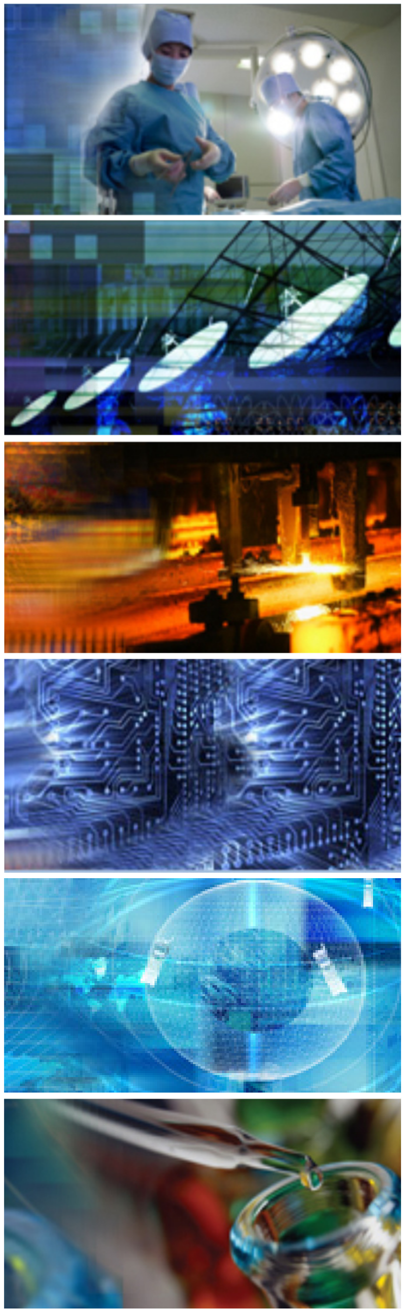


Globalview Advisors

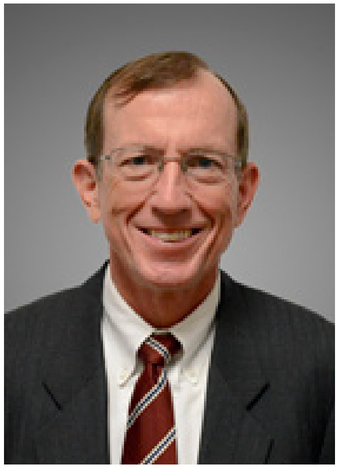
Financial Valuation and Advisory Services

Business and Intangible Asset Valuation for Financial Reporting

May 23, 2013

CalCPA

Presenter’s Contact Information



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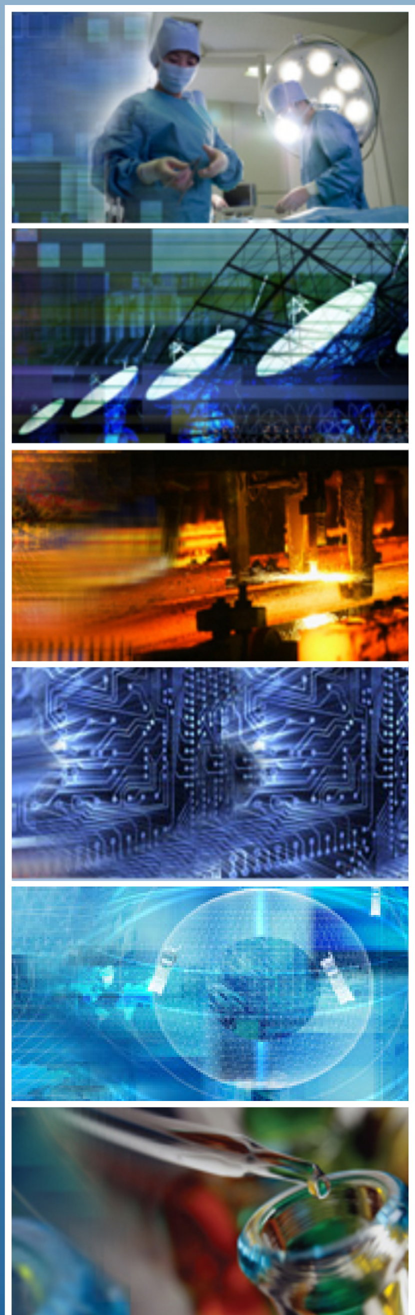
"By its very nature, valuation work cannot be regarded as an exact science and the conclusions arrived at in many cases will of necessity be subjective and dependent on the exercise of individual judgment."

Valuation Report for the Congressional Oversight Panel, Feb. 4, 2009

Overview of Presentation—Recent Developments

- Status of Valuation Profession
  - Financial Reporting
  - Tax, ESOP and Small Business Administration
- PCAOB Inspection Report Highlights
  - Overview
  - Inspection Report Highlights
- Accounting Developments
  - Recent Accounting Developments
  - Documents Providing Fair Value Guidance
- Business Valuation Updates
  - Cheap Stock Practice Aid
- Intangible Asset Valuation Updates
  - IPR&D Practice Aid
  - Customer-Related Assets Discussion Draft
- Valuation Reviews Updates
  - Fair Value Reviews
  - Goodwill Impairments



Developments in the Valuation Profession

The Regulatory Environment—Financial Reporting

- Appraisals prepared for financial reporting purposes are being reviewed more frequently and in more detail
  - Securities and Exchange Commission (SEC)
  - Public Company Accounting Oversight Board (PCAOB)
- Accounting requirements driving valuations are generally increasing
  - ASC 805, 350, 360, 718 and 805 among others
  - Some discussions of possible undue cost and burden on financial statement preparers
- Increased focus on value of assets of financial institutions
- Increased focus on valuation of investments of venture capital and private equity funds

SEC Comments on Valuation Profession—Paul Beswick, Deputy Chief Accountant, SEC, December 2011

- "The broadening application of fair value . . . and the 2008 financial crisis have cast the **spotlight on valuation professionals**. At last count, valuation professionals in the US can choose among five business valuation credentials available from four different organizations, each with its own set of criteria for attainment. **Risks created by the differences in valuation credentials that exist today range from the seemingly innocuous concerns of market confusion to the more overt concerns of objectivity of the valuator and analytical inconsistency.**"

SEC Comments on Valuation Profession—Paul Beswick, Deputy Chief Accountant, SEC, December 2011

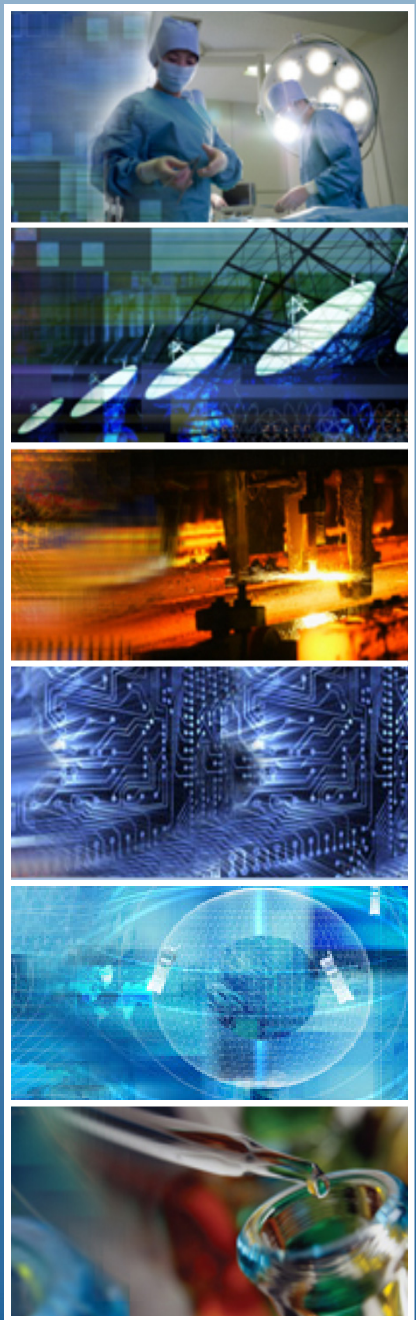
- “One potential solution to consider is whether there should be, similar to other professions, a **single set of qualifications with respect to the education level and work experience, a continuing education curriculum, standards of practice and ethics, and a code of conduct.** One could also contemplate whether a comprehensive inspection program and a fair disciplinary mechanism should be established to encourage proper behavior and enforce the rules of the profession in the public interest.”

The Regulatory Environment—Tax and ESOP Valuations

- Internal Revenue Service (IRS) increase in penalties and sanctions
  - Definitions of qualified appraisal and qualified appraiser
  - Financial penalties on appraiser for significant over or under valuations
  - Potential sanctions to prevent future valuation work
- US Department of Labor has responsibility for Employee Stock Ownership Plans (ESOP)
  - ESOPs are a mechanism to incentivize employees of private companies through participating in increases in the value of a private company employer.
  - Recent draft legislation to include appraisers as a fiduciary. Responsibilities of a fiduciary are complex and may be inconsistent with the role of an independent appraiser. Area of current discussion prior to finalization of changes in rules.

The Regulatory Environment—Small Business Administration Valuations

- US Small Business Administration (SBA) provides a variety of services to small businesses including loans and loan guarantees
  - Some businesses are primarily real estate oriented (hotels and motels, nursing homes, other) but have differing degrees of intangible value.
  - Valuations are required in connection with the loan guarantee. In some cases, the business may be valued by real estate rather than business appraisers.
  - The Appraisal Institute developed a mandatory course for real estate appraisers appraising these "real estate oriented" businesses. SBA requirements for mandatory course attendance for real estate appraisers performing these valuations.
  - Following review, the course requirement was withdrawn. Development of appropriate course as well as determination of when a real estate appraiser is competent (or a business appraiser is required) is presently being assessed as an area for further consideration.



PCAOB Inspection Results

PCAOB Inspection Reports and Valuation Matters

- Public Company Accounting Oversight Board (PCAOB) is a quasi-governmental agency which audits the work of audit firms (pcaobus.org)
- Inspections of the Big 4 accounting firms in 2009 resulted in 37 audits containing an audit "deficiency." Of these, 26 (70%) involved fair value measurements.

Financial instruments	11
Goodwill impairment	8
Long-lived asset impairment	3
Inventory valuation	2
Other	2
Total	26

- Deficiency relates to audit files that do not contain adequate evidence of audit procedures performed or audit evidence / procedures that are insufficient. A deficiency does not necessarily suggest a restatement of financial statements.

KPMG Inspection Report of August 15, 2012

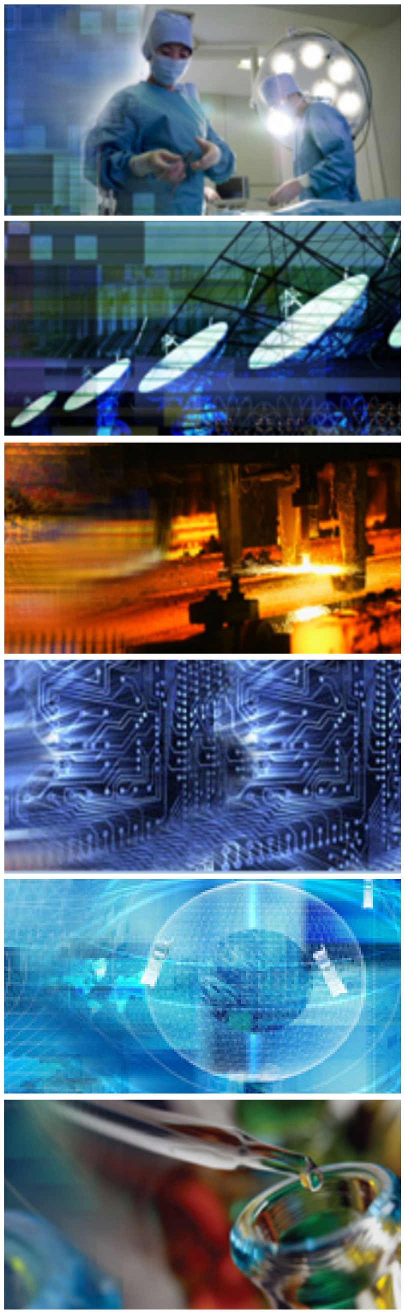
- Issuer A
  - Difference between discount rate in valuation and that the firm's valuation specialist considered reasonable
  - Wide range of values for indemnification assets
  - AFS (Available-For-Sale) testing procedures—**methods** and assumptions
- Issuer B
  - Loan guarantee—inadequate procedures to test assertions
- Issuer D
  - Investment securities testing
- Issuer G
  - Absence of evidence of testing of risk factors
  - No evidence of testing projections and other assumptions

KPMG Inspection Report of August 15, 2012

- Issuer I
  - No understanding of methods and assumptions
  - “Firm obtained evidence that indicated that the prices for some securities may not have been reliable”
  - Difference between price and internal valuation specialists indication
  - Several other comments
- Issuer J & K
  - Testing of pricing indications from third party services for investment securities

PwC Inspection Report of September 27, 2012

- Issuer B—Inventory reserve valuation
- Issuer C—Financial instruments—Inadequate test of assumptions in issuer's valuation of financial instruments
- A4—Eight audits with hard-to-value financial instruments. Methods and assumptions not adequately documented
- Issuer E—Goodwill impairment
  - Failed to test certain assumptions
  - Failed to test control premium which significantly exceeded those in the market
- Issuer L—Failed to test significant assumptions in business combinations
- Issuer O
  - Assumptions for acquired intangibles—cash flows, attrition rates, probability of achieving milestones
  - Assumptions for contingent consideration



Accounting Developments Impacting the Valuation Profession

Recent Accounting Developments—Overview

- Goodwill and indefinite lived assets—addition of a "qualitative" test. Intent is to reduce measurement burden of registrants. (Accounting challenges associated with a qualitative rather than a quantitative test.)
  - Accounting Standard Update ("ASU") 2011-08, *Testing Goodwill for Impairment* issued September 2011
  - ASU 2012-02, *Testing Indefinite-Lived Intangible Assets for Impairment* issued July 2012
- Accounting and valuation guides under development
  - *Assets Acquired to be Used in Research and Development Activities*
  - *Valuation of Privately Held-Company Stock Issued as Compensation (final document due very soon) (ASC 718 focus)*
  - *Testing Goodwill for Impairment (ASC 350)*
  - *Business Combinations (ASC 805)*
- Audit guide under development
  - *Special Considerations in Auditing Financial Instruments*

Testing Goodwill for Impairment Guide

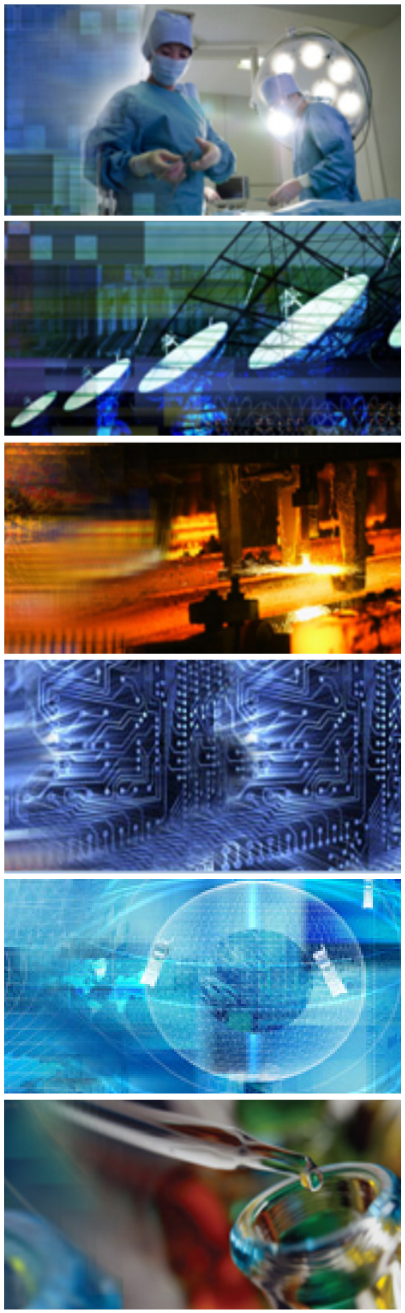
- Working draft issued November 2011—final expected in 2013
- Includes step one and step two examples—DCF, guideline public company and guideline transactions method
- Will include a chapter with guidance on qualitative assessments
- Guidance on assets shared by reporting units
- Guidance on developing market participant assumptions

Other Guides in Development

- *Business Combinations* Guide is at a very early stage
  - Task group formed
  - Scope of project being discussed
- *Special Considerations in Auditing Financial Instruments* Audit Guide
  - Purposes
    - Provide background information on financial instruments
    - Provide audit guidance
  - Expected issuance in late 2012
- New AICPA guide under development *Determining Fair Value of Portfolio Company Investments of Venture Capital and Private Equity Firms and other Investment Companies*
  - *Reduce divergence in practice in portfolio asset valuations*

Control Premiums (Market Participant Acquisition Premiums) in Financial Reporting

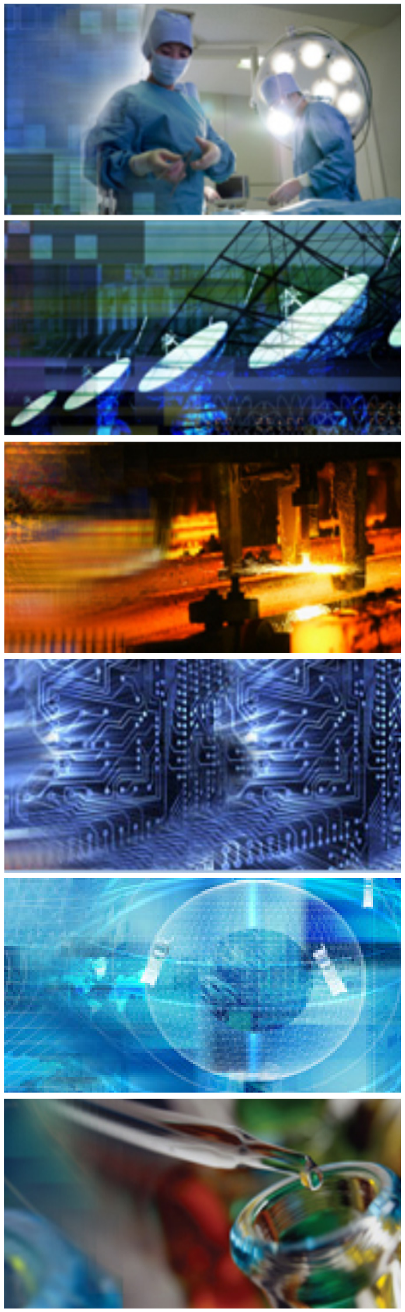
- Control premiums are often used in ASC 350 step one calculations and the valuation of portfolio investments of private equity firms
- Interpretation of “control premiums” is an area of challenge
  - Measurement is challenging as control premiums are influenced by buyer specific factors, stock price movements, choice of measurement dates, capital structure and other factors
- A draft document, *The Measurement and Application of Market Participant Acquisition Premiums,* was just released to provide assistance
- Introduction of term “Market Participant Acquisition Premium” (MPAP) rather than prior concept of a control premium
  - Premiums are not paid for control but for other elements of value
- Quantification of MPAP focuses on
  - Cash flow impact—revenues, margins, capital expenditures
  - Risk (discount rate) impact (larger size, better access to capital, enhanced financing mix)
  - Not simply a percentage to be added based on transactions that may or may not be comparable



Business Valuation Developments

Updates in Technical Guidance—AICPA Cheap Stock

1. Discussion draft issued in August 2012. Final guide expected for release in May or June 2013. Guidance for ASC 718 valuations.
2. Wide ranging discussion on preferred methodologies for enterprise valuation.
3. Discussion of methodologies for valuation of debt.
   - Separate valuation of debt and subtraction from enterprise value, or
   - Inclusion in a model for the allocation of the value of the enterprise to debt and equity securities
4. Detailed discussion of means of determining values for different elements of a complex capital structure (possibly multiple types of preferred stock, options, common stock)
5. Provides framework for assessing whether transactions in the shares of a company are meaningful
   - Depth of trading
   - Knowledge of parties
   - Motivation of parties



Intangible Asset Valuation Developments

Updates in Technical Guidance

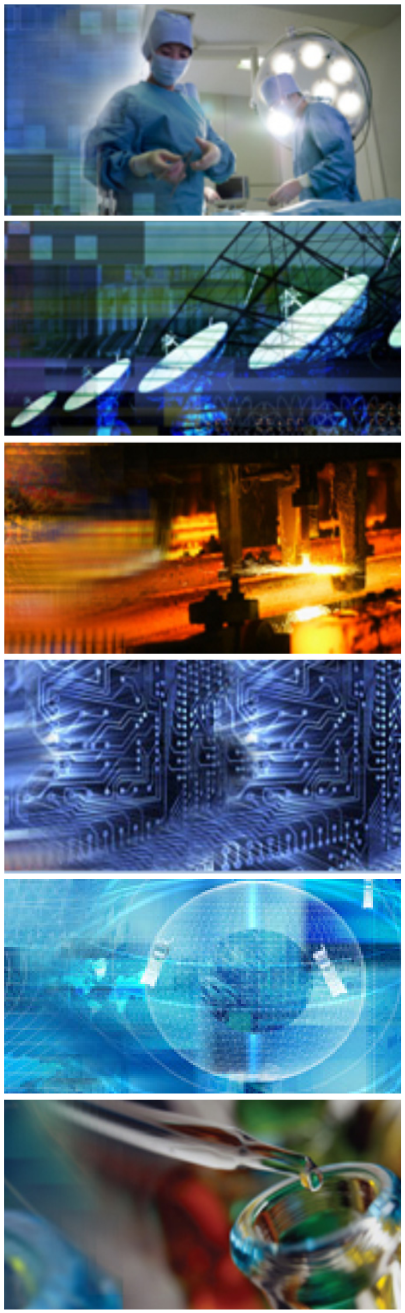
- Documents providing detailed discussions of intangible asset valuation include (ASC 805 and ASC 350 step two focus):
  1. The Appraisal Foundation, Best Practices for Valuations in Financial Reporting: Intangible Asset Working Group, *"The Identification of Contributory Assets and the Calculation of Economic Rents",* issued May 31, 2010.
  2. AICPA Practice Aid entitled *"Assets Acquired to Be Used in Research and Development Activities,"* working draft released November 18, 2011. Final version expected for release in 2013.
  3. The Appraisal Foundation, *"The Valuation of Customer-Related Assets,"* discussion draft issued June 5, 2012.
  4. Market Participant Acquisition Premiums (Control Premiums) in Financial Reporting—discussion draft released in April 2013
  5. Contingent Consideration—study group recently formed.

Assets Acquired to Be Used in Research and Development Activities (IPR&D Guide)

- This document will update a prior version released in 2001. Valuation of in-process technology has been an area of concern with wide divergence in practice.
- Discussion draft eliminated prior concept of "core technology" and focused more on technology migration.
  - Firms may have multiple technologies that have different lives
- Discussion of Discount Rate Adjustment Technique (DRAT) vs. Expected Present Value Technique (EPVT).
  - For DRAT, risk is considered through an adjustment to a discount rate (WACC plus or minus a premium).
  - For EPVT, risk is captured by weighting a variety of scenarios (potentially broad range from failure to success). This allows use of WACC and reduces concern about reasonably quantified a potentially large risk adjustment.
  - EPVT is conceptually superior. DRAT is still frequently observed.

The Valuation of Customer-Related-Assets Guide

- Discussion draft issued in June 2012
- Discusses various methodologies
  - MPEEM
  - Distributor Method
  - With and Without Method
  - Cost Approach
- Provides insights on a variety of matters
  - Attrition
  - Backlog
  - Deferred revenue
  - Overlapping customers



Valuation Reviews Updates

Reviews of Fair Value Estimates

- PCAOB review comments suggest need for increased involvement of high level valuation professionals in performing fair value reviews. Some Big 4 firms are increasing Valuation Partner involvement by assigning a Valuation Partner to all reviews.
- Private Equity and Venture Capital Portfolio valuations - Review area with continuing developments and expanded procedures

Key Insights from PCAOB Reviews

- Increased Partner involvement (both in number of reviews and depth of involvement)
- Continued enhancement of documentation/evidence in support of valuation conclusions
  - Logic as to why key assumptions are reasonable
    - Cannot only comment on whether fair value in aggregate was reasonable
    - Should comment on whether key inputs are reasonable as well as fair value in aggregate
  - Documentation of work performed to gain comfort with key assumptions
- Increased communication of key matters and audit follow-up points with the audit Partner

Types of Reviews: Full Scope Review

- Provide positive assurance on reasonableness of FV of an entire valuation analysis (certain assets/liabilities/reporting units may be scoped out as requested by Audit Team)
  - Strongest risk management tool
  - Best practices include completion of memo, program that documents procedures performs and tests of methodologies and assumptions, and questionnaire with close out comments
  - Some items (assets/liabilities/reporting units) may be scoped out as requested by the audit team
    - Importance of agreement on scope of review between audit and valuation teams
    - Confirm reasonableness of scope exclusions – can't opine on a discount rate if you don't understand the cash flow projections

Types of Reviews: Positive Assurance Limited Scope Review

- Provide positive assurance on **reasonableness of Fair Value for *certain* assets/liabilities** requested by Audit Team
  - Carves out certain items from a full scope review
  - Audit team would be responsible for any exclusions that would be expected to be completed in a full scope review

Types of Reviews: No Assurance Limited Scope Review

- "No Assurance" Limited Scope reviews provide list of "matters" for the audit team to consider, but do not conclude on the reasonableness of appraiser/management analysis
  - Valuation team reviews reports and develops questions for the audit team
  - Audit team is responsible for "closing out" items identified
  - Does an audit team have the expertise to comment on certain elements of a valuation analysis
  - No assurance provided by valuation team
  - Review of an updated analysis could lead to further "matters" for consideration

Types of Reviews: Sensitivity Limited Scope Review

- “Sensitivity” Limited Scope reviews perform exact sensitivity calculation procedures prescribed by the audit team, but do not conclude on anything
  - Cannot conclude on the reasonableness of methodologies, assumptions, or fair values

Situations Where Positive Assurance Limited Scope Review is Not Appropriate

- Review of a single or very limited number of inputs only
  - E.g., WACC
    - Application of the WACC to the projections is appropriate when the projections are appropriately calculated and represent expected cash flows
    - It is often the case that the cash flows are not expected cash flows but best estimate and/or may contain management biases
      - Often appraisers will not adjust management cash flows but apply an alpha adjustment to the discount rate which can only be assessed for reasonability by reviewing the WACC and related cash flow projections
    - The projections to be discounted contain valuation formulae, which many audit teams are not familiar with.
      - Can perform a positive assurance limited scope review on a WACC if cash flow projections are also reviewed

Situations Where Positive Assurance Limited Scope Review is Not Appropriate

- Review of a single or very limited number of inputs only
  - E.g., Royalty Rate (ASC 805 or ASC 350 step one or two)
    - Determination of an appropriate Royalty Rate often needs to consider the development of cash flow projections that the royalty rate is applied to
    - The projections to be discounted contain valuation formulae, which many audit teams are not familiar. Valuation team testing of mathematical accuracy may be appropriate
    - Can perform a positive assurance limited scope review on a Royalty Rate if cash flow projections are also reviewed
- Material Assets (alone or in aggregate) are out of Scope (e.g., Fixed Assets)
  - A common valuation methodology applied to intangible assets is an Multi-period Excess Earnings Method (MEEM)
    - In a MEEM, a lease charge for the fair value of "contributing assets" needs to be deducted to arrive at the fair value of the subject asset
    - If material contributing assets (alone or in aggregate) are out of ' scope, there is a risk the fair value of the subject asset valued through a MEEM may be materially different

Goodwill Impairment—US GAAP & IFRS

- US GAAP and IFRS standards were largely converged in 2012 with respect to Fair Value and Business Combinations
- However, significant differences still exist for impairment testing
  - IFRS does not have a Step 0
  - IFRS is a 1-step test in which the carrying value of the cash generating unit is tested for recoverability with the recoverable amount being the higher of the Value in Use and Fair Value less Cost to Sell

Goodwill Impairments

- Given the increase in goodwill impairments, Staff comments have focused on "foreshadowing" disclosures.
- Additional disclosure for reporting units that are at risk for failing step one of impairment test. A reporting unit may be "at risk" if the reporting unit's fair value is not "substantially in excess of its carrying value."

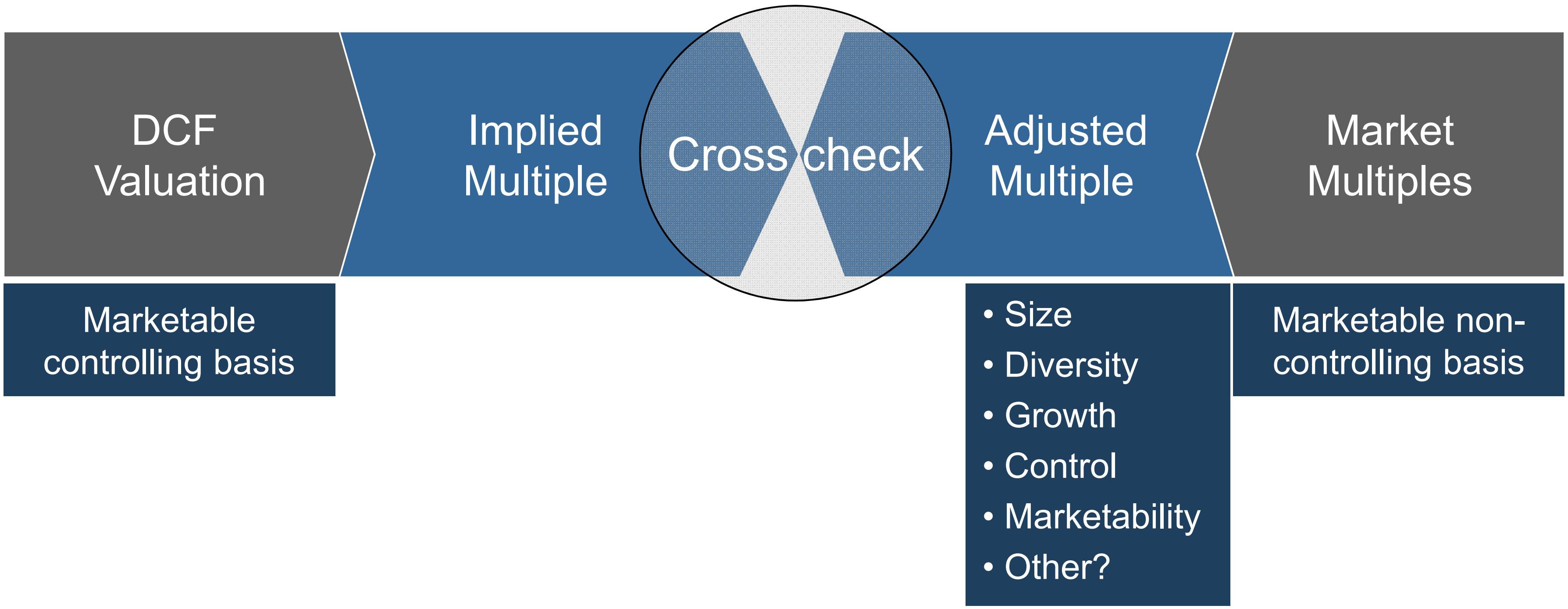
Fair Value Issues of Importance to the SEC

- Multiple valuation techniques
  - SEC continues to discourage the use of only one approach
  - Need a rationale for changing weightings between approaches from year to year
- Observations with third-party valuation reports
  - In general SEC notices significant lack of detail of how assumptions were selected and discussion around why they were reasonable

Market Approach Versus Income Approach

	Pros	Cons
Market Multiples	▪ Easy to use ▪ No terminal value estimate to worry about ▪ Captures information provided by an "efficient market"	▪ Pure play comparables rarely exist ▪ Potentially distorted by accounting numbers ▪ Embeds many assumptions in only two variables – cash flow or discount rate
DCF	▪ Captures more detailed outlook for the business being evaluated ▪ Driven by cash flow, not accounting earnings	▪ More time consuming and complex ▪ Sensitive to discount rate and terminal value assumptions ▪ Wide range of forecasts possible – matching of CF and discount rate

Importance of Cross Checks



Goodwill Impairment: Key Elements

- Three key matters related to goodwill impairment testing relate to:
  - Veracity of Prospective Financial Information ("PFI")
  - Consideration of taxable versus nontaxable transactions
  - Comparison to other Market Indicators

Goodwill Impairment: Key Elements

- Veracity of Prospective Financial Information ("PFI")
  - Understanding the projections is the responsibility of management, the audit team, and the valuation team
  - Look to historical forecasts, actual vs. forecast, market comparisons, other valuations performed
  - Commonly seen pitfalls include: intercompany pricing (not market participant assumptions), including forecasts of future acquisitions, excluding non-operating assets and liabilities
  - Synergies can be tricky—attaining synergies may carry a higher degree of risk. Not all synergies are as risky (i.e., cost savings synergies versus revenue synergies)
  - Control Premiums are not automatic; there are no bright line rules

Goodwill Impairment: Key Elements

- Taxable versus non-taxable transactions and consideration of ASC 350-20-35 (formerly EITF 02-13)
  - Taxable transaction – sale of assets result in stepped up tax basis.
  - Non-taxable – Sale of stock of C corporation with no step up in basis expected.
  - Transaction type should be from a market participant perspective
  - RU doesn't need its own equity to assume a stock deal
  - If you fail under both scenarios, does it even matter? YES—becomes basis for assumptions in Step 2; If you pass under both scenarios—can set precedent

Goodwill Impairment: Key Elements

- Goodwill testing for public firms may required a “market-cap reconciliation”
  - Compare total of FV’s of all RU’s plus any corporate assets / liabilities to the market cap.
  - *What stock price to use when performing a market cap reconciliation?* Generally, should not exceed 20 trading days, but judgment is involved.
  - *What drives the control premium?* Very judgmental and case specific. Needs to be robustly supported (10% premium can be too much, 30% premium can be too little). Consider types and extent of synergies, number of willing buyers, trading volume, excessive short positions, public float, other

Goodwill Impairment: Key Elements

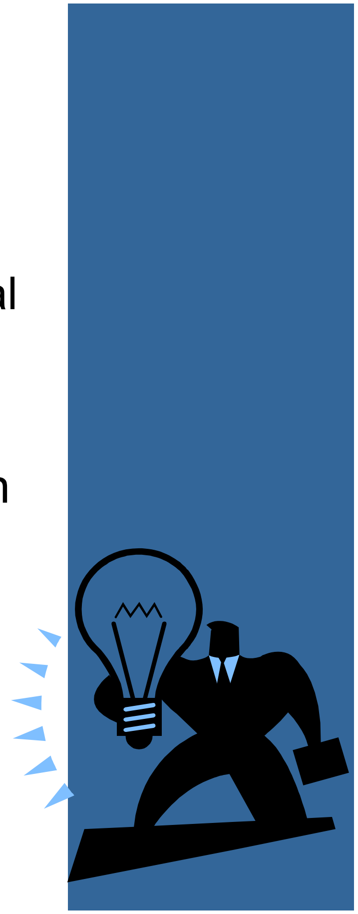
- When assigning assets and liabilities to RUs need to understand, among other things:
  - Basis of cash flow projections
  - Market participant perspective (i.e., would a liability be taken on by an acquirer)
  - How assets and liabilities relate to operations
  - Structure of debt (is there collateral? If so, where?)
- Carrying value of net assets and the ASC 350 debate—Is the carrying value at the equity, enterprise value or total asset value?
  - Consensus recently reached (EITF Issue No 10-A)
  - Test will remain an equity based test; however, will need to evaluate the reasonableness of equity test in certain situations (i.e., view of some that a negative carrying equity value shields impairments)

Goodwill Impairment: Key Elements

- Goodwill impairment and MD&A disclosures—should include:
  - Percent by which FV > CV
  - Amount of goodwill allocated to RUs
  - A discussion of the key assumptions and the uncertainty of those assumptions
  - Discussion of potential events that could have negative effect on assumptions
- Even if the audit firm agrees with the values, if the process to get there is not adequate, it could cause issues from a SOX 404 perspective

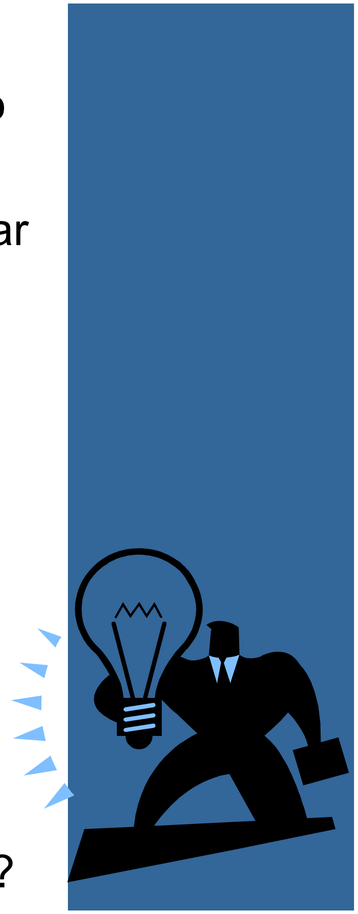
Key Areas of Judgment

- Are management's projections realistic and/or reasonable?
  - How do they compare to historical performance?
  - How many years of data was provided? Do projections continue until a steady state (reasonable constant growth rate) is reached?
  - How do the margins compare to historical levels? What is basis for any change? Are margins normalized in the terminal year?
  - Have projections been adjusted for one-time items?
- Has consideration been given to the differences between cash and accrual basis? Tax versus book basis?
  - Have you made adjustments for items? (e.g., prepaid rent)
    - See example on the next slide
  - Are you using book depreciation or tax depreciation?
    - Generally, tax depreciation should be used.
  - Is the amortization of intangible asset values tax deductible?
  - Have other non-cash adjustments been considered?



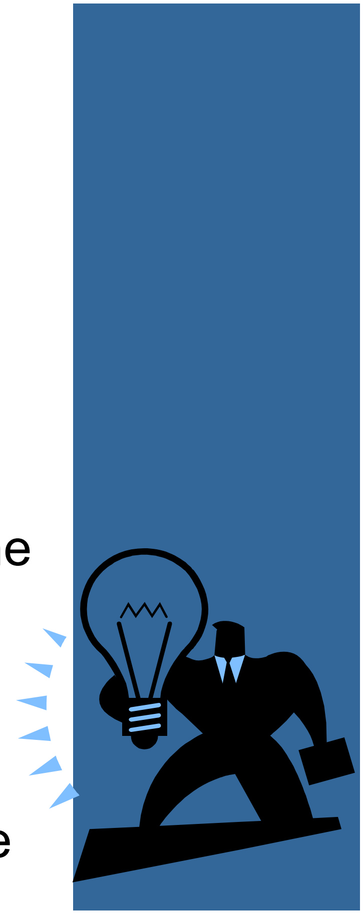
Key Areas of Judgment

- What tax rate should be used? (effective rate or statutory rate)
  - Effective tax rate may be used for valuation at the business level
- How do margins of individual assets or reporting units compare to the overall business?
  - Does the level of depreciation and capital expenditures appear reasonable given the company's stage of development?
- Is the level of working capital reasonable relative to expected growth?
  - The level of working capital may vary across reporting units
  - What is management's expectation with regards to working capital (e.g., future plans of injection or release)?
  - What is the level of working capital requirement for market participants?
- Is the cash-flow at a normalized level in the terminal year?
  - Is the long-term growth rate in line with the business/industry?
  - How does the exit multiple compare with management expectations?



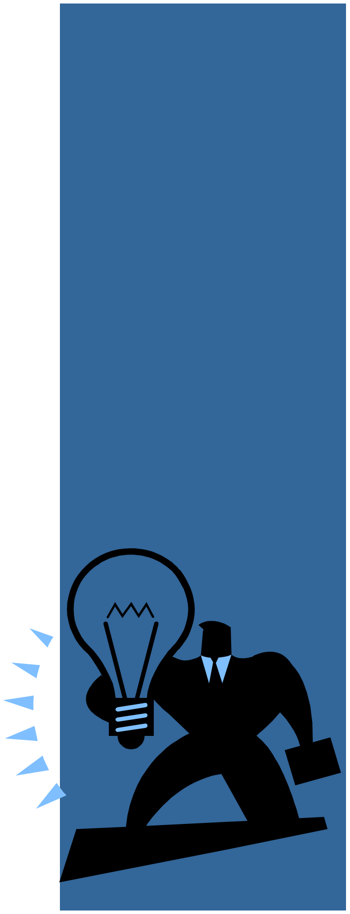
Key Areas of Judgment

- Did the selected multiple reflect differences between subject company/reporting units and comparables in product mix, expected growth, size, geography/international presence?
- What type of multiples should you use? What are the industry specific metrics?
- Have you considered using forward-looking multiples?
- Are the multiples in line with what you expect them to be given market conditions?
  - If there are outliers, what factors (lawsuits, pending acquisition, depressed earnings, other) could skew the multiples? Are they still a comparable company?
- Should multiples from all the comparable companies be considered? Or should a subset be selected?
- How much weight should be assigned to the different value indicators calculated using the different multiples?



Key Areas of Judgment

- Do the value indicators from the Market and Income Approach reconcile? If not, what factors caused the spread?
- Looking at the allocation of value amongst assets or reporting unit, does the allocation at a high level make sense?
- Have you considered all adjustments for debt (corporate level and reporting unit level), non-operating assets and liabilities, excess working capital adjustment?
- Did you make adjustments for minority interest?
- What additional consideration is there for equity method investment?
- What levers result in the greatest sensitivity to the concluded fair values?



Conclusion

Questions?