where a valuation professional is engaged to perform a valuation that

a. falls within the subject matter scope of the MPF documents (that is, business, business interest, intangible asset, certain liabilities, and inventory)
b. is for a client/entity that does not issue financial statements in accordance with MPF sections 1.2.1-.3, and
c. the valuation professional elects NOT to adhere to MPF documents

Therefore, in instances where the valuation professional is conducting a valuation on a subject matter that falls outside of the MPF documents; is performing a non-financial reporting engagement; or is providing valuation related services (for example, estimating cost of capital, calculating valuation multiples, performing an acquisition premium or 'benchmarking' study, etc.), and not 'valuation services' as defined by the MPF, the valuation professional does not need to state that his or her report or work product is not in compliance with the MPF.

Return to Top

5. What if I am engaged to perform a valuation that is in scope of the MPF, but parts of the engagement require the valuations of subject matter that does not fall within the subject matter of the MPF?

The Performance Workstream recognizes that engagements that fall within the scope of the MPF (MPF section 1.2), may also require the valuation of assets, liabilities, or entities that comprise part of the interest being valued but fall outside the scope of the MPF as currently defined in section 1.1 (for example, real estate or machinery and equipment assets). When this occurs, the valuation professional will need to decide whether he or she is professionally competent to do the *specialized valuation work*[3] or retain a subject matter expert (SME) who is.

In instances where the valuation professional believes he or she is *not* professionally competent to do specialized valuation work, the MPF and relevant professional standards require the valuation professional to retain an internal or external SME to perform the work. Furthermore, the MPF requires that the valuation professional assess the SME's professional competence as well as establish a reasonable basis for relying on the SME's work (MPF section 2.14).

In instances where the valuation professional believes he or she *is* professionally competent to perform the specialized valuation work, and is doing the work, the Performance Workstream believes the guidance in MPF should be applied to the extent it is appropriate and helps result in work that is prepared in accordance with the concepts in the MPF. This includes, but is not limited to, adherence to other relevant valuation, professional, and ethical standards (MPF sections 1.6, 1.13 and 1.14).

Return to Top

6. Does the MPF and the AMPF apply to valuations in the following areas?
- **Real and Personal Property Assets**
- **Portfolio Valuations**
- **Stock Compensation (ASC 718) and Equity (ASC 505)**
- **Other Assets, Liabilities, and Entities Outside of the MPF Scope**

Initial Considerations
Regardless of the subject matter of the engagement, the valuation professional needs to evaluate whether he or she has the appropriate level of expertise to accept and complete a valuation engagement. For CEIV credential holders, this includes complying with the professional and ethical standards of the VPO that issued the credential.

The following is a more detailed discussion on the subject matters listed previously.

Real and Personal Property Assets – When these assets are valued as part of stand-alone engagements, such engagements are not within the scope of the MPF. If the valuation professional is retained to provide a valuation of real estate or personal property on a *stand-alone basis* that may be used in financial statements issued with the SEC or issued in accordance with U.S. GAAP, the valuation professional may choose to follow the MPF documents; however, because the specific subject matter is not yet included as part of the AMPF , it is not mandatory for the valuation professional to follow the MPF documents or disclose in the report or supporting working papers the work product is not in compliance with the MPF documents.

[3] For purposes of this FAQ, valuation work that is performed within an in-scope valuation engagement (MPF 1.2) and addresses a subject matter that is not within the scope of the MPF as currently defined in section 1.1 (for example, real estate or machinery and equipment assets), the FAQ will refer to this as '*specialized valuation work*'.

However, if a valuation professional is professionally competent to perform and is doing the specialized valuation work (as defined by this FAQ document – see FAQ #5 under 'Scope') that involves real and/or personal property assets, then the Performance Workstream believes the valuation professional should apply the concepts of the MPF when preparing his or her work product.

Portfolio Valuations – The Performance Workstream understands that valuations for portfolio company investments of venture capital, private equity and other investment companies often involve the valuation of businesses, business interests, as well as other assets and liabilities that may be viewed as financial instruments for financial reporting purposes. Regardless of how they are viewed, the Performance Workstream intended for the MPF documents to apply to financial reporting valuations of businesses and business interests (for example, debt or equity investments in this context).

Stock Compensation (ASC 718) and Equity (ASC 505)[4] – If a valuation professional performs a valuation of a business or business interest that is used as an input to determine the value of equity interests issued for employee compensation under ASC 718 and equity within the scope of ASC 505, the Performance Workstream believes the valuation of the aforementioned businesses and business interests are within the scope of the MPF documents.

Other Assets, Liabilities or Entities Outside of the MPF Scope - When these interests are valued as part of stand-alone engagements, such engagements are not within the scope of the MPF. If the valuation professional is retained to provide a valuation of other assets, liabilities or entities outside the MPF scope on a *stand-alone basis* that may be used in financial statements issued with the SEC or issued in accordance with U.S. GAAP, the valuation professional may choose to follow the MPF documents; however, when the subject matter is out of scope it is not mandatory for the valuation professional to follow the MPF documents or disclose in the report or supporting working papers the work product is not in compliance with the MPF documents.

However, if a valuation professional is professionally competent to perform and is doing the specialized valuation work (as defined by this FAQ document – see FAQ #5 under 'Scope') that involves other assets, liabilities or entities outside of the MPF scope, then the Performance Workstream believes the valuation professional should apply the concepts of the MPF when preparing his or her work product.

Return to Top

7. What liabilities are covered by the MPF documents?

The current version of the AMPF (January 2017), covers the following liabilities in the following instances:

[4] In June 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2018-07 Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-based Payment Accounting. The FASB issued this ASU as part of its Simplification Initiative and expands the scope of ASC 718 to include share-based payments issued to non-employees for goods and services. This ASU helps align the accounting for share-based payments to employees and non-employees, and will supersede a part of Topic 505.

- AMPF section A3.11 addresses contract liabilities. This type of liability was formally known as deferred revenue, but to be consistent with the new revenue recognition guidance[5] the Performance Workstream used the updated nomenclature.
- Debt that is valued for the purposes of valuing equity[6]. However, the Performance Workstream understands that, at times, additional claims may need to be subtracted from business enterprise value to arrive at equity. In that regard, see FAQ #6, paragraph on 'Other Assets, Liabilities or Entities Outside of the MPF Scope' or in connection with paragraph on 'Portfolio Valuations.'

Return to Top

8. Are valuation professionals precluded from performing valuation related services that may be used by management to support their assertions or disclosures in financial reports or impairment analyses (for example, estimating cost of capital) calculating valuation multiples, performing an acquisition premium or 'benchmarking' study)?

No. Valuation-related services that do not result in an opinion or conclusion of value are not considered valuations as defined by the MPF and therefore it is not mandatory for a valuation professional to adhere to the MPF documents.

Return to Top

9. Does a valuation professional need to adhere to the MPF documents when preparing pro-forma analyses?

It depends. The intended use of the pro forma analyses will dictate whether it is mandatory for a valuation professional to follow the MPF documents. For example, if the pro forma analysis is for management's internal reporting requirements (for example, budgeting, 'what-if analyses', deal models) and will *not* be used for financial reporting purposes, then it is not mandatory for a valuation professional to adhere to the MPF documents.

However, if the pro forma analyses will be used in an SEC filing (for example, SEC form S-3) then it is mandatory for a valuation professional to follow the MPF documents with respect to any fair value measurements because that would fall within the scope of MPF section 1.2.1.

In performing analyses for pro-forma purposes related to a pending transaction, it is often the case that only limited information is available; also, typically, the analysis is further adjusted and finalized when more information becomes available post-completion of the transaction. Thus, the pro-forma analysis represents a phase in the overall analysis. Given the limited access to information and the typical short time available for many pro-forma analyses, it is likely that this phase would often constitute a limited analysis, per the MPF.

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[5] In May 2014, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued converged new revenue recognition standards.

[6] When valuing equity, please note that the Performance Workstream intended for the MPF to also apply to the asset side of the debt liability, that is, the debt investment.

In this case, based on the guidance in the 'Important' note in MPF section 2.20 , if a valuation professional deems that a limited analysis is appropriate for management's pro-forma purposes, the letter of engagement (LoE) and report must prominently state that this phase of the analysis and related report do not meet the requirements of the MPF and AMPF, and must identify the sections that have not been complied with.

To the extent further analysis is conducted, when the limitations on information and time are removed, this next phase may result in a complete analysis, as long as the appropriate MPF and AMPF requirements are met.

Return to Top

Special Purpose Framework (SPF)

10. The 'Important' note below MPF section 1.2.3 references special purpose frameworks and states that when a valuation professional performs valuation services for this type of client, following the MPF is best practice. Can you explain what special purpose frameworks are and why following the MPF is only considered best practice?

Special purpose frameworks in the United States represents a system of accounting that is presented on a basis other than U.S. GAAP. SPFs are also referred to by the accounting profession as 'other comprehensive basis of accounting' and include but are not limited to preparing financial information on a i) cash basis; ii) tax basis; iii) regulatory basis; or iv) contractual basis.

Engagements in which the valuation professional is preparing a valuation for use in SPFs and fall within the subject matter scope of the MPF documents, the valuation professional *should* consider adhering to the MPF documents but it is not mandatory to do so. As explained in the MPF Executive Summary, the VPOs were charged with "establishing rigorous and uniform qualifications, training, accreditation, and oversight of individuals conducting *fair value measurements*". As such, the Performance Workstream believed that requiring compliance with the MPF for SPF engagements was outside of its mandate.

As noted before, when a valuation professional is engaged to provide valuation services considered outside the scope of the MPF documents – as would be the case for engagements where the client prepares its financial statements in accordance with an SPF - the valuation professional is not required to adhere to the MPF documents and does not have to disclose in the report or supporting working papers that the valuation is not in compliance with the MPF documents.

Return to Top

MPF Conflicts with Published Governmental, Judicial or Accounting Authority

11. There appears to be language in the AMPF that is not exactly the same language in various ASCs also cited within the AMPF. How should these differences be interpreted?

It was not the intent of the Performance Workstream to modify or paraphrase any of the guidance provided in any accounting or audit standard. If there are instances where it appears that the MPF documents have modified, paraphrased, or are in any way inconsistent with any accounting or audit standard, MPF section 1.14 requires that valuation professional 'follow the applicable published authority or stated procedures with respect to the part applicable to the valuation in which the valuation professional is engaged.'

Return to Top

Documentation Requirements

12. What are the documentation requirements to comply with the MPF and AMPF?

To comply with the MPF and AMPF, the valuation professional <u>must perform a complete valuation analysis</u>. For each complete valuation analysis, the valuation professional <u>must</u> prepare either

- a comprehensive valuation report, or
- an abbreviated valuation report

as defined in MPF section 2.20.

As identified in MPF sections 2.7 to 2.9, the valuation professional must include **source documents,** including any known and relevant contrary evidence, as well as **analysis documents** within the work file (as defined in section 1.4 of the MPF) to support the conclusion of value such that an **experienced professional** not involved in the valuation engagement could review and understand the significant inputs, analyses, and outputs and how they support the final conclusion of value.

Professional judgment must be used when determining the extent to which source documents and analysis documents are included in the final valuation report or the working papers. Incorporating source documents by reference is also appropriate when it is not feasible or practicable to include in the work file (see MPF sections 2.8.1 and 2.8.2).

Return to Top

13. The MPF Glossary defines 'Engagement to estimate fair value' to include 1) a valuation engagement that can be either comprehensive or limited (note to reader: the use of the word 'comprehensive' in this definition will be updated in the next version of the MPF to 'complete'), or 2) a calculation engagement. Can a valuation professional perform a limited or calculation engagement and still be compliant with the MPF documents?

No. The Performance Workstream's intent was to provide a definition that discussed the various types of engagements that exist, and not to provide a list of engagements that are MPF compliant. MPF section 2.20 requires that valuation professionals perform complete valuation analyses when preparing a valuation for financial reporting purposes (as defined by the MPF section 1.2).

In circumstances where the valuation professional elects to accept a limited or a calculation engagement, where he or she has a reason to believe that such analysis will be appropriate for management's intended use of the analysis and report, the valuation professional must ensure the letter of engagement (LoE) and final valuation report (this includes any work product intended for client use) prominently state that the analyses and final valuation report do not meet the requirements of the framework and the

Application of the MPF and specifically identify the scope of the engagement. See 'Important' note in MPF section 2.20.3.

[Return to Top]

14. The MPF identifies the components of a 'comprehensive report', but not the components of an 'abbreviated report'. Are all of the components in MPF section 2.27 required in order to comply with the MPF, and can you clarify what needs to be included in an abbreviated report?

All the components in 2.27 that are *relevant* to the engagement must be included in the valuation report in order to issue a comprehensive report that is in compliance with the MPF. In the event a component in 2.27 is not relevant, a valuation professional can still prepare a comprehensive report that complies with the MPF. For example, if a valuation professional does not encounter any limitations during an engagement then MPF section 2.27.12 would not be relevant and therefore this component would not be required in order to prepare an MPF compliant comprehensive report.

An abbreviated report is a report that does not contain one or more relevant components listed in 2.27. The level of detail and components of an abbreviated report can be agreed upon between the valuation professional and the client.

If a valuation professional prepares an abbreviated report, he or she must still conduct a complete analysis (see MPF section 2.20.2 – *abbreviated report* bullet).

CEIV credential holders must also adhere to their VPO valuation standards that establish report requirements, and in the event of a difference between the VPO and MPF report requirements, the VPO requirements take priority.

[Return to Top]

Materiality

15. Is there a materiality threshold for the inclusion of certain assets, liabilities or entities in valuations covered by the MPF and the AMPF?

Materiality is a concept used by the audit profession to help determine a threshold by which missing or incorrect information within the financial statements could have an impact on the decisions of those using the financial statements. The determination about whether an asset or liability is "material" and must be included in the financial statements is a decision made by management in consultation with their auditors. The valuation professional cannot make this determination.

When valuation professionals are discussing materiality concerns with their clients (or vice versa), it is the responsibility of the valuation professionals and their clients to engage with the auditor to make this assessment. Having this discussion with the client and auditor before work begins or before significant work begins will ensure the valuation professional knows how to incorporate into scope (or not) a particular asset or liability and how it should be handled within a valuation prepared for financial reporting purposes as described within the MPF.

In circumstances where the client has directed the valuation professional not to perform a valuation because the client believes the asset or liability is immaterial and the valuation professional:

a. believes, based on his or her prior experience or professional judgment, that an asset or liability may be significant to the valuation in that it may impact the value of other assets or liabilities within the client-provided valuation scope, or may affect the integrity of the overall analysis, and
b. is unable to have a discussion with the auditor

then the valuation professional must assess the proper course of action within the ethical and professional guidelines of his or her respective VPO as well as the requirements in MPF sections 2.27.11 - .13.

Return to Top

16. Can the valuation professional provide input into management's determination about whether certain assets, liabilities or entities are appropriate for inclusion in a valuation performed for financial reporting purposes?

Yes. The valuation professional can provide relevant input to management when management needs to identify the significant assets, liabilities or entities that are appropriate for inclusion in a valuation for financial reporting purposes as defined by the MPF. Factors that can influence the valuation professional's input to management may include, but not limited to:

- professional judgment based on experience with similar businesses
- industry conventions
- interviews with management
- management's public comments about what factors contributed to the decision to buy a business or its collection of assets, liabilities or entities, and
- management's internal justifications from sources such as board minutes about an acquisition, the acquisition price, and the assets that were identified as being significant in determining the price to be paid

While the valuation professional can provide key input into this process, the valuation professional cannot decide if the impact on other assets or liabilities (by not valuing a certain asset or a liability) is material or not. This must be decided by the client and the client's auditor. Furthermore, the client, in consultation with the client's auditor, is responsible for identifying which assets, liabilities or entities meet the recognition criteria for financial reporting purposes.

Return to Top

17. What is required by the MPF if the client seeks to limit the scope of the valuation to exclude the valuation of certain assets or liabilities (for example, inventory, supply agreements, non-compete agreements, favorable or unfavorable leasehold interests)?

The valuation professional must use professional judgment and experience to evaluate the client-imposed restrictions and their impact on the resulting fair value conclusion for the assets, liabilities, or entities that the valuation professional has been engaged to value, and the integrity of the overall analysis. MPF sections 2.20.3 and 2.27.11 -.13

provide guidance that includes disclosure of client imposed limitations, scope changes, and the potential for withdrawal from the engagement.

If a client excludes certain assets or liabilities from being valued, the valuation professional cannot make a determination about whether the impact on other assets or liabilities (by not valuing a certain asset or a liability), or the impact on the overall analysis, is material or not. However, if

- the client, in consultation with the client's auditor, explains that they have excluded the asset or liability because they believe it is immaterial, and
- the valuation professional believes, based on his or her professional judgment, that the excluded asset or liability will not preclude him or her from complying with the MPF documents

then the valuation professional can conduct the valuation engagement without the excluded asset or liability and does not need to disclose the exclusion in the valuation report but should document this in the work papers.

Return to Top

Management/Internal Valuation Professionals

18. How does the MPF apply to employees or members of management of companies that perform internal valuations that will be used for financial reporting purposes?

As explained in the Executive Summary of the MPF, the MPF documents were designed to be used by all valuation professionals preparing valuations that will be used for financial reporting purposes, including employees or members of management (referred to as 'internal valuation professionals'). In drafting the MPF documents, the Performance Workstream understood that not all the formal engagement requirements would be necessary for an internal valuation professional (see MPF section 2.21). It is up to the valuation professional to use professional judgment to evaluate whether a section of the MPF documents is or is not applicable to an engagement or assignment. To illustrate this point, an internal valuation professional does not need to obtain a letter of engagement to do his or her internal valuation. A short note in the work file explaining this fact and a clear definition of the work to be done, documented as part of the company's internal documentation meet the MPF documentation requirements.

The Performance Workstream believes the MPF documents provide best practice guidance for disclosure, transparency and documentation that is sufficient, supportable and auditable for valuations prepared for financial reporting purposes as described within the documents. Therefore, all persons performing work for financial reporting purposes can benefit from the guidance presented in the MPF. However, if such employees or members of management (internal valuation professionals) are not CEIV credential holders, the MPF requirements are voluntary. If internal valuation professionals are CEIV credential holders the MPF documents are mandatory (see MPF Executive Summary – Scope of Adoption and Adherence by Valuation Professionals).

Return to Top

19. If a financial statement preparer (management) uses a valuation professional to measure fair value, and the resulting fair value measurements are used by management as the basis for material financial statement assertions, does this circumstance decrease the risk associated with auditing the financial statements, and therefore the cost and time associated with performing the audit?

Regardless of whether the valuation professional adheres to the MPF documents or not, "the inherent risk" associated with the audit remains the same. In performing the audit however, auditors are likely to assess the experience and any relevant credentials held by the valuation professional when determining the nature, scope and timing of audit procedures pertaining to the fair value measurement. For instance, the auditor may conclude that the risk surrounding internal controls over financial reporting is reduced using qualified valuation personnel, and the nature of procedures performed may reflect a reduced level of skepticism surrounding the relevant fair value measurements. Over time, this in turn could reduce the nature, timing, and scope of the relevant audit procedures.

Return to Top

20. Does the MPF apply to valuation reviews?

Valuation-related services that do not result in an opinion or conclusion of value are not considered valuations as defined by the MPF and; therefore, a valuation professional does not need to adhere to the MPF documents.

Therefore, if a valuation professional reviews a valuation analysis with the objective of stating that either certain inputs or the valuation conclusion are reasonable (or are not reasonable), without providing an opinion of value (in the form of either a conclusion of value, a concluded range of values, or a benchmark range of values) as part of this process, then this review does not fall in the scope of the MPF.

Return to Top

21. How does the MPF apply to private equity firms for their holdings?

For valuations performed by external or internal valuation professionals, the MPF pertains to private equity firms as it does to other companies where the purpose is fair value measurement (regardless of the premise of value) for financial reporting purposes for US (SEC and U.S. GAAP) reporting requirements, resulting in an opinion or conclusion of value.

If the valuation professional holds the CEIV credential, compliance is mandatory and the work of the valuation professional, whether external or internal, will be subject to external quality control and compliance audits.

Return to Top

Professional Summary / Curriculum Vitae

22. Are CEIV credential holders required to include a curriculum vitae (CV) or professional summary in the final valuation report?

A CEIV credential holder must include the required items listed under the MPF Section 2.27.22 in the final valuation report. A CV is not listed under this paragraph as a required document, however, this does not prohibit the inclusion of one in the final valuation report produced by a CEIV credential holder (note: auditors frequently ask for CVs as part of their audit procedures). The CEIV credential holder should also take into consideration the minimum requirements of the VPO that issued the CEIV credential together with his or her firm's policy regarding the inclusion of the CV.

Return to Top

Application of the Mandatory Performance Framework Questions

AMPF Requirements

23. Is the Application of the MPF intended to be treated as a checklist or should it be interpreted as best practices that should be applied when they are appropriate, reasonable, or necessary?

The MPF documents are not intended to be a checklist. As stated in the Executive Summary, adherence to MPF documents is mandatory for CEIV credential holders and the Performance Workstream believes they are best practice for valuation professionals who voluntarily apply the MPF documents to their valuations.

The documentation requirements in the Application of the MPF are designed to "address matters that need i) greater consistency in the application of valuation approaches and methods, ii) support for issues that require the application of professional judgment, and iii) documentation of inputs." And while the specific requirements have the appearance of a 'checklist', the language at the start of each documentation requirement section is written so that the valuation professionals must apply professional judgment to assess if a particular requirement is *applicable* to an engagement's unique facts and circumstances: "The valuation professional, at a minimum, must document the following in writing within the work file**, if applicable**"

With those parameters in mind, the valuation professional needs to use professional judgment to determine if a documentation requirement i) applies to the facts and circumstances of an engagement AND ii) achieves the objectives of the MPF.

Return to Top

24. AMPF section A1.2 discusses the concept of calibration. Is the AMPF saying that if a transaction price is at fair value at the initial recognition, then the assumptions and other inputs I used to determine fair value need to be evaluated and updated at all subsequent measurement dates?

No. U.S. GAAP[7], not the AMPF, establishes this requirement. ASC 820-10-35-24C states that 'if the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price.'

[7] IFRS 13, Fair Value Measurement, has the same requirement.

However, ASC 820 – *Fair Value Measurement* does not presume a transaction price is fair value at initial recognition (see ASC 820-10-30-3 and -3A). If the calibration criteria in ASC 820 are met and the transaction price is determined to be fair value for an acquired asset or a liability, regardless of subject matter, then the valuation technique used must be calibrated initially, and on subsequent measurement dates.

ASC 820 goes on to say that valuation techniques need to be applied consistently (unless a change is appropriate) (ASC 820-10-35-25). The AMPF captures this concept in the documentation requirement at AMPF section A1.2.5(e).

Return to Top

Prospective Financial Information (PFI)

25. What is the valuation professional's responsibility with regards to the PFI? What does 'reasonable' mean in the context of evaluating PFI for use in a valuation?

It was the intent of the Performance Workstream to draft AMPF section A1.4 (Prospective Financial Information) to provide valuation professionals with guidance to help them assess whether it is reasonable to rely upon management's PFI for use in the valuation analysis. This section should not be interpreted as a requirement for the valuation professional to take responsibility for management's PFI and attest to its accuracy or achievability. Thus, although the valuation professional is not expected to attest to PFI's reasonableness, he or she should not simply accept PFI from management without investigating management's basis for the PFI and its suitability for use in the valuation analysis.

Refer to section A1.4.7 for some factors and common procedures the valuation professional may consider when evaluating the PFI provided by management for suitability for use in the valuation analysis.

Return to Top

26. A1.4 refers to 'expected cash flows'. What is the meaning of 'expected cash flows' in the context of the MPF guidance?

It was the intent of the Performance Workstream for the phrase 'expected cash flows' to be interpreted *practically* as PFI that represents a neutral and unbiased projection (not a conservative or aggressive / optimistic case estimate) of the company's or intangible asset's future cash flows. While this is *not* meant to require the valuation professional to evaluate, review or analyze multiple scenarios when analyzing PFI when using an EPV technique, the objective remains for the cash flow projections to reflect an expected case from a market participant perspective.

FASB ASC Master Glossary defines expected cash flow as "[t]he probability-weighted average (that is, mean of the distribution) of possible future cash flows." Therefore, in concept, expected cash flows are probability-weighted scenarios. However, in practice, multiple scenarios are often not available. FASB ASC 820-10-55-18 provides the following guidance on the expected present value technique and expected cash flows:

> "… to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete

> scenarios and probabilities that capture the array of possible cash flows. For example, a reporting entity might use realized cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (for example, changes in external factors, including economic or market conditions, industry trends, and competition as well as changes in internal factors affecting the reporting entity more specifically), taking into account the assumptions of market participants."

Thus, an unbiased and neutral set of PFI would not have to be based on a probability-weighted approach or a scenario analysis (although it can be), but instead it could also be derived based on discrete and well documented adjustments starting from management's single scenario by understanding the factors such as those listed in MPF FAQ #27 with the goal of reflecting an expected case from the perspective of market participants.

Separately, it is not the intent of the AMPF to prescribe a scenario based or a probability based expected cash flow model. Rather, the use of the term 'expected cash flows' is intended to highlight the need for the PFI to be free from bias (neither overly conservative nor optimistic) and thereby provide a reliable basis for the valuation analysis.

Furthermore, FASB ASC 820 does not prescribe the use of the expected cash flows and the expected present value technique. Specifically, FASB ASC 820-10-55-4 states that:

> Paragraphs 820-10-55-5 through 55-20 describe the use of present value techniques to measure fair value. Those paragraphs focus on a discount rate adjustment technique and an expected cash flow (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (for example, whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

Generally, if applied properly, both the discount rate adjustment technique (DRAT) and the expected present value techniques (EPVTs) would be expected to produce consistent results.

In summary, the intent of AMPF section A1.4 was not to prescribe the use of expected cash flows and expected cash flow techniques in the valuation analysis but to provide discipline for evaluating PFI to ensure that it is suitable for use in the valuation analysis. Furthermore, regardless of the ultimate approach chosen by the valuation professional, section A1.4 highlights the need to document the valuation professional's understanding of the PFI and how they address any identified shortcomings.

Return to Top

27. In A1.4.3, A.1.4.7, and A.1.4.8, the valuation professional is required to compare PFI to the 'expected cash flows' of the subject interest or entity. What does 'compare' imply in this context?

A1.4.3, A1.4.7 and A1.4.8, state in part:

"A1.4.3…. In order for the valuation professional to determine whether PFI for an underlying asset of the subject entity is reasonable, he or she must compare it to the expected cash flows of the subject interest or entity (for example, expected cash flows might be determined by using probability-weighted scenarios of possible outcomes)…", and,

"A1.4.7 Part of the valuation professional's responsibility is to evaluate the PFI provided by management for reasonableness in general, as well as in specific areas. Factors and common procedures to consider when performing this assessment may include, but are not limited to, these:

- …The valuation professional should compare PFI for an underlying asset of the subject entity to expected cash flows of the subject interest or entity to evaluate for reasonableness. The evaluation of any differences between PFI and expected cash flows should be thoroughly documented in the work file.", and,

"A1.4.8The valuation professional, at a minimum, must document the following in writing within the work file, if applicable….

d. The steps used in, and results of, testing the PFI for reasonableness including, but not limited to

i. a comparison of the PFI to expected cash flows,"

The intent of the Performance Workstream here is to guide the valuation professional to execute a suitable level of care and due diligence when assessing the PFI provided by management, whether it is for an individual asset or the overall entity. Specifically, the intent of the "compare" requirement is to evaluate management's PFI to assess whether it approximates expected cash flows, as discussed previously. It is not intended to be a literal comparison of management's PFI to a set of expected cash flows that generally do not exist. The guidance in AMPF A1.4.7 provides a set of considerations that may be useful to the valuation professional in evaluating the reasonableness of management's PFI. Some of the considerations include obtaining an understanding about factors such as:

- The purpose the PFI was created (for example impairment testing, employee incentive compensation, compliance, transaction purposes)
- The presence of potential bias in the PFI (for example PFI created for lenders to assure them about compliance with loan covenants even in the worse-case scenario)
- The primary audience of the PFI (for example, management, majority shareholders, employees, investors, lenders, regulators)
- Who created the PFI and when it was created (for example for any transaction there might be multiple deal models – created by buyer, seller, and/or banks – that are created at different times and based on different available information.)
- The underlying PFI assumptions and how they were derived

The remaining bullets in section A1.4.7 provide the valuation professional with further guidance, factors and common procedures that should be considered when evaluating the reasonableness of the PFI provided by management for use in the valuation analysis (not all factors are applicable in all instances).

Return to Top

28. What is the underlying guidance driving the PFI discussion in the MPF? Is there an overarching principle?

The underlying purpose of the PFI discussion in the MPF and its overarching principle is an attempt to:

a. Encourage valuation professionals to apply professional skepticism and conduct an appropriate amount of due diligence over client-provided PFI by making comparison to any available relevant external data, performing backtesting and other procedures
b. Determine if the PFI provided by management is consistent with any observable relevant data by applying the procedures outlined in these FAQs and the MPF documents. In such a case, the appropriate discount rate might be a market participant WACC without a company specific risk adjustment (CSRA) (sometimes also referred to as 'alpha') as the basis for rates of return
c. Use the procedures to adjust the PFI as noted in the MPF and apply a market participant WACC, or
d. Apply DRAT, note why it is applied, document any CSRA factor utilized by referring to these procedures, and provide the appropriate quantitative and qualitative support for the selected CSRA

Return to Top

29. How should a valuation professional proceed when he or she has applied the steps in AMPF section 1.4.1 (a), (b), and (c) and still believes management's PFI is unsuitable for use in the valuation analysis?

When the valuation professional believes that management's PFI is unsuitable for use in the valuation analysis (for example, because it is substantially inaccurate and incomplete or there is material inconsistency with other information), the valuation professional should discuss the matter with management and request management to revise the PFI. If changes cannot be made to satisfy the valuation professional about those matters, he or she should determine whether to continue with the engagement or withdraw from the engagement. If the valuation professional decides to continue with the engagement, he or she should value the subject interest or entity using an entirely different approach from the income approach (that is, market or cost approach), if appropriate in the circumstances.

Return to Top

30. AMPF section A1.4.8(g) requires that the valuation professional provides evidence in the work file that a 'mathematical and logic check' was performed when evaluating management's PFI. Does this mean the valuation professional needs to validate or check PFI models in order to be in compliance with the MPF?

No. The Performance Workstream intended for the 'mathematical and logic check' described in A1.4.7 to be *clerical in nature*, and if applicable to an engagement, simply documenting what was done. This requirement was never meant to require model validation or model checking. As explained in A1.4.7, spreadsheets/models can contain inaccurate cell references, summation errors, or other unintended clerical and mechanical mistakes that might be identified if a mathematical or logic check is performed.

Return to Top

Tax Amortization Benefit

31. In the AMPF section A3.8.2 what does 'full fair value' of an entity mean?

The Performance Workstream intended for this phrase to capture the concept of fair value, inclusive of tax benefits. This phrase was not drafted with the intent on modifying or expanding the concept of fair value as defined in FASB ASC 820.

Return to Top

General Questions

External Subcontractors and Internal SMEs

32. Was the MPF designed to treat external resources (for example subcontractors), and internal resources (for example valuation professionals for real and personal property employed by the same firm) differently?

No. SMEs may be other employees from within the same firm or may be subcontractors.

The Performance Workstream intended for the definition in this section, as well as the related due diligence and documentation requirements to apply to all SMEs regardless of whether they are external or internal SMEs.

When SMEs are internal resources, the valuation professional does not need to adhere to the requirements in:

- MPF section 2.27.17 to state in the report that the valuation professional has relied on the subcontractor's (that is, internal SME's) work, or
- MPF section 2.14 to state the valuation professional has not assumed any responsibility for the work due to the professional's lack of subject matter expertise

if these requirements can be met through the internal processes and policies that evaluate and monitor quality, professionalism, and professional competence.

Return to Top

Minority Interests

33. In situations when a valuation professional performs an analysis such as a minority interest valuation and does not have access to all the requisite information as well as has limited access to management, how should the MPF and AMPF document be interpreted and applied?

In situations when it is not possible to comply with the MPF and the AMPF because the valuation professional does not have access to management as well as all the requisite information, this should be disclosed in the final valuation report, and the analysis would constitute a limited analysis.

Return to Top

Non-Valuation Engagements

34. Do the MPF and the AMPF apply to non-valuations performed by a valuation professional?

Valuation professionals are required to adhere to the MPF and the AMPF when engaged to prepare fair value measurements that will be used to support management assertions made in financial statements issued for financial reporting purposes (see MPF sections 1.1 and 1.2).

Certain financial reporting engagements do not require a fair value measurement or require a different basis of value such as a pricing analysis and a multi-element analysis that fall under the guidance of ASC 606 and value in use (VIU) analyses under IAS 36. These assignments do not result in a conclusion of fair value but are often prepared by a valuation professional. It is not mandatory for a valuation professional to adhere to the concepts and principles in the MPF documents when performing non-valuation engagements; however, the Performance Workstream believes it is best practice to do so to ensure the analysis is well documented and supported.

With respect to ASC 360, please refer to the subsequent question.

Return to Top

35. Is a valuation professional required to adhere to the MPF documents when preparing an impairment analysis of long-lived assets in accordance with ASC 360 - Property, Plant, and Equipment?

It is the understanding of the Performance Workstream that there are three required steps to identify, recognize and measure the impairment of a long-lived asset (or an asset group).

Step 1 – Indicators of Impairment

The company's management (*not the valuation professional*) is responsible for assessing whether impairment indicators (or triggers) are present.

Step 2 – Test for recoverability

The recoverability test is considered an accounting test and not a fair value measurement. Thus, it is not mandatory for a valuation professional to adhere to the MPF documents in this step. However, the concepts and principles in the MPF documents will still ensure the analysis is well documented and supported.

Step 3 – Measurement of an impairment loss

If management and their auditors determine that a long-lived asset (or an asset group) is not recoverable, they would calculate an impairment loss based on the excess of the carrying amount over and above the fair value measurement. If a valuation professional is engaged to provide the long-lived asset's (or an asset group's) fair value, then it is mandatory for the valuation professional to adhere to the MPF documents in this step of an ASC 360 analysis, for assets or interests within the stated scope of the MPF (also see FAQ#5 and FAQ#6).

Return to Top

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