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Certified in Entity and Intangible Valuations (CEIV): Advancing the Quality of Valuations

Raymond Rath, ASA, CEIV, CFA

The field of business and intangible asset valuations has many of the elements of a profession. In recent years, comments by the SEC expressed concern about the structure of the business valuation profession and the lack of sufficient quality assurance procedures. As a result of these concerns, the Mandatory Performance Framework ("MPF") and Application of the Mandatory Performance Framework ("AMPF") documents were released in January 2017 to provide guidance including minimum performance standards and documentation requirements for certain financial reporting valuation projects. In mid-2017, the Certified in Entity and Intangible Valuations designation was made available to qualified business appraisers. This article provides an overview of various efforts to advance valuation quality over the years. An overview of the MPF and AMPF is provided as is a discussion of the CEIV designation and related requirements.

People use both the terms "valuation industry" and "valuation profession." There is some debate regarding whether valuation is simply a business or has truly reached the level of a profession. This article provides an overview on the development of the business valuation profession and efforts to continue to advance the profession as it relates to valuations prepared for financial reporting purposes. We discuss the Certified in Entity and Intangible Valuations (CEIV) designation and the related Mandatory Performance Framework (MPF) and Application of the Mandatory Performance Framework (AMPF) documents.

Historical Developments and Background

One fair question to ask is why the concern about whether valuation is a profession or not exists. Professions are viewed as having a high degree of responsibility to those who use their services. The introduction of business valuation education in the early 1980s and certification of individuals performing business valuations by the ASA were two of the earliest steps in the move of business valuation toward becoming a profession. The release of the USPAP by The Appraisal Foundation (TAF) was another step in this progression.

While business valuations are addressed by USPAP, absent client or valuation professional organization (VPO) requirements, most business valuations are not required to be prepared in compliance with USPAP. When USPAP was first released, business valuations had limited 3rd-party reliance risk, and, therefore, most (almost all) business valuations were not required to be USPAP compliant.

In-process research and development (IPR&D) valuations lead to restatements of financial statements of public companies

Starting in 1998, the US SEC raised concerns that corporate earnings were being managed by classifying a significant portion of the price of an acquired entity as IPR&D. For accounting purposes, IPR&D had been immediately written off in a business combination.[1] IPR&D write-offs at the time of an acquisition result in improved future financial performance. Future earnings are increased, as there is less amortization expense and reduced risk of future impairment charges. In addition, future earnings may be "smoothed" as a result of these factors. Companies would also report increased return on assets, as fewer assets are reported on the balance sheet. These factors could lead investors and other parties to obtain an inaccurate picture of the financial performance of entities. As indicated by then–SEC Chief Accountant Lynn Turner. "Abuses of the valuation of IPR&D also are expected. This trend of larger write-offs could undermine

[1]The accounting treatment of acquired IPR&D changed with the release of FAS 141R (now ASC 805) in 2007. While IPR&D was previously expensed at the time of acquisitions, FAS 141R required capitalization of IPR&D at acquisition. IPR&D would then be either amortized or written off depending on the success of the IPR&D project.

public confidence in financial statements and presents significant challenges for the accounting profession."

SEC comments on the problems with IPR&D valuations suggest a variety of factors leading to the misvaluations. In 1998, SEC Chief Accountant Lynn Turner indicated that the SEC had "... identified circumstances where many of the facts appear at odds with the fair value assigned to that asset as part of the purchase price allocation." While many parties share responsibility, this comment raises the question of whether appropriate due diligence was performed by appraisers. A variety of other factors, including limited accounting guidance and inadequate valuation models and procedures to develop appropriate assumptions, contributed as well.

This scrutiny of IPR&D valuations resulted in the 2001 release of valuation and accounting guidance, including the American Institute of Certified Public Accountants (AICPA) Practice Aid *Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries*. This guide provided helpful technical accounting and valuation guidance to improve the quality of IPR&D valuations. The release of IPR&D technical guidance represented another step forward for valuations. Since the release of this guide, guidance in a variety of technical areas impacting business, security, and intangible asset valuations has been released by The Appraisal Foundation or the AICPA.

SEC 2011 comments on valuation profession

The genesis of this article and efforts to advance the valuation profession are reflected in then SEC Chief Accountant Paul Beswick's comments at the 2011 AICPA SEC Conference:

> 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.** [Emphasis added][2]

The concerns briefly addressed in Mr. Beswick's comments have been the subject of much discussion by regulators, accounting firms, and appraisers. There is general agreement that the valuation profession, at least as it relates to certain valuations prepared for financial reporting, needs to continue to advance.

Impacts from increased financial reporting requirements for valuations

Concerns about IPR&D valuations decreased following the restatements of prior estimates and the release of valuation guidance for IPR&D valuation and increased scrutiny afforded these valuations. However, a variety of accounting changes added new requirements for additional fair value estimates that impact income statements and balance sheets of many public and private companies. These increased requirements combined with limited guidance continued to raise concern on fair value estimates. As the SEC observations made clear, the impact on financial statements of fair value estimates can influence the decisions of equity and debt investors as well as suppliers, customers, potential employees, and others making decisions pertaining to an entity.

The expanded requirements for fair value estimates in financial reporting have increased 3rd-party reliance on valuation estimates. Whereas transaction and litigation valuations often have limited 3rd-party reliance, valuations for financial reporting purposes that involve public companies (and many private firms) have broad 3rd-party reliance. This increased 3rd-party reliance combined with observations from regulatory bodies such as the SEC and Public Company Accounting Oversight Board (PCAOB) have led to current concerns about the structure of the valuation profession.

The release of FAS 141 (now ASC 805), *Business Combinations*, and FAS 142 (now ASC 350), *Intangibles—Goodwill and Other*, in 2001 added new requirements to estimate fair values for certain elements of accounting for firms preparing financial statements. The release of FAS 123R (now ASC 718), *Share-Based Payment*, in 2004 further increased the need for fair value measurements. Existing accounting guidance, such as ASC 946, *Financial Services—Investment Companies* and others, also require fair value estimates. FAS 157 (now ASC 820), *Fair Value Measurements*, clarified the general understanding of the valuation process and further increased the focus on fair value estimates.

In assessing the need for continued development of the business valuation profession, it is important to focus on key attributes of many business and intangible asset valuations. First, value and valuations are inherently based on future results. In some cases, past results are a clear indication of the future, and valuations may be somewhat less challenging. However, many fair value estimates involve companies in dynamic industries in which valuations can be quite challenging. As an example, Hewlett Packard's $10.3 billion acquisition of

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[2] In addition to the implications for individuals representing themselves as professional appraisers, Mr. Beswick's comment raises interesting questions regarding when management can prepare an estimate of fair value. Discussion of this topic is beyond the scope of this article.

Autonomy in 2011 and subsequent $8.8 billion of write-offs associated with this acquisition is one high-profile example of the challenges in valuations. While not an example of a compliance-related valuation failure, this example highlights difficulties in measuring value.

Releases of technical valuation guidance

Numerous releases of detailed technical guidance on complex valuation topics by The Appraisal Foundation and AICPA have helped advance the application of methodologies and development of assumptions used in business and intangible asset valuations. Reduced divergence in valuation practice due to expanded technical guidance has advanced the profession.

Valuation quality

Valuation quality can be impacted by factors including

1. Advocacy—lack of independence
2. Insufficient technical competence (for example, inadequate knowledge of guidance impacting valuation [accounting guidance as an example] or insufficient technical skills)
3. Negligence (for example, inadequate valuation procedures or inadequate quality control).

Prior to the establishment of the CEIV, efforts to address quality concerns were modest. Quality assurance programs at valuation providers were internally developed. Additional efforts at insuring valuation quality were frequently tied to the audit review process performed by the assurance and valuation staff at accounting firms as a part of their audit procedures. PCAOB reviews of the audit of fair value estimates and SEC scrutiny of fair value estimates also influenced the quality of fair value estimates.

The introduction of the CEIV designation and the release of the MPF and AMPF provide substantive changes to the profession's structure specific to the preparation of fair value estimates. We now discuss the CEIV, MPF and AMPF.

Current Status of the CEIV and MPF

The CEIV and the MPF are intended to improve valuation quality. The MPF and AMPF documents were finalized in January 2017. CEIV education and tests became available in spring 2017. The 1st CEIV credentials were granted to individuals at this time as well.

Background on the CEIV

The CEIV credential and related procedures and the MPF and AMPF were developed by a not-for-profit entity, Corporate and Intangibles Valuation Organization, LLC (CIVO). The CIVO was created by three founding VPOs, including the AICPA, ASA, and the Royal Institution of Charter Surveyors (RICS). The Web site for the CEIV is https://ceiv-credential.org/.

Information on the CEIV designation can also be obtained from the ASA Web site at www.appraisers.org/credentials/ceiv-certification. Detailed information on the CEIV credential and overall process is included at the ASA Web site. Information includes detailed insights on the CEIV designation, a video discussing the benefits of the CEIV credential, a CEIV credential flowchart, registration information for the ASA CEIV course BV 401 (*Valuations for Financial Reporting*), a listing of "Frequently Asked Questions," and other pertinent information.

Types of valuations covered by the CEIV

The CEIV credential relates to valuation of businesses, securities interests, intangible assets, and certain other items (deferred revenue and inventory) for financial reporting purposes under US generally accepted accounting principles. The CEIV credential and its related requirements pertain to fair value estimates for both public and private companies. Individuals who meet certain requirements can obtain the CEIV designation from the ASA, AICPA, or RICS.

Intent of the CEIV

The CEIV credential is intended to demonstrate an individual's competence to develop fair value estimates for financial reporting purposes. Through this competence and expanded valuation procedures, the quality of fair value estimates is expected to improve. The SEC and others have expressed concern that incorrect fair value estimates may reduce the reliability of financial statements. Reduced confidence in financial information can reduce investors' and other parties' confidence in financial information and, hence, the financial markets.

The credential requirements relate to the additional specialized knowledge needed to perform valuations for financial reporting. The CEIV includes performance and documentation requirements specific to fair value matters. The CEIV testing includes information on accounting guidance, audit standards, and technical releases pertaining to fair value estimates. This knowledge is above and beyond the "basic" business valuation body of knowledge.

Requirements to obtain the CEIV

Requirements to obtain the CEIV credential include the following:

1. Minimum education/designation requirements, which comprise the following: (a) College degree

or equivalent; or (b) Existing business valuation designation or CFA charter and five years of BV experience—As the CEIV credential is intended to insure competence to perform valuations for financial reporting, an existing designation in business valuation is required. Appropriate credentials include Accredited Senior Appraiser in Business Valuation, as issued by the ASA; ABV, as issued by the AICPA or MRICS; or FRICS in Business Valuation, as issued by the RICS. The designation requirements can also be met for individuals who hold the CFA charter who also have five years of business valuation experience. As noted previously, the CEIV provides evidence of additional technical knowledge required to prepare financial reporting valuations and compliance with quality-related requirements.

2. Experience requirement: Applicants are required to have completed 3,000 hours of financial reporting–related valuation efforts in the five years prior to their application. For the purposes of meeting the requirement, qualifying hours can include the following activities:
   a. Preparation or review of fair value estimates;
   b. Performing, mentoring, supervising, and managing fair value engagements; and
   c. Consulting on, instructing, authoring, developing thought leadership, and staff development on fair value measurement matters.
   d. Documentation will be required to meet the experience requirement. Documentation can include attestation by a partner/peer or a detailed submission of hours.
3. Fair value education: All candidates for the CEIV are required to complete a three-day course on the financial reporting body of knowledge. Elements of this body of knowledge include
   a. Fair Value Accounting and Regulatory Environment;
   b. Technical Guidance Related to Valuations for Financial Reporting (examples include the technical guides developed by TAF and the AICPA);
   c. Use of the Valuation Report in the Audit Process;
   d. MPF; and
   e. The course includes approximately four hours of time on the MPF, with the remaining time focused on the other areas of the financial reporting body of knowledge.

Following completion of the course, individuals must pass an exam on the CEIV course materials. The exams consist of multiple-choice questions that are administered online and are timed. There are two sections of the exam with sixty questions each, including

1. Fair Value Measurement Environment, Guidance and Related Auditing Requirements; and
2. MPF.

CEIV credential maintenance

To retain the CEIV credential, individuals must meet several credential maintenance requirements, including the following:

1. Education/Training: (a) Complete eight-hour annual fair value update offered by one of the three approved VPOs; and (b) Forty-eight hours of fair value specific education completed every three years.
2. Ongoing Business Experience: Performing a minimum of 1,500 hours of fair value–related experience every three years is required. Tasks that are eligible for the ongoing business experience requirement are similar to those involved in the hours for the initial experience requirements.
3. Compliance: (a) Adherence to the MPF and (b) Annual engagement level quality review.

CEIV quality control process

All CEIV credential holders will be required to submit to an annual engagement level quality control program. The quality control program encompasses a combination of reviews of CPE requirements, a review of work performed, and a review of complaints received (anonymous or otherwise), if applicable. Reviews will be structured to gather and evaluate the information needed to demonstrate that core areas of the MPF are being properly followed.

Each credential holder will undergo an initial quality control review no sooner than nine months after obtaining the credential unless a complaint against the credential holder requires an investigative review. Following the initial quality control review, an annual risk-based approach will be implemented.

The results of the risk-based review will determine the level of ongoing quality control review required for the individual, if any. More information on the review process and levels of compliance will be conveyed after the initial roll-out of the CEIV credential.

Elements of the MPF and AMPF

A key element of the CEIV process is the MPF and AMPF (collectively, the MPF, unless otherwise noted). (Copies of both are available free of charge at ceiv-credential.org.) The MPF defines 'how much' work is necessary to provide supportable and auditable fair value measurements for financial reporting. The MPF and related AMPF are intended to insure adequate valuation procedures are performed and documented. They will also enhance consistency and transparency in the performance of fair value measurements and provide a resource for the valuation review process. CEIV credential holders are required to comply with the MPF. Compliance with the MPF is viewed as a best practice for individuals who do not hold the CEIV designation.

Briefly, the MPF document can be viewed more as a guide to the general process of the "Mandatory Performance Framework" and the AMPF provides specific performance and documentation requirements for specific technical valuation areas. Specific elements of the MPF document include the following:

1. Applicability of MPF
2. Overview of purpose and scope
3. Discussion of relevant valuation, accounting, and auditing standards
4. Scope of the Mandatory Performance Framework—indicates that MPF covers any engagement for the valuation of a business, business interest, intangible asset, certain liabilities, and inventory to serve as a basis for management's preparation of financial statements
5. Conceptual discussion of documentation requirements
6. Professionalism and professional competence
7. Professional skepticism
8. Discussion of valuation reports
9. Glossary of terms

The AMPF document includes specific procedures and documentation requirements. Areas covered by the AMPF include the following:

1. General Valuation Guidance
   a. Calibration
   b. Prospective Financial Information ("PFI")
2. Business Valuation Guidance
   a. Discount Rate Derivation
   b. Growth Rates
   c. Terminal Value Multiple Methods/Models
   d. Selection of, and Adjustments to, Valuation Multiples
   e. Selection of Guideline Public Companies or Comparable Company Transactions
   f. Discounts and Premiums
3. Intangible Asset, Certain Liabilities, and Inventory Guidance
   a. Identified Assets and Liabilities
   b. Operating Rights
   c. Life for Projection Period
   d. Customer-related intangible assets
   e. Royalty Rates
   f. Contributory Asset Charges
   g. Tax Amortization Benefit (TAB)
   h. Reconciliation of Intangible Asset Values
   i. Discounts/Internal Rate of Return/Weighted Average Cost of Capital
   j. Contract Liabilities (Deferred Revenue)
   k. Inventory

In addition to performing the specific procedures established by the MPF, the MPF requires written documentation within the engagement file that supports a final conclusion of value. The engagement file includes the valuation report and any additional work papers that document the procedures performed. Recognizing the limited users of many fair value estimates (financial statement preparer and auditor), the MPF provides flexibility in the degree of documentation provided in the report. Documentation can be included in the work papers.

The MPF 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.

Composition of valuation documentation

Documentation is the written record within the final valuation report, supporting working papers, or both. 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, e-mail, recordings of calls, voice messages), client-provided documents, representation letters, field notes, electronic spreadsheets, and internally prepared memoranda to the work file.

The MPF also discusses the analysis documents to include in the documentation. These generally fall into two subcategories:

Computational analysis (spreadsheets, database use)—To the extent that this type of analysis provides evidential support (or contradictory indications) to an input, process, or output, they are 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.

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 (not a complete list)

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

The MPF and AMPF documents include significant additional guidance on the valuation process and its documentation. Readers are referred to the CEIV courses offered by the three VPOs and the MPF and AMPF documents for further insights.

Conclusion

Prior to the release of the CEIV designation and the MPF, the valuation profession has made meaningful advances. Despite these education and technical advancements, deficiencies observed by regulatory parties suggested that further enhancements are required. The CEIV and MPF significantly "raise the bar" for those performing certain valuations for financial reporting purposes.