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Mandatory Performance Framework for the Certified in Entity and Intangible Valuations™ Credential

CORPORATE AND INTANGIBLES VALUATION ORGANIZATION, LLC

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EXECUTIVE SUMMARY

Problem Identification

During the last 15 years, the global accounting model has increasingly gravitated towards the use of fair value as the measurement basis for assets and liabilities for **financial reporting purposes**.[1] Estimating these fair value measurements often involves the use of sophisticated financial models, various valuation approaches and analytical assumptions, and professional judgment.

Within the past several years, public statements by U.S. capital market regulators have called into question whether some of the individuals that assist SEC registrants with estimating fair value for financial reporting purposes have the requisite training, qualifications, experience, and expertise to perform this type of work. The SEC staff has expressed a desire that the various stakeholders in the valuation profession coordinate their efforts to establish rigorous and uniform qualifications, training, accreditation, and oversight of individuals conducting fair value measurements.

Regulatory, creditor, and shareholder concerns as well as public perceptions are driving the need for **valuation professionals** to conduct themselves with professionalism and demonstrate professional competence.

In response to these regulatory concerns and the public perceptions, numerous groups including not-for-profit **valuation professional organizations** (VPOs), **nonmembership VPOs**, and others collaborated to form a task force that focused on the issues facing the valuation profession and how best to address them.

The task force formed four work streams designed to address VPO governance and operational issues relevant to developing, implementing, and maintaining an infrastructure to support the Certified in Entity and Intangible Valuations™ (CEIV™) credential. The work streams and the collaborative initiative to establish a more cohesive valuation profession and improve fair value reporting for financial reporting purposes are known collectively as the *fair value quality initiative*. The work streams are as follows:

- Governance and Coordination
- Performance Requirements
- Qualifications
- Quality Control

Each of these work streams had its own integral set of responsibilities to help the VPOs develop and support an infrastructure that will provide valuation professionals who obtain the CEIV credential with a roadmap to conduct more consistent, higher quality, and better documented valuation engagements. The following section summarizes the Performance Requirements work stream, the work stream tasked with developing the **Mandatory Performance Framework** (MPF or framework).

Performance Requirements

U.S. accounting standards have evolved to a "mixed model," combining aspects of historical cost measurement attributes with fair value measurement attributes. The regulators and the public have increased their expectations

[1] Words or terms defined in the glossary are set in **bold** type the *first time they are applied in context* within this document.

of financial statement preparers and their advisers to provide consistent, supportable, and auditable fair value measurements.

The valuation profession has responded to this evolution by developing technical standards and guidance, essentially addressing the "how-to" question. Further, VPOs have increased their focus on providing training, accreditation, technical guidance, and frameworks for ethical conduct, essentially addressing the "who is to do" question.

One area, however, where gaps in guidance are believed to still exist relates to performance (that is, addressing the "how *much* to do" question). Various terms have been used to describe this topic, such as "level of rigor," "depth of analysis," "scope of work," "level of due diligence," "extent of documentation," and "extent of investigation."

As previously mentioned, the Performance Requirements work stream was tasked with developing this framework to establish a minimum threshold for the how-much question for valuation professionals.

The following definitions are intended to differentiate "professional standards" and "technical standards" from "performance framework" for the purposes of this framework:

Professional standards. Standards that encourage professional behavior. Examples are codes of ethics and codes of conduct that require acting competently, independently, objectively, and transparently. These can also be considered standards that define the qualities of a professional: ethical, independent, objective, having requisite skills, educated, experienced, tested, trained, and credentialed or licensed. Professional standards focus on characteristics of individual professionals and their conduct.

Technical standards. Standards that address the *how to* of work that must be done to prepare a professional work product. These standards address the technical correctness of the work product by considering appropriate input factors, application of methods and techniques, and reporting guidelines. Both mandatory standards and voluntary guidance have been developed around technical issues in valuation in general and, to a lesser extent, around fair value measurement.

Performance framework. Contains requirements that cover how much work should be performed in order to prepare a professional work product. The performance framework addresses scope of work, extent of documentation and analysis, consideration of contrary evidence, and documentation in both the report and the supporting working papers. Alternatively, the performance framework establishes the extent to which valuation professionals perform their work in terms of depth of analysis and documentation.

Structure of the Mandatory Performance Framework and the Application of the MPF Sections

- Mandatory Performance Framework
  - MPF section 1, *Preamble*, provides an overview of the framework's scope and purpose (that is, who must adhere to it and when must it be followed).
  - MPF section 2, *Valuation Engagement Guidance*, establishes the parameters of the documentation requirements that valuation professionals must adhere to. This includes the fundamental engagement considerations and scope of work that manifest themselves within the engagement letter, the extent

of documentation requirements, and the professional skepticism required in the valuation process and in the reporting of any conclusions.

- MPF section 3, *Mandatory Performance Framework Glossary*, sets forth definitions of terms that may be unique to the framework and, when necessary, defines their meaning within the context of the framework.

- MPF section 4, *Authoritative and Technical Guidance*, includes a list of accounting standards, auditing standards, valuations standards, and certain technical literature applicable to the guidance presented in the framework.

  The content cited in MPF section 4 is organized based on authoritative weight. The accounting standards are issued by regulators and accounting standard setters and are mandatory for all financial statements issued for financial reporting purposes. The valuation standards issued by the VPOs are mandatory only for their respective members. Nonmembers who practice in certain jurisdictions, specialty subject interests, or both should be aware that they may be required by federal, state, or local laws or regulations to adhere to specified valuation standards promulgated by either VPOs or by nonmembership organizations (for example, The Appraisal Foundation and the International Valuation Standards Council). The technical literature is nonauthoritative; however, these publications are prepared by professionals with in-depth knowledge of the topics and were broadly vetted by preparers and users of valuations and by auditors.

- Application of the Mandatory Performance Framework for the CEIV (separate document)
  - Application of MPF section A1, *General Valuation Guidance*, applies the framework to selected areas of professional valuation practice that are misapplied or insufficiently supported or documented (or all) in valuations prepared for financial reporting purposes.

  - Application of MPF sections A2 and A3, *Business Valuation Guidance* and *Valuation of Assets and Liabilities Guidance*, identify and apply the framework to the most common components of an engagement in which the valuation professional provides a conclusion of value of a business or business interest. These sections govern the scope of work and extent of documentation for selected areas associated with the valuation of businesses, business interests, intangibles assets, certain liabilities, and inventory that are prepared for financial reporting purposes. Specifically, these sections address matters that need

    - greater consistency in the application of valuation approaches and methods,
    - support for issues that require the application of professional judgment, and
    - documentation of inputs.

    These sections will continue to evolve and expand to cover a broader spectrum of subject matter topics and professional practice trends in the valuation profession.

By design, the framework and the Application of the MPF do not provide illustrative examples that might otherwise be interpreted as requirements for how to perform a valuation. The purpose of the framework is to provide valuation professionals with guidance on how much documentation is required when performing valuation services for financial reporting purposes. However, in certain circumstances, the Application of the MPF may provide *some* how-to discussion in order to complement the usability and application of the framework.

Scope of Adoption and Adherence by Valuation Professionals

The framework and the Application of the MPF were designed to be used by *all* valuation professionals who provide valuation services for financial reporting purposes.

An overview of the scope of adoption and adherence by valuation professionals follows:

- *Valuation professionals with the CEIV credential.* It is mandatory for valuation professionals who have earned the CEIV credential to adhere to the framework and the Application of the MPF (collectively referred to as 'MPF documents') when engaged by (*a*) an entity required to submit registration statements or filings to the SEC or (*b*) a privately held entity that prepares and issues financial statements in accordance with US GAAP, to perform a valuation of a business, business interest, intangible asset, certain liabilities, and inventory used to support management's assertions made in financial statements issued for financial reporting purposes.
- *Valuation professionals without the CEIV credential*. As noted previously, the framework and the Application of the MPF were designed for use by all valuation professionals. Although only those valuation professionals who have the CEIV credential are required to adhere to the MPF documents, the Performance Requirements Work Stream believes that adhering to the MPF documents should be considered **best practice** by valuation professionals who do *not* have the CEIV credential and who perform valuation of a business, business interest, intangible asset, certain liabilities, and inventory used to support management assertions made in financial statements issued for financial reporting purposes.

Important: All Mandatory Performance Framework requirements that are specific to CEIV credential holders will be identified as such throughout the framework.

Conclusion

Valuations for financial reporting purposes completed in a professional manner require adherence to a consistent set of professional, technical, and ethical standards as well as a set of guiding principles that help define how much work is necessary in order to provide supportable and auditable fair value measurements that serve as the basis for management's preparation of financial statements for financial reporting purposes.

THE MANDATORY PERFORMANCE FRAMEWORK FOR THE CERTIFIED IN ENTITY AND INTANGIBLE VALUATIONS CREDENTIAL

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1. PREAMBLE

Introduction

1.1 The Mandatory Performance Framework (MPF or framework) is a document for valuation professionals that provides guidance on how much support, in terms of scope of work and documentation, should be prepared or obtained when designing, implementing, and conducting valuations of businesses, business interests, intangible assets, certain liabilities, and inventory used for management assertions made in financial statements issued for financial reporting purposes.

1.2 Financial statements issued for financial reporting purposes include, but are not limited to, financial reports issued by the following:

1.2.1 entities required to submit registration statements or filings to the SEC

1.2.2 privately held entities that prepare and issue financial statements in accordance with United States generally accepted accounting principles (U.S. GAAP)

1.2.3 any other engagement where the individual is performing services as a valuation professional

Important: If a CEIV credential holder is engaged by a privately held entity that does not issue financial statements in accordance with U.S. GAAP (for example, financial statements issued in accordance with special purpose frameworks), the CEIV credential holder **should** follow the MPF documents for the engagement; however, if the CEIV credential holder elects not to follow the MPF documents, this fact and rationale must be prominently displayed on the first page of the final valuation report.

1.3 The primary goal of the framework is to provide valuation professionals with parameters of how much work should be performed and how to effectively and efficiently identify valuation documentation requirements in order to meet the changing needs of clients and other potential stakeholders, mitigate engagement risk, and support and document sound decision making. This framework is a set of interrelated and interacting elements that valuation professionals can use in conjunction with relevant valuation standards and technical guidance to promote quality, consistency, and auditability. The framework is not intended to address valuation theory or to be a how-to guide regarding valuation steps.

1.4 Written documentation within the engagement file that supports a final conclusion of value (referenced in the framework as *working papers*) and the final valuation report will be referenced collectively as the **work file** unless otherwise specified.

1.4.1 The framework requires that the valuation professional provide within the work file sufficient documentation to support a 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.

1.4.2 The valuation professional should include sufficient documentation to support a conclusion of value as identified in MPF section 1.4.1 within the final valuation report.

1.4.3 The framework sets forth minimum scope of work and documentation requirements for valuation professionals. Circumstances in which a valuation professional has agreed to comply with more stringent scope of work and documentation requirements are not restricted or negated by this framework.

1.5 CEIV credential holders who perform **valuation services** for their clients or employers, or as part of another engagement, are required to adhere to the framework for financial reporting purposes.

Important: CEIV credential holders who are employees of an entity that is required to prepare financial statements issued for financial reporting purposes (subsequently referenced as a reporting entity), and who are responsible for preparing conclusions of fair value that provide support for information included in the financial statements and accompanying footnotes, are required to comply with this framework. However, for such situations, certain administrative matters such as formal letters of engagement (LoE) are excluded, and the communication of value conclusions **may** not include a formal valuation report.

If a CEIV credential holder who is an employee of a reporting entity concludes that a section (or sections) of the framework is (or are) not applicable because of his or her employment at the reporting entity, the valuation professional may elect not to comply with the identified sections of the framework. The valuation professional **must**, however, document in the work file which sections of the framework were not complied with and the rationale for the noncompliance.

1.6 In the event that there are professional requirements prescribed by the valuation professional organization (VPO) that issued the credential holder's CEIV credential and those requirements are not required by the framework, the CEIV credential holder must also conduct himself or herself in accordance with the VPO's requirements.

1.7 The valuation profession uses a broad spectrum of approaches and methods when conducting a valuation. Therefore, in circumstances in which the extent of research and analysis, documentation, or both, related to a valuation approach or method is not addressed by the framework, the valuation professional should look to the framework for analogous guidance considered to be the most appropriate for the engagement's relevant facts and circumstances.

1.8 For the valuation professional, this framework provides the following:

1.8.1 A method to align a valuation engagement with procedures that will meet the needs of the client and other potential stakeholders in response to the greater focus by regulators on fair value measurements

1.8.2 A resource to help identify and mitigate ineffective, inefficient, or incomplete valuation procedures that result in insufficient support for, and auditability of, the final conclusion of value

1.8.3 A resource for the valuation review process

1.9 For the reporting entity's management, auditors, and external stakeholders, the use of the framework promotes the following:

1.9.1 Greater confidence in the valuation professional's ability to assist the company in meeting the entity's internal and external reporting requirements

1.9.2 Greater confidence in the valuation professional's application of an acceptable process of evaluation, analysis, and documentation of fair value measurements that may serve as a basis for management's financial statement assertions

1.9.3 Greater understanding of the valuation professional's use of judgment, estimates, and industry knowledge

1.9.4 Greater consistency in how much documentation is prepared among valuation professionals

Applicable Business Valuation Standards

1.10 As the valuation profession has grown, so too has the need for augmented consistency and quality in the profession. The valuation standards identified in the following list represent standards that are voluntary in nature to the extent that valuation professionals elect to abide by these standards through the types of engagements they undertake and the organizations they align with. Membership valuation organizations are referenced in the framework as VPOs. The founding VPOs of the CEIV credential and their respective business valuations standards are the following:

1.10.1 American Institute of Certified Public Accountants (AICPA): VS Section 100, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* (VS sec. 100).

1.10.2 American Society of Appraisers (ASA): *ASA Business Valuation Standards*. The *Business Valuation Standards* of the ASA are used in conjunction with the *Uniform Standards of Professional Appraisal Practice* (USPAP) of The Appraisal Foundation.

1.10.3 Royal Institution of Chartered Surveyors (RICS): *RICS Valuation—Professional Standards* that incorporate the International Valuation Standards (IVS).

The following are nonmembership valuation organizations and their respective valuation standards:

1.10.4 The Appraisal Foundation: *Uniform Standards of Professional Appraisal Practice* (USPAP). The Appraisal Standards Board of The Appraisal Foundation develops, interprets, and amends USPAP on behalf of appraisers and users of appraisal services. The "Preamble," "Definitions," "Rules," and more specifically, standards 9 and 10 of USPAP relate to fair value measurements of business interests and intangible assets.

1.10.5 International Valuation Standards Council: *International Valuation Standards* (IVS)—The IVS Framework, IVS General Standards 101–105. IVS section 200, *Businesses and Business Interests*, and IVS section 210, *Intangible Assets*, relate to the fair value measurement of businesses and intangible assets, in addition to the supporting IVS Framework and IVS General Standards.

Relevant Accounting and Audit Standards Applicable to Business Valuation and Intangible Assets

1.11 Due to the interrelated nature of valuation engagements and accounting standards, valuation professionals must, where applicable and necessary, understand the relevant accounting standards that may dictate the scope of work to be performed.

This includes instances in which international accounting standards issued by the International Accounting Standards Board (IASB) may be incorporated into financial statements prepared for financial reporting purposes.

Both U.S. and international accounting standards can impact the nature, timing, and scope of a valuation professional's work.

Valuation professionals must also be aware of auditing standards that the audit profession uses as guidance when conducting an audit of financial statements prepared for financial reporting.

A list of important accounting and auditing standards relevant to the valuation of businesses, business interests, and intangible assets is provided in MPF section 4, *Authoritative and Technical Guidance*.

Scope of the Mandatory Performance Framework

1.12 The term **engagement to estimate fair value** refers to any engagement or part of an engagement that involves estimating the fair value of businesses, business interests, intangible assets, certain liabilities, or inventory (subsequently referenced individually or collectively as **subject interest**) to serve as a basis for management's preparation of financial statements for financial reporting purposes. An engagement to estimate fair value culminates in a written conclusion of value.

1.13 Valuation professionals should be aware of any governmental regulations and other professional standards applicable to engagements to estimate fair value (or applicable to valuation professionals when they are performing such engagements). Compliance is the responsibility of the valuation professional.

Exceptions to the Mandatory Performance Framework

1.14 If any part of this framework conflicts with a published governmental, judicial, or accounting authority, then the valuation professional should follow the applicable published authority or stated procedures with respect to the part applicable to the valuation in which the valuation professional is engaged. The other parts of this framework continue in full force and effect. If a published governmental, judicial, or accounting authority differs in that it simply requires less than this framework, then the requirements of this framework still must be met.

2. VALUATION ENGAGEMENT GUIDANCE

Overview

2.1 As the valuation profession has evolved, valuation firms and VPOs have developed various engagement processes and procedures for engagement acceptance, many of which are applicable to valuations prepared for financial reporting purposes (see MPF section 1.2 for definition).

2.2 The following sections will address the framework's requirements for valuation professionals engaged to perform valuations that are prepared to serve as a basis for management's financial statement assertions.

Documentation Requirements for Fair Value Engagements

2.3 The valuation professional must conduct and document each engagement or part of an engagement to estimate fair value of a subject interest to assist in management's preparation of financial statements for financial reporting purposes in accordance with the applicable guidance within this framework.

Composition of Valuation Documentation

2.4 Documentation is the written record within the final valuation report, supporting working papers, or both, used to support a valuation conclusion used by management in their assertions of fair value and their preparation of financial statements issued for financial reporting purposes.

2.5 Appropriate documentation provides evidence that the valuation engagement was completed in accordance with this framework.

2.6 Written documentation may include paper, electronic files, or other forms of recorded media. Examples include, but are not limited to, letters of engagement, correspondence with clients (for example, email, recordings of calls, voice messages), client-provided documents, representation letters, field notes, electronic spreadsheets, and internally prepared memoranda to the work file.

2.7 Documentation comprises two key components:

2.7.1 **Source documents** include, but are not limited to, data and information (including interview notes) collected from both company sources and external third-party data accumulation resources relating to the company, its financial position, its competitors, the industry it competes in, its customers and suppliers, the state of the economy, financial markets, and risk factors.

2.7.2 **Analysis documents** include, but are not limited to, exhibits, schedules, and working papers that numerically set forth the analysis that was performed, and memos to file or other narratives that document and explain the valuation professional's reasoning behind such matters as the selection of methods, selection of inputs used in applying methods, and judgments made regarding valuation assumptions.

2.8 Source documents should be included in the work file to the extent that they provide evidential support to an input, process, or output required to arrive at a conclusion of value.

2.8.1 Identification of source documents and specific selection criteria used to identify information used to support the final valuation report is appropriate when inclusion of source documents in the work file is not

feasible or practicable (for example, all 10K filings for a particular industry, historical risk free rates for the last 30 years).

2.8.2 Source documents that are relevant to the analysis and indicate *contrary evidence to the conclusion of value*, along with the valuation professional's explanation of how this information was considered, should be included in the final valuation report (and such source documentation should be identified in accordance with MPF section 2.8.1 if not included in the work file because not feasible or practicable to do so).

2.9 Analysis documents generally fall into two subcategories:

2.9.1 *Computational analysis* (for example, spreadsheets, database use). To the extent that this type of analysis provides evidential support (or contradictory indications) to an input, process, or output, it is required to be included in the work file (that is, supporting work papers, final valuation report). This analysis demonstrates "what" the valuation professional did and how they did it.

2.9.2 *Narrative-based documents.* These documents complement the computational analyses by providing commentary on "why" the valuation professional elected certain methods, inputs, and judgments within the work product. For example, narrative-based documents could be included in the following (this list is not all-inclusive):

- The narrative of the report
- The analysis documents (for example, footnotes, narrative fields)
- Memoranda to the work file

Extent of Documentation Requirements

2.10 The valuation professional must support the conclusion of value with sufficient detail to provide a clear and well-organized link from the data and information gathered to the final conclusion of value presented in the final valuation report. An experienced professional (note: who may or may not be a valuation professional) reviewing the final valuation report who has no involvement with the engagement must be able to do the following:

2.10.1 Understand the purpose, nature, extent, and results of the valuation procedures performed.

2.10.2 Understand all approaches and methods used in the valuation analysis and, if applicable, understand why commonly used approaches and methods were not used in the valuation analysis.

2.10.3 Understand the inputs, judgments, and assumptions made and the rationale for their use.

2.10.4 Determine who performed the work and their qualifications (for example, valuation professional, subcontractor, management).

2.10.5 Identify the intended users of the valuation report.

2.10.6 Identify the sources and supporting data for the inputs, judgments, and assumptions made.

2.10.7 Identify the measurement date.

2.11 When considering the extent of documentation to support a conclusion of value, the valuation professional should consider the following:

2.11.1 The significance the data or information has on the conclusion of value

2.11.2 The risk of management bias affecting the conclusion of value

2.11.3 The risk that insufficient documentation may result in a misunderstood conclusion of value

2.11.4 The degree of judgment required by the valuation professional to prepare information used to estimate the conclusion of value

2.11.5 The reasonableness or appropriateness of the approaches and methods used to estimate the fair value of the subject interest

Professionalism and Professional Competence

2.12 A valuation professional, prior to accepting an engagement, must conclude that he or she can reasonably expect to complete the engagement with professional competence that includes adherence to the framework.

A valuation professional must be able to demonstrate, at a minimum, the fulfillment of the following criteria:

2.12.1 The appropriate academic and professional qualifications demonstrating technical competence

2.12.2 The appropriate level of experience, including specific industry and fair value experience, to identify the problem to be addressed

2.12.3 The appropriate level of experience in valuing the subject interest and in completing engagements for a similar purpose

2.12.4 Recognition of and compliance with applicable local laws and regulations that apply to the valuation engagement or valuation professional

2.12.5 For CEIV credential holders, professional competence also includes compliance with the CEIV requirements for education, qualifications, and quality control, and adherence to the framework and the Application of the MPF.

2.13 If a valuation professional determines prior to accepting an engagement, or during the course of an engagement, that he or she does not have the required level of subject interest expertise to competently complete the engagement, the following steps should be considered:

2.13.1 When possible, assemble and use appropriately competent and qualified subject interest specialists within the professional's firm or company.

2.13.2 Retain an appropriately competent and qualified subcontractor.

2.13.3 Do not accept the engagement, or withdraw from the engagement if already accepted.

2.14 *Subcontractors.* If a subcontractor is used to either (*a*) assist with work the valuation professional is professionally competent to do but unable to do (for example, because of time or geographic constraints) or (*b*) assist with work the valuation professional is not professionally competent to do (for example, because he or she is an expert in a niche field or very technical subject matter), the valuation professional must do the following:

2.14.1 Provide written notification to and obtain written approval from the client (for example, this may be done within the LoE, in an addendum to the LoE if the need for a subcontractor identified after the initial LoE is executed, or by email).

2.14.2 Document in the report the level of responsibility, if any, being assumed by the primary valuation professional and, if applicable, the subcontractor.

2.14.3 Assemble and evaluate relevant information from the retained subcontractor and retain such relevant information and interpretation in the work file. Whether or not the valuation professional is professionally competent to do the work of the subcontractor will determine the level of responsibility assumed by the valuation professional and the amount of documentation required by the framework. These requirements are as follows:

1. Valuation professionals who retain subcontractors to assist with work the valuation professional responsible for the valuation engagement (or his or her firm) is professionally competent to do but is unable to do must evaluate all such subcontractors' contributions (see MPF sections 2.10 and 2.11). If necessary, the valuation professional should prepare supplemental documentation and analysis to complement the subcontractor's work product to ensure the valuation professional's work file complies with the framework.
2. Valuation professionals who retain subcontractors to perform valuation services the valuation professional responsible for the valuation engagement (or his or her firm) is not professionally competent to do (for example, the valuation of real estate, machinery and equipment, fine art, and so forth) must not take responsibility for the subcontractor's work and must provide adequate disclosure of subcontractor participation in the final valuation report (see "The Valuation Report" at MPF section 2.24 and "Content of the Final Valuation Report" at MPF section 2.27).

Important: The valuation professional who retains a subcontractor to assist with work the valuation professional is professionally competent to do but is unable to do is responsible for all aspects of the subcontracted valuation that will be included in the work file. Furthermore, the valuation professional who retains a subcontractor in this capacity must retain the subcontractor's report and, to the extent possible, the subcontractor's work papers in the work file.

Valuation professionals who retain subcontractors to assist with valuation services outside of the valuation professional's area of expertise must establish a reasonable basis for the decision to rely on the subcontractor's work. This includes evaluating and concluding that the subcontractor performing the work is competent. For example, the valuation professional may use the criteria in MPF section 2.12 to evaluate the subcontractor's professionalism and professional competence and MPF sections 2.10 and 2.11 to determine if the subcontractor's work product is sufficiently documented to support his or her conclusion of value.

2.15 The framework's requirements for professionalism and professional competence are adhered to when the valuation professional taking responsibility for the analyses and conclusion of value ensures that all contributing valuation professionals have followed the framework and Application of the Mandatory Performance Framework.

Important: CEIV credential holders who sign the final valuation report must comply with reporting requirements required by MPF section 2.27.22.

Professional Skepticism

2.16 Professional skepticism is an attitude that includes a questioning mind and critical assessment of valuation evidence. The valuation professional uses the knowledge, skill, and ability called for by the valuation profession to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence.

Every valuation professional must exercise professional skepticism during each engagement where the valuation professional is providing a conclusion of value that will be used to support management's assertions in financial statements issued for financial reporting purposes.

2.17 Professional skepticism requires that the valuation professional have an attitude that emphasizes the following:

2.17.1 ***Evidential skepticism.*** Valuation professionals must exercise due professional care by regularly questioning and critiquing all information and data with the appropriate level of skepticism. The level of skepticism should be based on the potential for bias within the information and data (for example, multiple sources of external corroboration versus a management-generated estimate with no external corroborating support).

Important: When evaluating management-generated and management-provided information, the valuation professional must consider the experience of management and the sufficiency of the documentation and analyses provided by management throughout the valuation engagement. The valuation professional should not presume management is biased; however, the valuation professional should not accept and rely on less-than-persuasive evidence because the valuation professional believes management is unbiased. This requirement extends to third-party specialists retained by management, their competence, and the sufficiency of their work product.

2.17.2 ***Self-skepticism.*** The valuation professional must regularly monitor his or her own client-based presuppositions that could detract from evidencing skepticism as a result of comfort level or familiarity with the client, industry, or both.

2.18 Each valuation professional must implement a degree of professional skepticism with the expectation that the conclusions reached in the report will be subjected to review (for example, by the client, external auditors, regulators).

Code of Ethics

2.19 All valuation professionals must follow the code of ethics published by the VPO that issued the valuation professional's credential.

Types of Engagements

2.20 In general, valuation engagements include analyses that are either (*a*) complete or (*b*) limited as it relates to the extent of research and analysis included in the valuation report. Also, valuation reports can be very detailed or quite brief.[2]

[2] Note that VS sec. 100 addresses the concept of **calculation engagements** (and reports) that do not include all of the procedures required for a complete valuation engagement. Similarly, USPAP's Scope of Work Rule addresses the required extent of research

A **complete valuation analysis** results in a conclusion of value by the valuation professional after having considered and evaluated all relevant factors. The valuation professional uses **professional judgment** to determine which valuation approaches and methods, and what amount of documentation, are appropriate based on the facts and circumstances of each engagement.

Engagements performed for financial reporting purposes must include a complete valuation analysis that conforms to the framework requirements, but the report type can vary according to the requirements of the engagement.

2.20.1 For each engagement, valuation professionals must prepare either a **comprehensive valuation report** or an **abbreviated valuation report**. Valuation professionals must prepare a valuation report that is sufficiently detailed to serve as a basis for management's financial statement assertions in financial reporting, with the understanding that the sufficiency of the conclusions reached in the report may be subject to regulatory scrutiny and subject to audit procedures in accordance with generally accepted auditing standards within the context of an overall audit of the entity's financial statements.

2.20.2 In order to enhance auditability, the valuation professional must prepare the work file in alignment with the framework to ensure sufficient detail exists to support the conclusion of value. Therefore, the valuation professional must determine, based on the facts and circumstances of the engagement to estimate fair value, whether to prepare

- a *comprehensive valuation report* that provides sufficient information for the intended users or expected recipients of the report to identify the data, analyses, assumptions, models and rationale used by the valuation professional in order to arrive at a conclusion of value as prescribed in MPF section 2.27; or

- an *abbreviated valuation report* that condenses the requirements of a comprehensive valuation report based on criteria agreed upon by the client and the valuation professional. Although an abbreviated valuation report may not contain sufficient details for the intended users or expected recipients to understand all of the data, analyses, assumptions, models and rationales used to support the conclusion of value, valuation professionals must conduct a complete valuation analysis

Regardless of the type of valuation report that will be issued, the valuation professional must include the analysis and accompanying explanatory narrative for all internally prepared analyses, findings, and conclusions within the work file. This documentation may take the form of internally prepared memoranda or a narrative that will be used to develop the valuation report.

2.20.3 If the valuation professional has reason to believe the results of a limited analysis or calculation engagement will be inappropriate for management's intended use of the analyses and report, the valuation professional must decline the engagement.

and analysis, and further references appraisal reports (more thorough content and information) and restricted appraisal reports (less thorough content and information).

Important: If a valuation professional accepts a client engagement that will result in a limited analysis or calculation engagement, the LoE and final valuation report (this includes any work product intended for client use) must *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.* This includes identifying which sections of the framework and Application of the MPF have not been complied with. In these circumstances, valuation professionals must use the criteria presented in MPF sections 2.27.11 and 2.27.12 (and 2.27.13 when applicable) for purposes of disclosures within the final valuation report.

2.20.4 As part of the complete valuation analysis, valuation professionals may retain subcontractors to assist with outsourced components of their analyses. Such components may be complete or limited analyses, or calculations that the valuation professionals will specify as such and then incorporate into their complete valuation analysis, conclusions of value, and final valuation report. The valuation professional who retained the subcontractor must adhere to the professionalism and documentation requirements in MPF sections 2.14 and 2.27, respectively.

Engagement Letter

2.21 When valuation professionals are engaged by an entity, firm, or individual other than their employer (that is, for engagements other than internal engagements),[3] they must obtain a signed LoE for every engagement that results in the valuation professional providing a conclusion of value. The LoE establishes the nature, timing, and scope of the agreed-upon valuation assignment. The facts and circumstances of each valuation engagement will dictate the content of the LoE. An executed LoE between the valuation professional and the client must contain the following components (to the extent they are applicable):

2.21.1 *Identification of the client.* The LoE must identify the client that has contracted for the valuation services. If there are several clients (that is, more than one), the LoE must identify all clients to the engagement.

2.21.2 *Type of report.* The LoE must clearly state the type of report that will be prepared for the engagement (see MPF section 2.20 for description of the most common reports, and refer to valuation standards for specific report types).

2.21.3 *Scope of work.* The LoE must clearly state the scope of work to be completed by the valuation professional in compliance with this framework. This includes, but is not limited to,

- whether the report will be prepared in accordance with the MPF and Application of the MPF;
- using the appropriate level of professional judgment to avoid errors of omission (for example, not including or considering certain assets or liabilities that may exist); and
- limiting or omitting otherwise relevant components of a typical scope of work by agreement with the client (for example, attrition, and prospective financial information [PFI] review).

2.21.4 *Client responsibility.* The LoE must establish identifiable and actionable client responsibilities when those responsibilities have a significant impact on the valuation professional's procedures and conclusion of value. For example, client responsibilities might include providing complete and accurate financial records and

[3] If the valuation professional is engaged to conduct a valuation for internal purposes, a clear definition of the work should be explained and documented in the company's internal documentation.

data; appropriate and sufficient access to the client's personnel and records; appropriate and sufficient access to the client's facilities, to the extent it is relevant for the valuation procedures; and well-documented and supported prospective financial information.

2.21.5 *Identification of the intended use of the report.* The LoE must clearly state the intended use of the valuation analysis and report that will be prepared by the valuation professional. The report is valid only for that stated purpose or use (for example, additional support for management's fair value disclosures in the entity's financial report).

2.21.6 *Identification of the intended users and expected recipients.* The intended user of the report will generally be the client of record and may include other parties specifically identified as addressees in the LoE and the subsequent report. The client may share the LoE and report with additional expected recipients of the report including its advisers (for example, auditors or attorneys) in conjunction with the client's intended use of the valuation as specified within the LoE. Additional non-clients may subsequently be added as intended users based on a contractual agreement between the valuation professional and client.

2.21.7 *Measurement date for the valuation engagement.* The LoE must clearly state the measurement date (also known as the "valuation date," "as of date," or "effective date") for the valuation engagement (if known by the client when the LoE is presented to and signed by the client). If the measurement date is not known with certainty when the LoE is presented to and signed by the client, the LoE may state that the measurement date is to be determined.

2.21.8 *Standard of value.* The LoE must include the applicable standard of value and its definition. This aligns client expectations with the nature and extent of valuation services to be performed.

2.21.9 *Premise of value.* The LoE must state the premise of value that will be used (if known) and its definition. This helps ensure the client and the valuation professional are in agreement on terminology and concepts. If premise of value is determined, modified, or changed during the engagement, the valuation professional must receive from or provide to management written confirmation of the new or modified information and disclose this information in the written report.

2.21.10 *Description and (if relevant) listing of the business(es), business interest(s), intangible asset(s), liabilities, inventory, or any other assets that are to be valued.* The LoE must identify and describe the business, business interest(s), or intangible and other assets that are expected to be valued. It is acceptable for the LoE to state that modifications to the identified subject interests may be made as the modifications are identified during the engagement as additional information becomes known.

2.21.11 *Fee, timing, and deliverable.* The LoE should address the fee, timing of the valuation, delivery of any interim or draft conclusions, and the delivery of a final valuation report. (Note: The timing of the engagement should include adequate time for the valuation professional to conduct the appropriate scope of work; this should include time to access members of management for interviews and in-person meetings [see section 2.23], and should allow for sufficient time for self-review, internal review, and auditor review.)

2.21.12 *Known assumptions or limiting conditions.* To the extent that any known and relevant assumptions, including extraordinary or hypothetical assumptions, or limiting conditions will be used in the valuation, they must be included in the LoE to make the client aware of the potential impact on the engagement (for example, conclusions that might otherwise be different). For any known and relevant assumptions, extraordinary or

hypothetical assumptions, or limiting conditions that are developed during the engagement, the valuation professional must receive from or provide to management written confirmation of the new or modified information and disclose this information in the written report.

2.22 In addition to the required elements of an LoE, the valuation professional should consider supplementing the LoE with components that further improve the understanding with the client. Examples include the following:

2.22.1 *Approach and method.* The LoE may contain a description of the valuation approach(es), method(s), or both that will be considered and applied to each of the subject interests during the valuation engagement.

2.22.2 *Firm-specific terms and conditions.* Valuation professionals may incorporate their firm-specific contractual terms and conditions that address various risk management matters such as indemnification, and so forth.

Management Interviews

2.23 The valuation professional should conduct on-site management interviews with the appropriate parties whenever practicable. Professional judgment must be used in making this determination (for example, cost-benefit concerns). Regardless of how interviews are conducted, the valuation professional should document the following (at a minimum):

1. The date of the interview
2. Who conducted the interview
3. Which members of management were interviewed (and the role or responsibility of each person interviewed, time, and location of each interview)
4. Notes regarding the questions and related responses (field notes)
5. Which facilities were visited (if applicable) and their locations
6. Any other relevant content discussed and observations made during the interview

2.23.1 Telephone interviews should be used when in-person or on-site management interviews are not practicable. Any telephone interviews should be documented, at a minimum, in accordance with the criteria in MPF section 2.23.

The Valuation Report

2.24 The final valuation report represents the planning, execution, and conclusion of the valuation professional's services for a client. For purposes of the framework, valuation professionals must prepare their work file, which includes the final valuation report, in accordance with the guidance provided in this section for all engagements to estimate fair value used to support management assertions made in financial statements issued for financial reporting purposes.

2.25 This section provides valuation professionals with a threshold for the minimum amount of information required in their final valuation report to the extent the components are applicable and relevant. The substance and style of valuation reports may differ substantially depending on the specific requirements of an engagement, the purpose or intended use of the valuation, and whether the report is prepared for an otherwise unrelated client or prepared internally for or by management.

2.26 The final valuation report should be organized and written so that the intended users and other expected recipients can readily understand the analyses, narrative-based documents, and any exhibits that are included in the final valuation report.

Important: As noted in MPF section 2.20.2, if the valuation professional is engaged to provide valuation services and prepare a valuation report with supporting analyses and documentation that do not comply with the framework and Application of the MPF, the valuation professional must *prominently state in the final valuation report 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.* This includes identifying which sections of the framework and Application of the MPF have not been complied with. In these circumstances, valuation professionals must use the criteria presented in MPF sections 2.27.11 and 2.27.12 (and 2.27.13 when applicable) for purposes of disclosures within the final valuation report.

Content of the Final Valuation Report

2.27 In order for a comprehensive valuation report to be prepared in accordance with this framework, the valuation professional must, at a minimum, include the following components, where relevant, within the final valuation report:

2.27.1 *Client identification.* The valuation report must clearly identify the client.

2.27.2 *Purpose and intended use of the valuation report.* The valuation report must clearly state why the valuation is needed and how the valuation report will be used (for example, "The valuation report was prepared to assist the client with its test for possible impairment of long-lived assets as of the measurement date."). It is not acceptable for the purpose to be devoid of the intended use of the valuation (note: an example of this is, "The purpose of the valuation report is to estimate the fair value of the identified assets.").

Important: If a CEIV credential holder elects not to adhere to the MPF documents, this fact must be prominently disclosed on the first page of the final valuation report.

2.27.3 *Intended users of the valuation report.* Each intended user that will have authorized access to use, review, or rely on the contents of the final valuation report for its intended use must be clearly identified within the report. When the intended user is an entity, the term *intended users* may include the company's executives, board of directors, and management. In addition, the entity's external advisers with respect to the intended use of the valuation report may be expected recipients (for example, the entity's external auditors and legal counsel).

2.27.4 *Measurement date.* The measurement date (also known as the "valuation date," "as of date," or "effective date") is the point in time used by the valuation professional to estimate the subject interest's fair value. This is not the same as the "valuation report date," or "date of report issuance," that is typically subsequent to the measurement date.

2.27.5 *Valuation report date.* This is the date the final valuation report is signed and issued by the valuation professional or firm and delivered to the client.

2.27.6 *Subsequent events (if applicable and appropriate).* Events that occur between the measurement date and the valuation report date that were not known or knowable on the measurement date are typically not reflected in the analysis and conclusion; however, if any known subsequent events are disclosed in the valuation report, the relevant date(s) of the event(s) should be provided, and whether such subsequent events were considered in the valuation should be indicated.

2.27.7 *Identification of the subject interest.* The description of the subject interest must be specific enough for the intended users of the valuation report to easily identify the subject interest being valued. This description should include any significant legal rights, restrictions, or entity obligations associated with the subject interest.

2.27.8 *Sources of information.* The valuation report must identify sources of information with sufficient detail to allow an experienced professional to independently identify all relevant sources of internal and external, client or non-client information used to estimate fair value of the subject interest.

2.27.9 *Client-prepared information.* Valuation professionals must use their professional skepticism and judgment to assess the relevance and reliability of any client-prepared information and the extent to which they will rely on the information in the assessment of fair value. Valuation professionals must describe the information they relied on and the rationale for the reliance (Note: the description of the client-prepared information may be very general, such as "all capital leases," or very specific, such as "an amortization schedule for a certain asset").

2.27.10 *Valuation approaches and methods.* Each valuation approach and related valuation method considered and used must be clearly described along with a corresponding rationale for the selection of the method used. This should include a clear description of the valuation professional's consideration of each valuation approach and why (or why not) it was (or was not) selected. This should also include, where appropriate, the rationale for deviation from common practice within the valuation profession and why the more common approach and method were not chosen.

2.27.11 *Limitations on the scope of research and analysis.* In circumstances in which the valuation professional does not have access to information that is significant and relevant to a conclusion of value, the valuation professional must determine whether to continue with the engagement or withdraw from the engagement. The valuation professional should assess whether the imposed limitations are significant enough that they result in a change of scope for the engagement. If the valuation professional determines a change in scope for the engagement has, in fact, occurred he or she must evaluate the impact based on the criteria in MPF section 2.27.13.

Important: An example might include direction by the client to not value inventory. If inventory valuation would normally result in a step-up, the valuation professional should advise the client of this during the engagement contracting process. If the client insists that inventory not be valued, the valuation professional must decide whether to (*a*) withdraw from the engagement or (*b*) prominently disclose in the report that the inventory was not valued at the direction of the client, and had the inventory valuation resulted in a step-up in basis, this step-up in basis would affect the fair value of the other subject interests.

2.27.12 *Disclosure of limitations.* If the valuation professional elects to continue with the engagement, he or she must clearly disclose in the valuation report, at a minimum, the

1. limitations placed on the extent of research and analysis and the circumstances for the limitations and
2. a statement that the limitation might have affected the conclusion of value, and the possible directional impact on that conclusion if known.

2.27.13 *Disclosure of scope changes.* The valuation professional must prominently disclose a change of scope that reduces the level of service as compared to what was agreed upon in the executed LoE (for example, an engagement to perform a complete valuation analysis reduced to a limited-scope engagement or calculation procedures), and the valuation professional's conclusion of value will still be used to support management assertions made in financial statements issued for financial reporting purposes.

1. The valuation professional must evaluate the impact of the reduced level of service to the client and whether the valuation professional is able to conduct the engagement in accordance with the framework requirements. In circumstances in which the valuation professional believes the reduced level of service precludes him or her from complying with the framework and Application of the MPF requirements, the valuation professional must either
    a. withdraw from the engagement or
    b. continue providing valuation services to the client and
        i. obtain a new LoE or amend the original LoE and
        ii. issue a report (this includes any work product intended for client use) that prominently states the analyses and report do not meet the requirements of the framework and Application of the MPF.

2.27.14 *Non-assured financial information.* In some engagements, the valuation report includes financial information (either as part of an exhibit or the narrative or incorporated by reference), that is derived from sources other than the client's audited financial statements. Any financial information that does not appear in the audited financial statements (for example, information from the company's general ledger, reports from ERP systems, tax returns) cannot be considered to have been subject to an assurance engagement even if that information is from a period that was subject to an audit engagement. Therefore, the valuation professional must

1. identify the source of the financial information (for example, derived from client ERP),
2. disclose that the financial information is client-prepared, and
3. disclose that the financial information was not subject to any form of assurance that the valuation professional is aware of and that the valuation professional is relying on the client for the completeness and accuracy of the information.

Important: A common labeling convention used to refer to any client financial information included in the report is to describe the information as a "summary of selected financial data" or "derived from financial statements" rather than as "financial statements."

2.27.15 *Financial information adjustments.* When the valuation professional adjusts or changes the client's financial information (for example, restated historical financial statements, PFI), he or she must disclose in the final valuation report, at a minimum,

1. the dollar amount, proportional percentage, or both, of each adjustment or change and
2. the rationale for the adjustment or change.

2.27.16 *Significant assumptions and estimates—documentation requirements.* In order for the valuation report to be prepared in accordance with this framework, the valuation professional must ensure that the valuation documentation identifies (*a*) each significant assumption, (*b*) the person, persons, or firm responsible for developing the assumption, (*c*) the rationale for using the assumption, and (*d*) how the assumption supports the conclusion of value.

Important: The decision to categorize an assumption or estimate as significant must be based on professional judgment and communication with management and, where appropriate, communication and input from subcontractors (retained by valuation professional) or third-party specialists (retained by management).

2.27.17 *Subcontractors with subject interest expertise retained by valuation professional.* When a subcontractor has been retained by a valuation professional because the valuation professional does not have the required level of subject interest expertise to competently complete the engagement, the valuation professional must identify the subcontractor's work and conclusions in the final valuation report. In addition, the final valuation report must indicate that the valuation professional has relied on the subcontractor's work but has not assumed any responsibility for the work due to the professional's lack of subject interest expertise.

Important: For subcontracted valuation assignments outside of the valuation professional's area of expertise, the valuation professional must establish a reasonable basis for the decision to rely on the subcontractor's work. This includes evaluating and concluding that the subcontractor performing the work is competent. For example, the valuation professional may use the criteria in MPF section 2.12 to evaluate the subcontractor's professionalism and professional competence and MPF sections 2.10 and 2.11 to determine whether the subcontractor's work product is sufficiently documented to support his or her conclusion of value.

2.27.18 *Third-party specialist retained by client.* When a client retains a third-party specialist to separately value certain assets (for example, real property or fine art) the valuation professional may include the third-party specialist's conclusion by reference or include the report of the third-party specialist in the written report of the valuation professional (with the third-party specialist's consent).

2.27.19 *Reliance on conclusions of third-party specialist retained by client.* When the valuation professional relies on other client-provided information (this includes information prepared by third-party specialists retained by the client) and does not assess or evaluate it for reasonableness (for example, does not have the subject matter expertise to evaluate and does not retain a subject matter expert to evaluate), the valuation professional must clearly describe in the valuation documentation the information he or she relied on and the rationale for the reliance.

Important: valuation professionals should use professional judgment to determine if the work provided by the third-party specialist requires review and evaluation by a subcontractor with subject matter expertise if the valuation professional is not professionally competent to review and evaluate the third-party specialist's work.

2.27.20 *Conclusion of value.* The final report must include a conclusion of value.

2.27.21 *Valuation report representation and signature for valuation professionals who do not have the CEIV credential.* The final valuation report that is delivered to the client must contain the signature of at least one valuation professional who will take responsibility for the reported analyses and conclusions of value. The final valuation report should include the following:

1. A professional summary (for example, academic background, professional experience, subject matter expertise, credentials held) of valuation professionals who have undertaken or contributed to the valuation engagement
2. A representation that the final valuation report and supporting analyses and underlying documentation was prepared in compliance with this framework and the Application of the MPF
3. Signatures of all valuation professionals who take full responsibility for elements of the analyses, conclusions of value, and final valuation report

2.27.22 *Valuation report representation or certification for valuation professionals with the CEIV credential who have adhered to the MPF documents.* CEIV credential holders who take responsibility for the final valuation report must include in the final report a representation or certification that includes the following:

1. A representation that the credential holder signing the report is in good standing with the educational, training, quality control, and ethical requirements of the VPO that issued the credential
2. A list of CEIV credential holders who have contributed to the work file
3. A representation that each credential holder who has contributed to the engagement has complied with the educational, training, quality control, and ethical requirements of the VPO that issued the credential
4. A representation that the final valuation report and supporting analyses and underlying documentation was prepared in compliance with this framework and the Application of the MPF;
5. Signatures of all valuation professionals who take full responsibility for elements of the analyses, conclusions of value, and final valuation report
6. Any additional representations or certifications required by the VPO that issued the credential holder's CEIV

3. PERFORMANCE FRAMEWORK GLOSSARY

Note to the reader: This glossary sets forth definitions of terms that may be unique to the framework, or defines their meaning within the context of the framework. Words or terms defined in the glossary are set in **bold** type the first time they are applied in proper context within this framework.

Abbreviated valuation report. Compared to a comprehensive valuation report, an abbreviated report condenses the requirements of a comprehensive valuation report based on criteria agreed upon by the client and the valuation professional. The final valuation report might not contain sufficient details for the intended users or expected recipients to understand the data, analysis, and rationale for the value conclusions (for example, an abbreviated valuation report includes fewer details within the report in order to comply with a client's request or focus the reader's attention toward specific content). Although the content of the report may be less detailed than a comprehensive valuation report, valuation professionals must conduct a complete valuation analysis that applies their own analyses and reasoning. Furthermore, valuation professionals must prepare the work file in alignment with the framework to ensure sufficient detail exists to support the conclusion of value.

Analysis documents. These generally comprise two types of documents:

1. *Computational analysis.* Examples of these analyses may include spreadsheets or database analyses. This documentation and analysis demonstrates "what" the valuation professional did.
2. *Narrative-based documents.* Examples of this type of analysis may include narratives within the report, footnotes, and memoranda to the work file. This documentation and analysis demonstrates "why" the valuation professional elected certain methods, inputs, or judgments within the actual analyses.

Best practices. Within the context of this framework, a best practice is a task, technique, procedure or method that would typically be performed by any valuation professional even without specific instruction to do so because experience has shown it leads to a reliable and high-quality end result.

Calculation engagement. This type of engagement requires the valuation professional to adhere to the instructions of the client and requires reduced professional judgment to calculate the value of the subject interest.

CEIV credential holder. A valuation professional who conducts valuation services for financial reporting purposes and is in good standing with the educational, training, quality control, and ethical requirements of the VPO that issued the credential.

Complete valuation analysis. This results in a conclusion of value by the valuation professional after having considered all relevant factors to determine and complete the appropriate scope of work for the purpose or intended use of the valuation engagement. The valuation professional uses professional judgment to consider and apply the valuation approaches and methods deemed appropriate for the facts and circumstances.

Comprehensive valuation report. The various VPOs use different names for valuation reports. Within the context of the framework, a comprehensive valuation report is one that contains sufficient content for the intended user or expected recipient to gain a complete understanding of the engagement's purpose and the valuation professional's analysis, reasoning, and support for the conclusions presented. It is still possible, however, that additional supporting information will be contained in the supporting work papers.

Engagement to estimate fair value. This encompasses any engagement or part of an engagement that involves estimating fair value of a subject interest to support management's assertions in their preparations of

financial statements for financial reporting purposes. There are two general classifications of an engagement to estimate fair value: (1) a valuation engagement that can be either comprehensive or limited (this refers to the scope of work and documentation prepared not the report issued) and (2) a calculation engagement.

Evidential skepticism. Evidential skepticism requires valuation professionals to continuously question and critique information and data provided by management for bias or misstatement, or both, taking into consideration the experience of management and the sufficiency of the documentation and analyses provided by management throughout the valuation engagement.

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).

Financial reporting purposes. Within the context of this framework, *financial reporting purposes* encompasses all audited financial statements that include fair value measurement disclosures for businesses, business interests, intangible assets, certain liabilities, and inventory.

Mandatory Performance Framework (framework). A set of interrelated and interacting elements that valuation professionals must use to establish quality objectives and establish best practices that are needed to ensure the framework is followed and its objectives are achieved. The framework delineates requirements that govern the scope of work and extent of documentation.

May. Within the context of this framework 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.

Must. Within the context of this framework, and when used in conjunction with identified tasks, techniques, or procedures, the word *must* indicates a mandatory or binding requirement that has to be implemented and applied as appropriate in order for the valuation professional to be in compliance with the framework.

Nonmembership VPOs. These are not-for-profit valuation organizations that do not have a membership base but that have been established to draft and issue valuation standards that are adopted by other valuation professional organizations. Examples of nonmembership VPOs include The Appraisal Foundation and the International Valuation Standards Council.

Performance framework. Contains requirements that cover how much work should be performed in order to prepare a professional work product. A performance framework addresses scope of work and extent of documentation and analysis, consideration of contrary evidence, and documentation in both the report and the supporting working papers. Alternatively, a performance framework addresses the depth of analysis and documentation professionals are expected to perform and provide.

Professional judgment. Within the context of this framework, this refers to the process of making informed and reasonable decisions that are based on the cumulative experiences of the valuation professional. This is a skill that evolves over time and results in decisions that reflect best practices of the valuation profession.

Professional standards. Standards that encourage professional behavior. Examples are codes of ethics and codes of conduct that encourage acting competently, independently, objectively, transparently. These can also be

considered standards that define the qualities of a professional: ethical, independent, objective, having requisite skills, educated, experienced, tested, trained, and credentialed or licensed. Professional standards focus on characteristics of individual professionals and their conduct.

Self-skepticism. Self-skepticism is the awareness of and monitoring of one's own client-based presuppositions that could detract from evidencing skepticism as a result of comfort level or familiarity with the client, industry, or both.

Should. Within the context of this framework, and when used in conjunction with identified tasks, techniques, or procedures, the word *should* indicates a best practice that is presumed mandatory; however, in rare circumstances, the valuation professional can elect an alternative option.

Source documents. These include, but are not limited to, data and information (including interview notes) collected from both company sources and external third-party data accumulation resources relating to the company, its financial position, its competitors, the industry it competes in, its customers and suppliers, the state of the economy, financial markets, risk factors, and so forth.

Subject interest. Refers collectively or individually to any or all businesses, business interests, intangible assets, certain liabilities, and inventory being valued for financial reporting purposes.

Technical standards. Standards that address the "how to" of work that must be done to prepare a professional work product. These standards address the technical correctness of the work product by considering appropriate input factors, application of methods and techniques, and reporting guidelines. Both mandatory standards and voluntary guidance have been developed around technical issues in valuation in general and, to a lesser extent, around fair value measurement.

Valuation professional. Within the context of this document, an individual who conducts valuation services for financial reporting purposes.

Valuation professional organization (VPO). A not-for-profit membership organization that sponsors and supports valuation credentials with qualification requirements, quality controls, education, and codes of ethics.

Valuation services. Valuations used to support management assertions made in financial statements issued for financial reporting purposes.

Work file. Written documentation within the engagement file that supports a final conclusion of value (note: this includes information that is relevant to the analysis and indicates contrary evidence to the conclusion of value and the valuation professional's explanation of how this information was considered). This includes working papers (documentation not included in the final valuation report but that is retained by the valuation professional that supports the final valuation report) and the final valuation report. Within the context of this framework, this documentation is collectively referred to as the work file. Written documentation may include paper, electronic files, or other forms of recorded media.

4. AUTHORITATIVE AND TECHNICAL GUIDANCE

In addition to the accounting and valuation standards that affect valuation engagements for financial reporting, various technical guidance has been published by the AICPA, the IVSC, and The Appraisal Foundation. These publications are included in this section and represent the best practices for the valuation of businesses, business interests, and intangible assets for financial reporting. Additional relevant technical guidance from VPOs is also included in this section. Valuation professionals will also have developed their own body of knowledge from various other source materials and authors about topics pertaining to businesses, business interests, and intangibles valuations that may be relevant but not referenced within the framework. Although they are likely relevant to the practice of valuation, the framework does not cite or endorse the publications or views of individual authors.

Relevant Accounting Standards

The following accounting standards are issued by the Financial Accounting Standards Board (FASB) and are common subject interest topics that might be applicable when a company engages a valuation professional (this list is not all-inclusive):

- FASB *Accounting Standards Codification* (ASC) 350, *Intangibles—Goodwill and Other*
- FASB ASC 360*, Property, Plant, and Equipment* (specifically long-lived asset impairment)
- FASB ASC 606, *Revenue from Contracts with Customers*
- FASB ASC 715, *Compensation—Retirement Benefits*
- FASB ASC 718, *Compensation—Stock Compensation*
- FASB ASC 805, *Business Combinations*
- FASB ASC 820, *Fair Value Measurement*
- FASB ASC 825, *Financial Instruments*
- FASB ASC 860, *Transfer and Servicing*
- FASB ASC 946, *Financial Services—Investment Companies*
- FASB ASC 965, *Plan Accounting* (This ASC is relevant for actuaries as it relates to pensions; however, knowledge that this ASC exists and its purpose is important to valuation professionals.)

Relevant Auditing Standards

Valuation professionals should also be aware of auditing standards that audit professionals use as guidance when they conduct an audit of financial statements prepared for financial reporting. These include, but should not be limited to,

- PCAOB AS 1105, *Audit Evidence* (formerly AS No. 15)
- PCAOB AS 1210, *Using the Work of a Specialist* (formerly AU section 336)
- PCAOB AS 1215, *Audit Documentation* (formerly AU section 339)
- PCAOB AS 2502, *Auditing Fair Value Measurement and Disclosures* (formerly AU section 328)
- PCAOB AS 2501, *Auditing Accounting Estimates* (formerly AU section 342)

International Accounting Standards

There are instances where international accounting standards may be incorporated into financial statements prepared for financial filings in the United States and might impact the nature, timing, and scope of a valuation professional's work. The following international accounting standards (IASs) are issued by the International Accounting Standards Board (IASB) and are associated with fair value measurement engagements (this list is not all-inclusive):

- IAS 16, *Property, Plant, and Equipment*
- IAS 36, *Impairment of Assets*
- IAS 38, *Intangibles*
- IAS 39, *Financial Instruments*
- IAS 40, *Investment Property*
- IAS 41, *Agriculture* (biological assets)
- IFRS 3, *Business Combinations*
- IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*
- IFRS 13, *Fair Value Measurement*

Applicable Valuation Standards

- Nonmembership Valuation Organization Standards
  - The Appraisal Foundation: *Uniform Standards of Professional Appraisal Practice* (USPAP)
  - International Valuation Standards Council: International Valuation Standards (IVS)
- Valuation Professional Organization Standards
  - American Institute of Certified Public Accountants (AICPA): VS Section 100, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* (VS sec. 100)
  - American Society of Appraisers (ASA): *ASA Business Valuation Standards*
  - Royal Institution of Chartered Surveyors (RICS): *RICS Valuation—Professional Standards,* which incorporates the International Valuation Standards (IVS)

Technical Literature

- Published Technical Literature (This list is not all-inclusive.):
  - AICPA Accounting and Valuation Guide *Assets Acquired to Be Used in Research and Development Activities*
  - AICPA Accounting and Valuation Guide *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*
  - AICPA Accounting and Valuation Guide *Testing Goodwill for Impairment*
  - AICPA Guide *Prospective Financial Information*
  - AICPA Audit Guide *Special Considerations in Auditing Financial Instruments*
  - The Appraisal Foundation's Appraisal Practices Board (APB) Valuation for Financial Reporting (VFR) Valuation Advisory #1: *The Identification of Contributory Assets and Calculation of Economic Rents*
  - The Appraisal Foundation's APB VFR Valuation Advisory #1 (Toolkit): *The Identification of Contributory Assets and Calculation of Economic Rents*

  - The Appraisal Foundation's APB VFR Valuation Advisory #2: *The Valuation of Customer-Related Assets*
  - IVSC's *A Guide to the Audit Process for Professional Valuers*
  - IVSC Technical Information Paper 3, *The Valuation of Intangible Assets*
  - IRS Revenue Procedure 2003-51 (and predecessor IRS Revenue Procedure 77-12)
- Other Valuation Literature
  - Time Warner Cable's "Valuation of Cable Franchise Rights White Paper," File No. 1-33335 (SEC EDGAR)

- Technical Literature (in development)
  - AICPA Accounting and Valuation Guide *Business Combinations*
  - AICPA Accounting and Valuation Guide *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies*
  - The Appraisal Foundation's *The Measurement and Application of Market Participant Acquisition Premiums*
  - The Appraisal Foundation's *The Valuation of Contingent Consideration*

The standards and technical literature cited herein are meant to provide direction to relevant guidance and resources that address a particular subject interest; they are *not* meant to be an all-inclusive list of references. All references are current as of the framework's publication date; however, the reader should not assume these references have been updated contemporaneously with any changes to the standards or guidance and, thus, should verify all references using a proper resource.