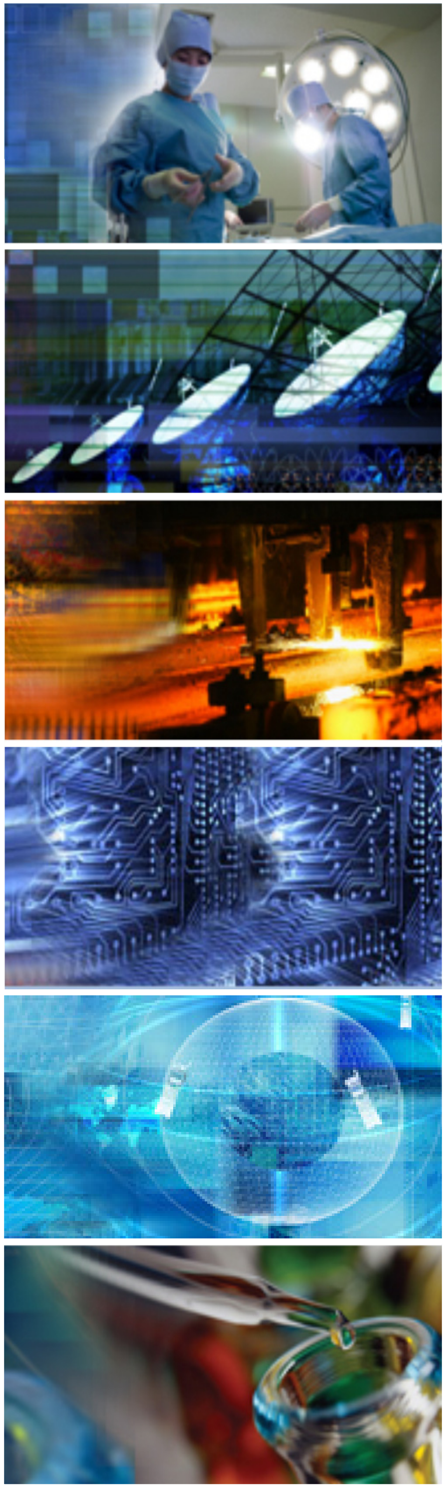

Globalview Advisors

Financial Valuation and Advisory Services

Valuation Update

FEI Orange County Chapter
July 7, 2015

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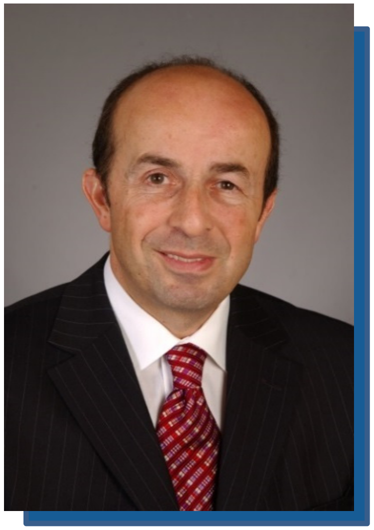
Presenter's Contact Information



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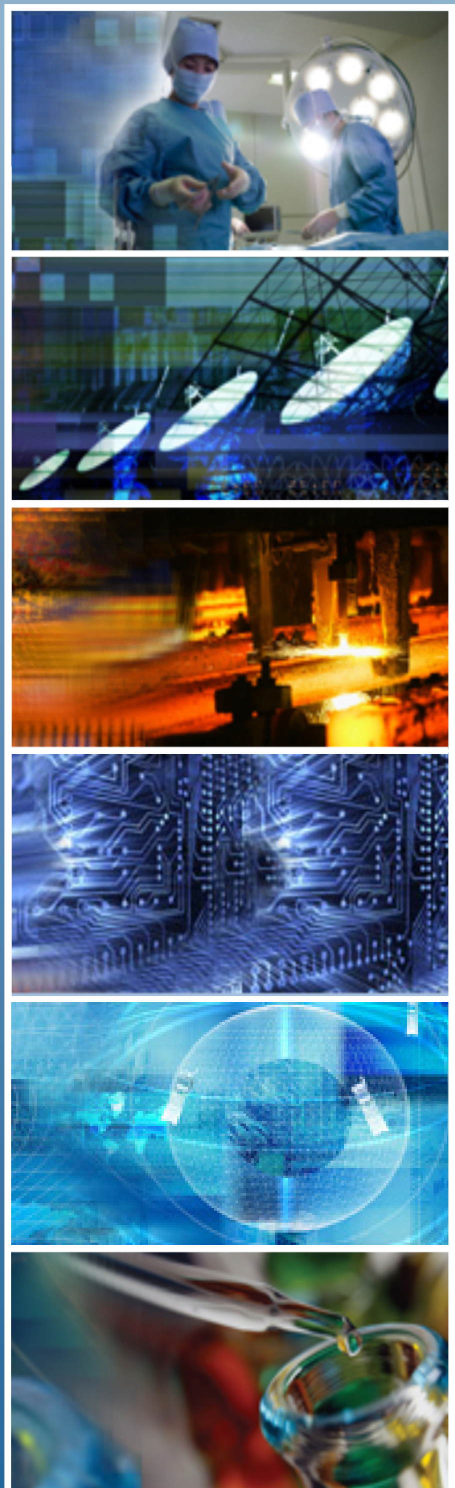
Presentation Overview

- Valuation Profession Update
- FASB and Other Developments Impacting Valuations
- ASC 718 and IRC 409A Valuation Issues
- Tax Valuation Overview and Update



Section One

Valuation Profession Update

Is Valuation a Profession?

- SEC and other groups have expressed concern over the status of the valuation profession / industry.
  - Several organizations including for-profit entities offer credentials and professional standards for valuation professionals.
  - Practitioners don’t have to be a member of any of these organizations to perform valuations.
  - Lack of professional infrastructure differs from the accounting, legal, medical and other professions.
- Real estate appraisers performing certain valuations are required to have a state license. No such restrictions on individuals / firms providing business valuations.

SEC Acting Chief Accountant Paul Beswick 2011 AICPA Conference Remarks

“**Valuation professionals** stand apart from other significant contributors in the financial reporting process for another reason, their **lack of a unified identity**. We accountants, for example, have a clearly defined professional identity. 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, yet **none of which is actually required to count oneself amongst the ranks of the profession**. There are also non-credentialing organizations that seek to advance the interests of the valuation profession. While the multiplicity of credentials in the profession is not a problem in and of itself, risks may exist. Risks created by the differences in valuation credentials that exist today range from the seemingly innocuous concerns of market confusion and an identity void for the profession to the more overt concerns of objectivity of the valuator and analytical inconsistency.

SEC Acting Chief Accountant
Paul Beswick 2011 AICPA SEC Conference Remarks

The **fragmented nature of the profession creates an environment where expectation gaps can exist between valuators, management, and auditors, as well as standard setters and regulators**. While much of this may be addressed during a particular engagement, this case-by-case approach has the potential to be an inefficient and costly solution to establish a baseline level of understanding of the analyses. Sometimes, expectation gaps can have broader consequences than just within an engagement, as we have seen in the use of third-party pricing sources to measure the fair value of certain financial instruments. You will hear more about this from others at this conference.

I think **one potential solution** to consider is whether there should be, similar to other professions, **a single set of qualifications with respect to 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**.

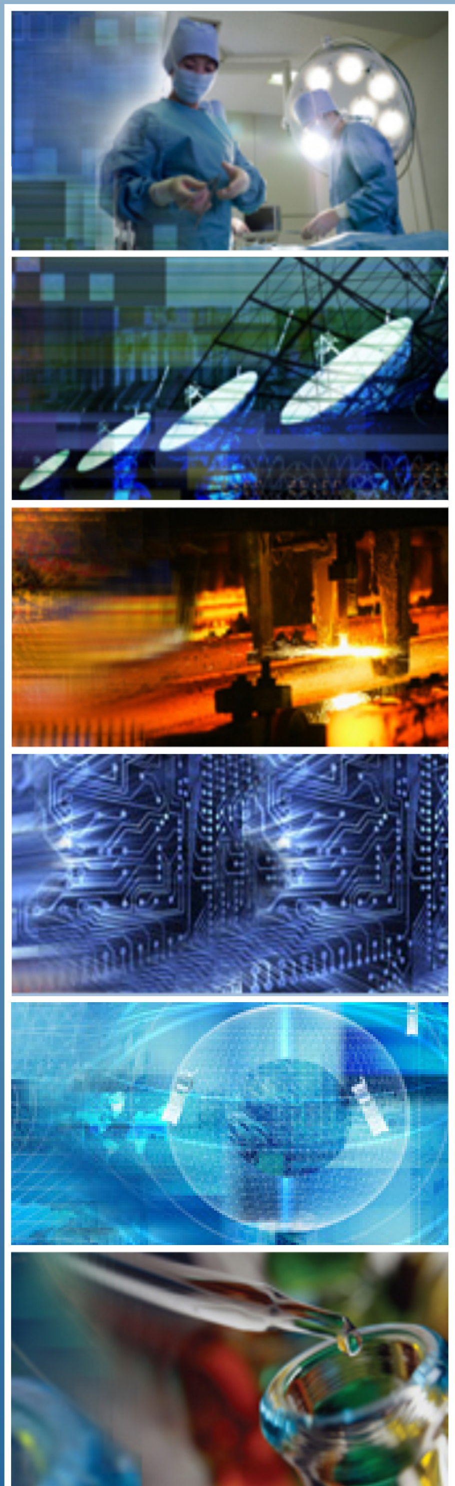
SEC Chief Accountant
Paul Beswick 2013 AICPA SEC Conference Remarks

"…The **valuation profession is highly fragmented**, and the maturity of the profession varies across asset classes. For example, credentials and the accompanying enforcement framework exist for certain aspects of valuing real estate, businesses, and intangibles; however, similar attributes are not prevalent for valuation of financial instruments. In less mature areas of the profession, though, there are some standardized methodologies for valuing certain assets.

In my discussion among valuation professionals, I feel that there is a general commitment by stakeholders to make the necessary improvements in the valuation profession. But it is too early to declare victory. While there has been a lot of healthy dialogue, the next step is still needed to make firm commitments to assess the valuation profession. I hope that collectively we can **improve the structure of the valuation profession so that investors have the confidence in the information they need to make sound investing decisions**…"

Summary Efforts on Valuation Profession

- Regulatory concerns about the valuation profession persist, as it relates to financial reporting, but have not yet led to substantive changes in the profession's structure.
- A major challenge continues to exist with regard to those preparing valuations that have no professional credentials and abide by no formal standards, or codes of ethics.
- Agreement on key attributes of the profession's infrastructure as it relates to valuations prepared for the public capital markets is essential:
  - Certification and renewal
  - Professional standards
  - Quality review and oversight/disciplinary activities
- Road-map outlining priorities and timing is being implemented.
- Current focus in on financial reporting valuations. Could be broadened to include tax valuations.



Section Two

FASB and Other Developments Impacting Valuations

FASB Developments—
Private Company Council Overview

PCC Overview

- The Private Company Council (“PCC”) was formed by the Financial Accounting Foundation in 2012.
- Purpose of PCC is to decide whether and when alternatives within U.S. GAAP are warranted for private companies.
- PCC decisions affect only private companies and need to be “endorsed” by the FASB; however, the FASB has decided that any issues addressed by the PCC should be assessed for public companies and not-for-profits as well.
- PCC has ten members—these include accountants (regional firms) and owners and finance officers of private companies.

FASB Developments

PCC Issues Addressed to Date

- **Issue 13-01A**: Accounting for Identifiable Intangible Assets in a Business Combination.
- **Issue 13-01B**: Accounting for Goodwill Subsequent to a Business Combination.
- Issue 13-02: Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements.
- Issue 13-03: Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps.

FASB Developments—PCC Issue 13-01B: Accounting for Goodwill Subsequent to a Business Combination

- PCC voted to finalize this accounting alternative on October 1, 2013—the proposal was endorsed by the FASB on November 25, 2013

CURRENT U.S. GAAP	PCC Accounting Alternative
Do not amortize goodwill	Amortize goodwill
— Test for impairment at least annually or more frequently	— Test for impairment upon occurrence of triggering event
— Goodwill impairment test	— Goodwill impairment test
— At reporting unit level	— At entity level or reporting unit level
— Two-step test	— One-step test
— Optional qualitative assessment	— Optional qualitative assessment

FASB Developments—
PCC Issue 13-01B: What's Next?

- FASB project to address goodwill for public businesses and not-for-profit entities.
- Staff is currently undergoing additional research, outreach and analysis, but presented four alternatives for consideration at the November 25, 2013 board meeting:
  - View A: Extension of the PCC alternative
  - View B: Amortization of goodwill over its useful life, not to exceed a specified number of years (an APB 17-like approach)
  - View C: Direct write-off
  - View D: Simplified (one-step) impairment test without amortization

Stay Tuned!

FASB Developments—PCC Issue 13-01A: Accounting for Identifiable Intangible Assets in a Business Combination

- ASU No. 2014–18 issued December 2014.
- An entity within the scope of this Update that elects the accounting alternative to recognize or otherwise consider the **fair value of intangible assets** as a result of any in-scope transactions should **no longer recognize separately from goodwill** (1) **customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business** and (2) **noncompetition agreements**.
- An **entity that elects the accounting alternative in this Update must adopt the private company alternative to amortize goodwill** as described in FASB Accounting Standards Update No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*. However, **an entity that elects the accounting alternative in Update 2014-02 is not required to adopt the amendments in this Update**.

FASB Developments—
PCC Issue 13-01A: FASB Consideration

- The Board is assessing whether Issue 13-01A on intangibles recognition should be considered for more than just private companies.
- Discussions are ongoing with stakeholders of all types:
  - Private company preparers and users
  - Public company preparers and users
  - Accounting/auditing practitioners
  - Not-for-Profit preparers and users

Financial Restatements—Impact of Complex Features

- Many financial arrangements have complex terms and features that may lead to additional accounting (and valuation) requirements that were not initially contemplated.
- The top accounting issues implicated in restatements for the past 10 consecutive years have been related to debt, quasi-debt, warrants & equity (BCF) security issues.*
  - *Source: Audit Analytics®, 2014 Financial Restatements—A Fourteen Year Comparison (April 2015)*
  - BCF—Beneficial Conversion Feature

Financial Restatements—Financial Instruments and Potential Embedded Derivatives

- Debt with certain embedded features:
  - Convertible debt
  - Preferred shares
  - Convertible preferred shares
  - Contingently redeemable preferred shares
  - Warrants
  - All embedded features in any the aforementioned instruments (e.g., calls, puts, interest rate reset forwards, and contingent interest features, etc.) should be evaluated

Financial Restatements—Embedded Derivatives

Examples of Host Contracts:

Debt Agreements

Equity Instruments

Purchase Agreements

Foreign Exchange Contracts

Leases

Insurance Policies

Sales Agreements

Examples of Embedded Derivatives:

Fx Options

Interest rate indexes

Leverage Features

Commodity Indexes

Equity Indexes

Financial Restatements—
Identification of Embedded Derivatives

Contracts with the following terms or characteristics "may" indicate the presence of an embedded derivative:

Calls and puts	Contingent calls and puts*
Contingent Interest feature	Interest rate reset forward
Conversion option	Early exercise rights
Exchanges/ exchangeable into	Premium
Indexed to/ adjusted by	Strike
Referenced to/ indexed to	Price based on following formula
Right to repurchase	Right to Purchase/ sell additional units
Right to return	Right to extend/ cancel

Auditing Fair Value Measurements—Selected Auditing Standards

- PCAOB standards on auditing fair value, using the work of specialists, and auditing estimates: AU 328: *Auditing Fair Value Measurements and Disclosures.*
- AU 332: *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities.*
- AU 336: *Using the Work of a Specialist.*
- AU 342: *Auditing Accounting Estimates.*

Auditing Fair Value Measurements—Relevant PCAOB Standards and Guidance

AU 328, *Auditing Fair Value Measurements and Disclosures*

- Substantive testing of fair value measurements may involve:
  - Testing management's significant assumptions, the valuation model, and the underlying data
  - Developing independent fair value estimates
  - Reviewing subsequent events and transactions

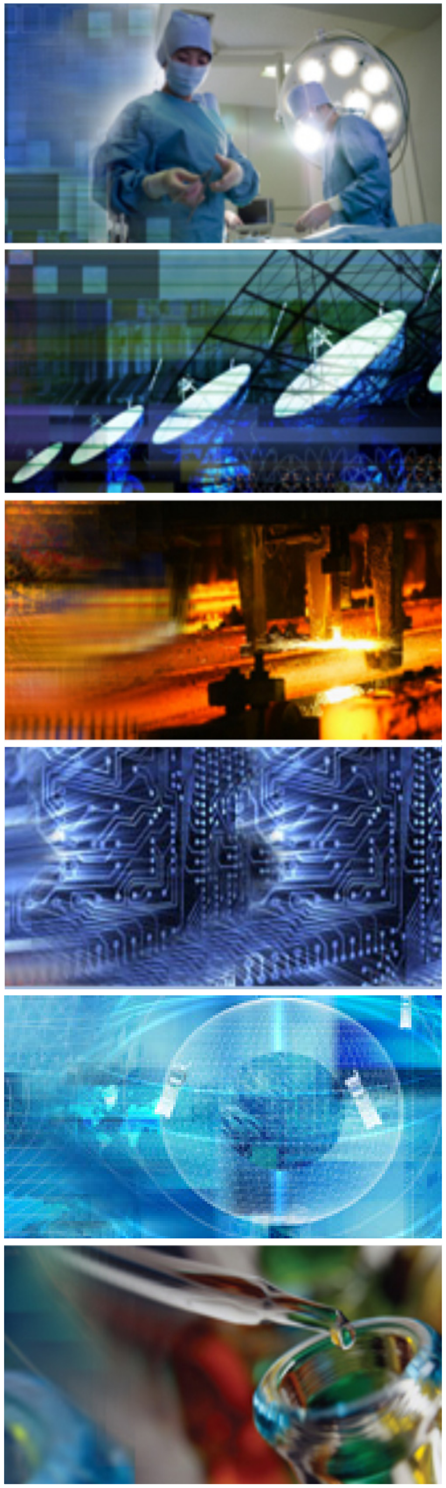
AU 328 and AS No. 5 require the auditor to obtain an understanding of the entity's process and assumptions used to determine fair value, regardless of the approach used to test the fair value estimate.

Auditing Fair Value Measurements—Relevant PCAOB Standards and Guidance

- Significant assumptions are generally:
  - Sensitive to variation or uncertainty in amount or nature susceptible to misapplication or bias
- In testing management's significant assumptions, the valuation model, and the underlying data, the auditor should determine if:
  - Assumptions are reasonable and reflect, or are not inconsistent with, market information (including specialist's assumptions)
  - Fair value was determined using an appropriate model for the entity's circumstances
  - The data used to develop fair value measurements (including management's data provided to specialists) is accurate, complete, and relevant information that was reasonably available at the time

Auditing Fair Value Measurements—Relevant PCAOB Standards and Guidance

- PCAOB Staff Audit Practice Alert No. 2 Reminds auditors of their responsibilities for auditing fair value measurements of financial instruments, which include: Obtaining an understanding of the company's process for determining fair value measurements and disclosures including relevant controls.
- Evaluating whether management's assumptions are reasonable and reflect, or are not inconsistent with market information.
- Evaluating whether the company's method for determining fair value measurements is applied consistently and if so, whether the consistency is appropriate considering possible changes in the environment or circumstances affecting the company.



Section Three

ASC 718 and IRC 409A Developments

ASC 718 and IRC 409A Developments—Introduction

- On May 29, 2013, the AICPA's Financial Reporting Executive Committee issued an Accounting and Valuation Guide entitled *Valuation of Privately-Held Company Equity Securities Issued as Compensation.*
- The Guide (also known as the Cheap Stock Guide) provides non-authoritative valuation guidance and illustrations for preparers, auditors, and valuation specialists related to the issuance of privately-held company equity securities for compensation.
- The Guide illustrates techniques used to determine the fair value of a company and the methods used to allocate the company’s fair value to the components of its capital structure.
- Guide discusses transactions in a company’s securities and the consideration of private or secondary market transactions in those securities when determining their fair values.

ASC 718 and IRC 409A Developments—Key Components of Guide

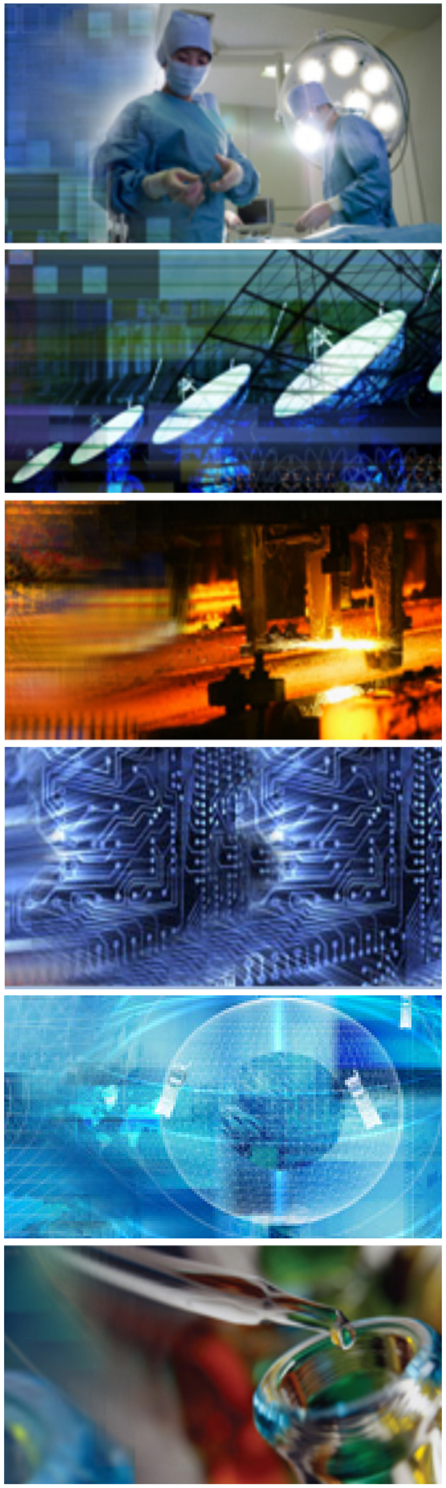
- Enterprise Valuation
  - Appropriate models given stage of development
  - Challenges with comparability
  - Use of expected cash flows
- Equity Allocation
  - Complex capital structures frequently observed
    - Multiple classes of securities
    - Unvested and vested options
  - "Auditability of Probability-Weighted Expected Return Method"
- Consideration of Transactions in the Stock of a Company
  - Prior capital raises
  - Third-party sales of stock
    - Orderly vs. disorderly transactions
- Valuation Discounts
  - Partially embedded in financing rounds
  - Quantitative Models

ASC 718—Private Company Council Simplification

- On June 8, 2015, the FASB issued a proposed Accounting Standards Update (ASU), *Improvements to Employee Share-Based Payment Accounting*, to amend ASC Topic 718, *Compensation – Stock Compensation*.
- Simplifications generally relate to aspects other than valuation specific elements associated with ASC 718.
- The proposed simplifications include:
  - **Recording all tax effects associated with stock-based compensation through the income statement**, as opposed to recording certain amounts in additional paid-in capital. This eliminates the complications of tracking a "windfall pool," but will increase the volatility of income tax expense.
  - **Allowing entities to withhold shares to satisfy the employer's tax withholding requirement** up to the highest marginal tax rate applicable to employees, rather than the employer's minimum statutory rate, without causing liability classification for the award.

ASC 718—Private Company Council Simplification

- **Modifying requirement to estimate the number of awards that will ultimately vest** by providing an accounting policy election to either estimate the number of forfeitures or recognize forfeitures as they occur.
- **Changing certain presentation requirements** in the statement of cash flows, including removing the requirement to present excess tax benefits as an inflow from financing activities and an outflow from operating activities, and requiring the cash paid to taxing authorities arising from withheld shares to be classified as a financing activity.
- Aligning the classification guidance (i.e., liability or equity) for repurchase rights that are contingent upon a future event that is within the employee's control so that classification would be consistent for both put and call features. These features will be relevant to the classification of an award only when the contingent event is probable of occurring before the employee bears the risks and rewards of stock ownership for a reasonable period of time.
- Creating certain provisions for nonpublic companies, including use of a **practical expedient for determining the expected term**, and providing a **one-time opportunity for a nonpublic entity to change its measurement basis to intrinsic value for all liability-classified awards.**



Section Four

Tax Valuation Update

Tax Valuation Update—Definition of FMV as Provided in Revenue Ruling 59-60

- For US tax reporting purposes the standard of value is "fair market value" which assumes a hypothetical transaction between a willing buyer and seller.
- “The price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.”
  - Note: RR 59-60 is the IRS guidance under the Gift Tax, Trust and Estate provisions of the Code that is often used to define fair market value.

Tax Valuation Update—FV and FMV

- Definition of FMV for tax reporting and fair value for financial reporting share similar elements:
  - No duress
  - Knowledgeable parties
  - Acting in their best interests
- Specific requirements for valuation may differ depending on specific tax vs. financial reporting rules and regulations:
  - Rules for purchase price allocation for tax and financial reporting are dramatically different
- Increasing “technical” guidance on valuations for financial reporting:
  - Guidance developed based on tax forces with public deliberation and multiple interested parties involved
- Guidance for tax reporting is less developed:
  - Tax court cases—very jurisdiction and fact specific. Possible advocates arguing valuation positions in front of tax court

More Common Corporate Events Requiring Tax Valuations

Event	Service
§ 351/368—Tax Reorganizations / restructuring	Valuation of legal entities and / or intangible assets
§ 338 / 754 / 1060—Purchase Price allocations	Valuation of intangible assets, tangible assets and legal entities
§ 367—International Reorganizations, including Transfer of IP	Valuation of IP
§ 382—Net Operation Loss Limitations	Legal Entity and branch valuations
§ 897—FIRPTA (Foreign Investment in Real Property Tax Act)	Legal Entity, Fixed Assets, and Real Estate Valuations
§ 861 / 864—Interest expense allocation	Valuation of tangible assets, possibly legal entities

Tax Valuation—IRC Sections Driving Valuations

83(b)	**Election to Recognize Gain**
108	Discharge of Indebtedness
165 (g)	Worthless Securities
166 (a) (2)	Partially Worthless Securities
170	**Charitable Contributions and Gifts**
197	**Amortization of Goodwill and Certain Other Intangibles**
280 (g)	**Golden Parachute Payments**
301	Distributions of Property
304	Redemption Through Use of Related Corporations
311	Taxability of Corporation on Distribution
334	Basis of Property Received in Liquidation
336	Distributions Received in Complete Liquidation
355	Distribution of Stock and Securities of a Controlled Corporation
367	Foreign Corporations—Transfer of Property

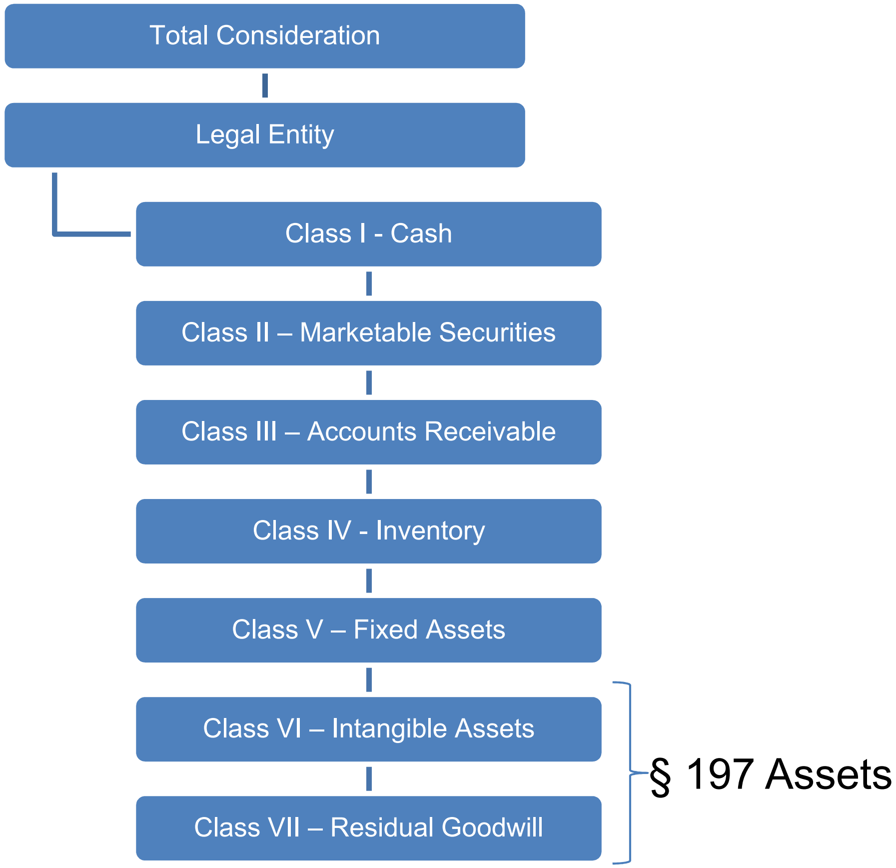
Tax Valuation—IRC Sections Driving Valuations

382	**Limitation on Net Operating Loss Carry forwards**
465	At Risk Requirement
475	Mark to Market Accounting Method for Dealers in Securities
482	**Allocation of Income and Deductions Among Taxpayers**
856 (c)	Definition of Real Estate Investment Trust
864	International Tax Apportionment
882	882 Allocation of Interest US Branches of Foreign Banks
897	Disposition of Investment in United States Real Property
1031	Exchange of Property Held for Productive Use or Investment
1060	Special Allocation Rules for Certain Asset Acquisitions
1287	Passive Foreign Investment Corporation
1374	**C to S Conversion**
2032	**Estate and Gift**
4958	**Private Benefit Transactions**
	Ad valorem property tax

Tax Allocation of Purchase Price

In an asset acquisition, buyer and seller typically agree to an allocation of the purchase price paid to the FMV of the various assets acquired.

- Allocation is performed sequentially, to seven asset classes based on §1060
- “Goodwill” and intangibles are reported as one number
- There are numerous, important differences between the purchase price allocation for tax and financial reporting



Purchase Price Allocations—Book vs. Tax Differences

Purchase Price	Financial Reporting (ASC 805)	Tax §338, §754, §1060
Transaction costs	Excluded	Some included
Contingent consideration	Included at Fair Value	Excluded
Deferred taxes	Included	Excluded
Accrued liabilities	Included	Some included
Debt	Assumed at Fair Value	Assumed at Face Value
Restructuring costs	Generally excluded	Excluded

Purchase Price Allocations—Book vs. Tax Differences

Allocation	Financial Reporting (ASC 805)	Tax §338, §754, §1060
Level of measurement	Reporting unit	Legal entity and then to other assets, if at all.
Bargain purchase	Reported as a gain	Allocation limited to the extent of the purchase price
Treatment of buyer's reporting units / legal entities	Assets can be allocated to pre-existing reporting units	Assets allocated only to acquired legal entities

Valuation	Financial Reporting (ASC 805)	Tax §338, §754, §1060
Standard of Value	Fair Value (market participant)	Fair Market Value (willing buyer / willing seller)
Aggregation of assets	May be aggregated by reporting unit	Should be valued by entity but often subsumed in goodwill
Basis of projections	May not consider legal ownership / transfer pricing	Must consider economic ownership
Tax amortization benefit	Always included in fair value, irrespective of deal structure	Included only to the extent of deductibility

IRS Tax Penalties

- Over 150 kinds of civil penalties in the U.S. Internal Revenue Code.
- **Failure to Pay**—The failure to pay penalty is one-half of one percent for each month, or part of a month, up to a maximum of 25% on the amount of tax that remains as unpaid from the due date of the return until paid in full. The one-half of one percent rate increases to one percent if the tax remains unpaid 10 days after the IRS issues a notice of intent to levy property.
  - (Penalties can be removed or reduced if taxpayer has reasonable cause.)
- **Fraud**—Penalty is 75 percent of the tax you didn't pay due to fraud.

IRS Interest

- **Interest**—Interest accrues on any unpaid tax from the due date of the return until the date of payment. The interest rate is determined quarterly and is the federal short-term rate plus 3 percent. Interest compounds daily.
- **Statute of Limitations**—No statue of limitations on assessment of tax, penalties and interest when a false tax return is filed.

Tax Valuation—Qualified Appraisal

- Benefits of hiring a competent appraiser:
  - IRS can waive penalties
  - Quality valuations are generally subject to less IRS scrutiny
- IRS has complex guidance on a qualified appraisal.
- Key elements include:
  - Prepared by a qualified appraiser
  - Prepared consistent with generally accepted appraisal standards

Tax Valuation—Qualified Appraiser

- Elements of a qualified appraiser include:
  - Hold appraisal designation appropriate for the valuation project at hand
  - Designation from a recognized professional appraiser organization
  - Minimum education and experience requirements
  - Experience in the property type

Tax Valuation—Penalties for Over or Under Valuation

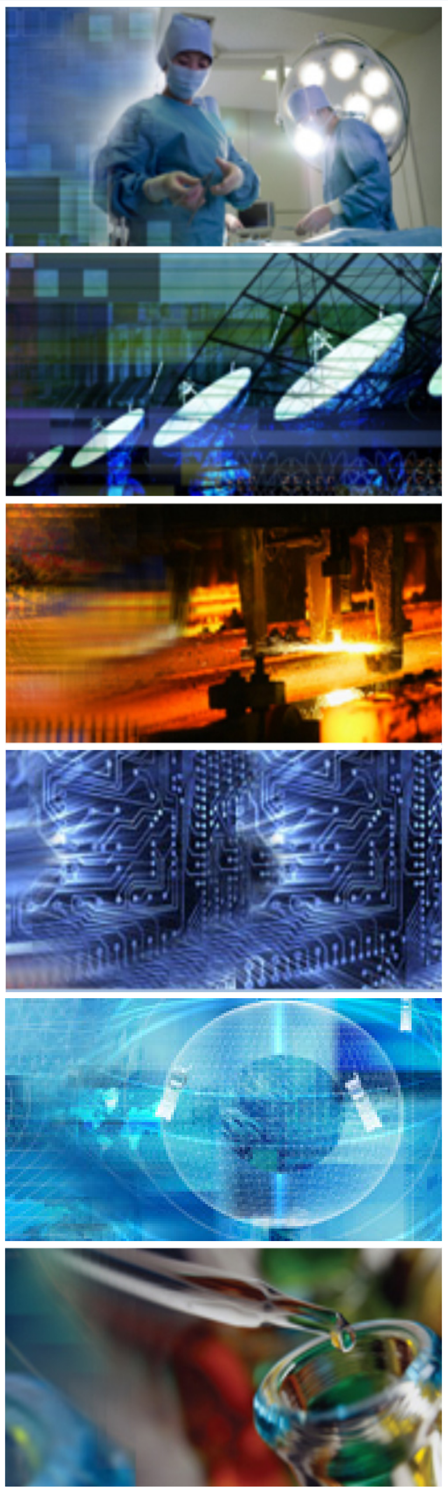
- IRC §6695A PENALTY—Substantial and Gross Valuation Misstatements Attributable to Incorrect Appraisals:
  - A person prepares an appraisal of the value of property and knows or should have known it would be used in connection with a return or claim for refund, and the claimed valuation results in:
    - Substantial Valuation Misstatement, IRC §6662(e),
    - Substantial Estate or Gift Tax Valuation Understatement, IRC §6662(9), or
    - Gross Valuation Misstatement, IRC §6662(h)

Tax Valuation Penalties

- A "Substantial Valuation Misstatement", IRC §6662(e), occurs if the value of property is 150% or more of the amount determined to be the correct amount of such valuation.
- A "Substantial Estate or Gift Tax Valuation Understatement", IRC §6662(g), occurs if the claimed value of property claimed is 65% or less of the amount determined to be the correct amount of such valuation.
- A "Gross Valuation Misstatement", IRC §6662(h), occurs if the claimed value of property is 200% or more of the amount determined to be the correct amount of such valuation.
- A "Gross Substantial Estate or Gift Tax Valuation Understatement", IRC §6662(h), occurs if the value of property claimed is 40% or less of the amount determined to be the correct amount of such valuation.

Tax Valuation Penalties

- Monetary penalty equal to the lesser of:
  - The greater of 10°/o of the amount of the underpayment (IRC §6664(a)] attributable to the misstatement or $1,000, or
  - 125% of the gross income received from the preparation of the appraisal
- Statutory exception to IRC §6695A if the appraiser can establish that it was "more likely than not" that the appraisal was accurate.
- "If the appraiser can not establish that the "more likely than not" exception applies, the examiner must impose the IRC section 6695A penalty." (IRS Memo to all Examiners, Estate and Gift Attorneys and Appellate Officers, August 18, 2009.)



Any Questions?