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# 3<sup>rd</sup> OIV International Business Valuation Conference

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## The U.S. Valuation Profession in Financial Reporting (VFR): an Evolution

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Marianna Todorova  
*Director, Duff & Phelps*

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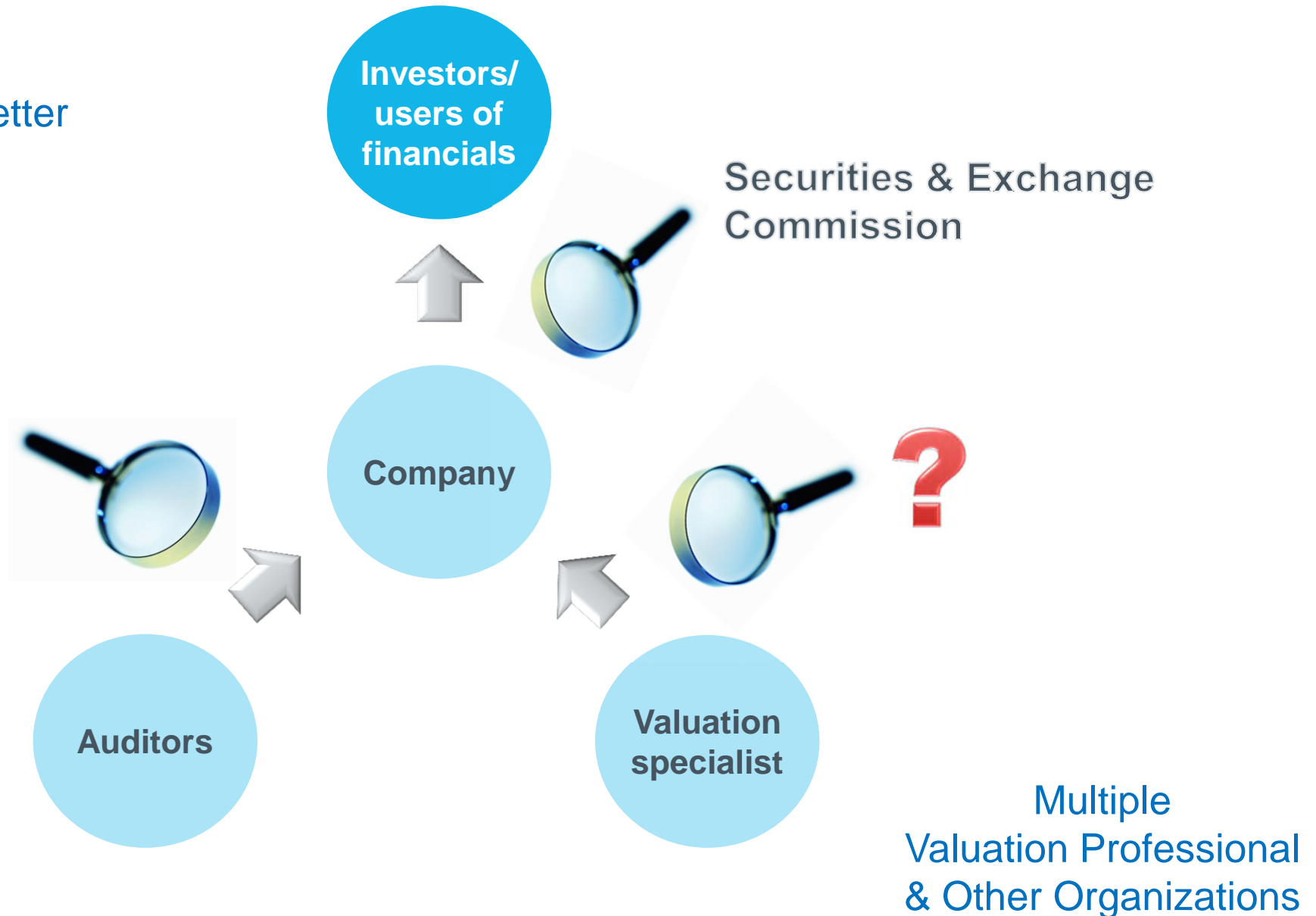
# Agenda

- **Objective of the session**
- **A brief journey back in time**
  - Roots of the valuation profession
  - Accelerating use of fair value
  - Key events
- **Where are we now?**
  - Status quo
  - Valuation infrastructure initiative
- **A vision for the future**
  - A common identity for the U.S. valuation profession in financial reporting
  - Focus on performance standards

# Financial Reporting Valuations – a Public Interest Issue

Accounting  
Standard Setter

PCAOB



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# Emergence of the Valuation Profession in Financial Reporting

- Roots of the profession (*methods* used and *people*) are in tax valuations:
  - IRS Revenue Ruling 59-60 (1959)
    - » Seven factors for *business valuation* (fair market value)
  - IRS Revenue Procedure 77-12 (1977; updated 2003-51)
    - » Fair market value of *inventory*
  - IRS Revenue Ruling 68-609 (1968)
    - » Excess cash flow or excess earnings method (“the treasury method”). Predecessor to the MPEEM used in *intangible asset* valuations today.

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# Evolution of Fair Value Requirements

- The need for fair value measurements gradually increases
- Historical cost was the bedrock of financial reporting until the 1990s
  - Fair value required in limited circumstances
    - » Business combinations & intangible assets (1970)
    - » Financial instruments – fair value disclosures
- 1990s onwards saw an increased focus on fair value information
  - » Financial instruments (1994 and various dates)
  - » Impairment of long-lived assets (1995)
  - » Concept Statement No. 7 (2000) (*Using Cash Flow Information and Present Value in Accounting Measurements*)
  - » Share-based payment (1995 and 2004)
  - » Business combinations (2001 and 2006)
  - » **Fair Value Measurement (2006)**

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# Valuation Industry Rallies via Ad-Hoc Efforts

- Post-2000: Ad hoc efforts to address valuation issues:
  - Valuation Resource Group (VRG) - FASB (2006)
  - The Appraisal Foundation and the AICPA task forces
  - Appraisal Issues Task Force (AITF)
  - Internationally an increased interest in the IVSC and its potential contribution to valuation guidance
  - Other informal efforts
- **Industry started to coalesce around these groups, with much cross-membership of individuals and/or firms**

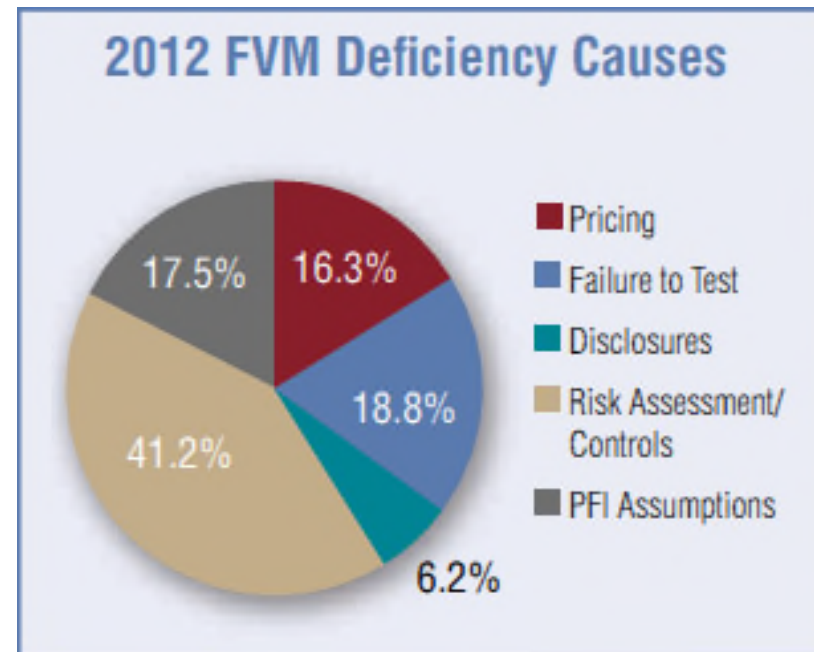
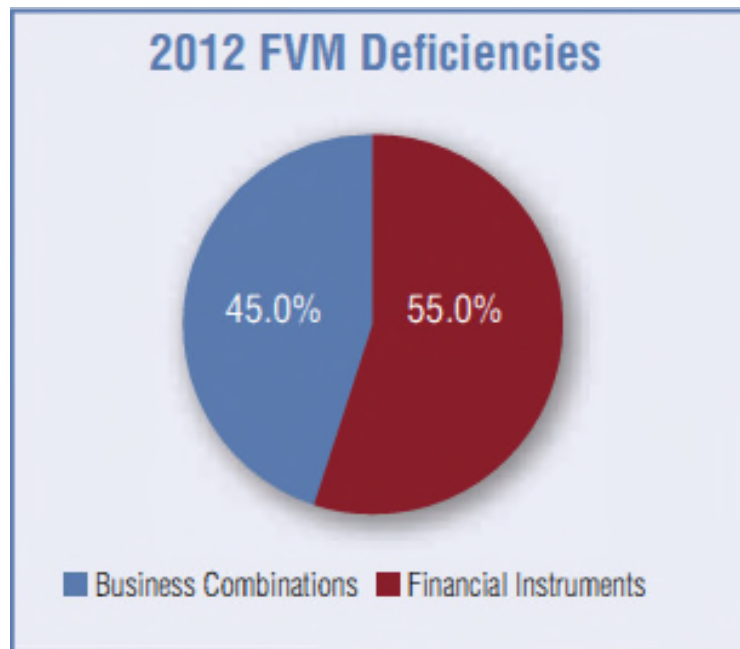
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# Key Events Fuel 'Growth spurts' in the Profession

- Savings & loan crisis: Creation of USPAP and The Appraisal Foundation – **first comprehensive set of valuation standards that also address BV**
- SEC draws attention to abuses related to IPR&D write-off (1998)
- AICPA issues the IPR&D guide (2001) – **1st major milestone setting valuation best practices for financial reporting**
- Sarbanes-Oxley (2002) created the Public Company Accounting Oversight Board – auditor of auditors
- Financial crisis (2008) – some believe fair value “caused” the crisis
- Recent focus on ICFR (internal controls for financial reporting)

# PCAOB Shines Spotlight on Fair Value Deficiencies

- PCAOB has found an increasing overall trend in audit deficiencies.
- FVM deficiencies dipped in recent years, but composition has changed
- Pricing services have also garnered significant attention (financial instruments).



Source: Acuitas, Inc's Survey of Fair Value Audit Deficiencies (2014)

- **N.B.:** The PCAOB states the deficiencies found do not necessarily indicate that the financial statements are misstated. Also, the results cannot be generalized to all audits.



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# SEC: Profession Fragmented, Lacks Common Identity

- 2005 - SEC seeks improvement in valuation profession infrastructure
- SEC chief accountant went even further in 2011:
  - Valuation professionals lack a unified identity
  - Fragmentation among the current professional organizations
  - No requirement to have any of the available designations
  - Expectation gaps can exist between interested parties
  - Potential solution? Consider 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.
    - » Inspection program and a fair disciplinary mechanism.

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# Current Landscape: VPOs and Standard Setters

## Valuation Professional Organizations:

- Multi-disciplinary: [ASA](#); [RICS](#)
- Business Valuation: [AICPA](#); [NACVA](#); [IBA](#); Others
- Real Property Valuation: [Appraisal Institute](#); Others
- Personal Property Valuation: [Various](#)
- Investment Management: [CFA](#)

## Valuation Standard Setters:

- TAF (U.S.): [ASB](#); [AQB](#); [APB](#)
- IVSC (global): [Standards Board](#); [Professional Board](#)

# Current Landscape: Standards

Organization	Standards
TAF	USPAP
ASA	BVS
AICPA	SSVS1
RICS	“Red Book”
NACVA	BVS
IBA	BVS
IVSC	IVS
CFA	GIPS

# Current Landscape: Multiplicity of Designations



American Society of Appraisers (ASA)  
- ASA (Accredited Senior Appraiser)  
- ASA - AM (Accredited Member)



American Institute of Certified Public Accountants (AICPA)  
- ABV (Accredited In Business Valuation)



CFA Institute  
- CFA (Chartered Financial Analyst)



Royal Institution of Chartered Surveyors (RICS)  
- MRICS  
- FRICS; and, ARICS (or AssocRICS)



Institute of Business Appraisers (IBA)  
- CBA (Certified Business Appraiser)  
- MCBA (Master Certified Business Appraiser)



National Association of Certified Valuation Analysts (NACVA)  
- CVA (Certified Valuation Analyst)  
- AVA (Accredited Valuation Analyst)

# What is a Profession?

**profession, n.**

II. 7. a. An occupation in which a professed knowledge of some subject, field, or science is applied; a vocation or career, especially one that involves prolonged training and a formal qualification.

II. 7. d. The body of people engaged in a particular occupation or calling; sometimes with defining word, as *legal, medical*, etc.

Entry

to

CPE

*Source: The Oxford English Dictionary*

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# Perception of Insufficient Quality - a Symptom of...?

- Is it performance?
  - Limited to certain individuals and certain circumstances
  - **Management: 50% of financial reporting valuations**
  - Auditor valuation specialists may not always review
- Is it the nature of the fair value measurement itself?
  - Judgment - parties might not always agree
  - Point estimate as opposed to a range
  - Could be difficult to audit, uncertainty is inherent
- However, the fact is...
  - No current requirement for certification or experience
  - Multiplicity of designations
- Can the market be left to regulate itself?
  - No regulation: market forces **OR** voluntary self-regulation?

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# The Appraisal Foundation

## Business Valuation Roundtable - VFR (2012)

### Qualifications

- Confusion about the minimum qualifications
- Many designations in market, on-the-job training critical
- No full academic degrees presently

### Standards

- Clients not really aware
- No convergence or mutual adoption of standards by VPOs
- Practice issues more around methodologies/best practices
- Many professional organizations & firms have codes of ethics

### Oversight

- VPOs have mechanisms for complaints
- Firms have internal oversight but no official body oversight

# The Pillars of a Valuation Professional Infrastructure





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# Building a Valuation Professional Infrastructure

## Emergence of the Valuation Quality Initiative

- VPOs and other organizations addressing the needs for building a valuation infrastructure for public interest valuations
  - Foster public trust; advance the profession; and improve valuation quality **overall**
- Four work streams
  - **Qualifications** (Education/Examination/Continuing Education)
  - **Performance Standards**
  - **Quality Control**
  - **Governance & Coordination**
- Initial focus on BV and intangibles; financial instruments and other areas to follow
- **This initiative is evolving...**

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# Qualifications Work Stream

- Develop recommendations and requirements for base knowledge, initial testing and ongoing continuing education.
- Consider various issues:
  - Create new material, testing, continuing education requirements OR leverage existing?
  - Utilize certain existing credentials OR create a new “credential” for providing public interest valuations?
  - Who will administer exams and develop material for CPE?
  - Requirements for existing valuation professionals?

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# Performance Standards Work Stream

- Consider the development of performance standards that govern the level of work needed to support a valuation opinion.
- Attempt to address gaps in practice not covered by standards and guidance
  - What constitutes a rigorous analysis? How to do it?
  - What constitutes adequate support and documentation?
- Level of detail needed for the performance standards?

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# Quality Control Work Stream

- Develop a framework for quality reviews of valuation firms and individual practitioners.
- Consider leveraging from:
  - AICPA existing peer review processes
  - Disciplinary processes within the existing VPOs
- Should a valuation firms existing quality control environment be considered, and if so how?
- Other considerations

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# Governance Work Stream

- Address a variety of governance issues, including:
- The form of the resulting “valuation infrastructure”
  - Consider the extent existing VPOs could be leveraged to perform certain functions
  - Consider whether to form a new standalone entity to handle certain functions
  - IP ownership
  - Funding
- In the near term, provide overall coordination of the project

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# A Possible Knowledge Portfolio

What could a valuation professional be equipped with to perform valuations for financial reporting?

- BV & Intangibles “Foundation”, *PLUS*
- Familiarity with the relevant accounting standards and related disclosures, *PLUS*
- Familiarity with leading practices, for example:
  - AICPA Accounting and Valuation Guides:
    - » Cheap Stock (F); Goodwill Impairment (F); IPR&D (F); and Business Combinations (in progress)
  - The Appraisal Foundation - APB Valuation Advisories
    - » Contributory Assets (F); Customer-Related Assets (D); Market Participant Acquisition Premiums (D); Valuation Issues in Separating Tangible and Intangible Assets (D); and Contingent Consideration (in progress)

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# A Possible Knowledge Portfolio

## **PLUS**

- **Familiarity with other relevant valuation literature, for example, IVSC-issued:**
  - **IVS TIPs** (Technical Information Papers): Discounted Cash Flow; Cost Approach for Tangible Assets; Valuation of Intangible Assets; and Valuation Uncertainty
  - Other IVSC publications: The Role of the Professional Valuer in the Audit Process

## **PLUS**

- *Awareness* of select **Auditing standards**

## **PLUS**

- Awareness of **current developments** in financial reporting and valuation practices

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# Types of Standards

- Technical Standards – “**what**” you need to know to perform the valuation; the technical foundation
- Professional Standards - “**who**” - attributes of the individual valuation professional
- Performance Standards –“**how**” – scope of work, extent and quality of investigation, analysis and documentation



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# 'Performance' is the Operative Word

- A “robust analysis”:
  - Scope of analysis and extent of procedures
  - Evaluation of data received; reasonableness of assumptions
  - Professional judgment; rigor of analysis; and documentation
- Bottom line:
  - Was work performed sufficient and can it withstand scrutiny?
- **Practical tip:** involve auditors and management in initial dialogue
- Valuation work is not audit work - Client is making representations
- Ultimately...
  - Can we get comfortable with judgment? (Difficult to audit)
  - Can we handle uncertainty? (Measurement uncertainty)

# Evaluating Fair Value as Accounting Information

- FASB Concepts Statement No. 2 (1980) sets out a hierarchy of qualities of accounting information, with **usefulness for decision making** being most important
- Can valuation standards and guidance improve the quality of fair value measurements, using these attributes as a benchmark?

Attributes of the Information	Standards & Guidance		
	Technical	Professional	Performance
<input type="checkbox"/> <b>Relevance</b>			
▪ Timely			
▪ Predictive/feedback value			
<input type="checkbox"/> <b>Reliability</b>			
▪ Representationally faithful	✓		✓
▪ Verifiable		✓	✓
▪ Precision & Uncertainty	✓	✓	✓
<input type="checkbox"/> <b>Neutrality</b>		✓	✓
<input type="checkbox"/> <b>Comparability &amp; Consistency</b>	✓	✓	✓
<input type="checkbox"/> <b>Materiality</b>		✓	✓
<input type="checkbox"/> <b>Benefits &amp; Costs</b>		✓	✓

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# Acting Locally... while Thinking Globally

- The observed issues are certainly not limited to the U.S. jurisdiction
- Solution may have a potential “spillover” effect outside the U.S.
- Valuation is a global profession
  - The benefits of having globally recognized designations
  - Spread of IFRS
- The role of the IVSC
  - Mission is to foster public trust in the valuation process and develop the valuation profession
- Key IVSC developments relevant to the global valuation profession:
  - Signing of a landmark MoU with certain VPOs and other organizations aimed to converge various valuation standards with International Valuation Standards (IVSs)
  - Development of International Professional Standards (IPSs)

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# What to Do Now...

- Valuation professionals
  - Take an ownership of your professional development
  - Read the relevant accounting standards and the leading practices guides
  - Follow current developments
- Valuation firms
  - Culture of continuing professional education, quality control, and a commitment to ethics
- **The valuation profession collectively must rise to the occasion and self-regulate**

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# Questions



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# Marianna Todorova



Duff & Phelps, LLC  
New York  
+1 212 871 6239  
Marianna.Todorova@duffandphelps.com

Marianna Todorova is a director in the Office of Professional Practice (OPP). As a member of OPP, Marianna provides technical interpretation and guidance on valuation issues in the context of financial reporting, assists in the implementation of best practices and quality control assessment, and engages in interactions with standard setters, regulators, and professional/industry associations, with the objective of supporting client facing efforts throughout the firm.

Prior to joining OPP, Marianna served as a Valuation Fellow at the Financial Accounting Standards Board (FASB) for two years. During that time, she contributed to the development of FASB Statement No. 157, Fair Value Measurements (currently codified in ASC Topic 820), FASB Statement No. 141(R), Business Combinations (currently codified in ASC Topic 805) and other projects. In her role, Marianna helped bring a valuation perspective to various FASB projects and acted as a liaison between FASB and valuation specialists. Marianna's experience also includes valuations of businesses and intangible assets, including trademarks, technology, patents, software, license agreements, non-compete agreements, customer relationships, with a particular focus on the consumer products, retail, information and publishing industries.

Marianna joined Duff & Phelps in conjunction with the merger of Standard & Poor's Corporate Value Consulting (CVC) with Duff & Phelps. Prior to the acquisition of CVC by Standard & Poor's, she was with the Lender Services practice of PricewaterhouseCoopers LLP, and with the Auditing and Business Advisory Services practice of Coopers & Lybrand LLP.

Marianna earned her B.S. in Economics from The Wharton School of the University of Pennsylvania with concentrations in finance, accounting and multinational management. She is also a Certified Public Accountant (inactive) and a member of the AICPA.

Marianna is the Vice-Chair of the International Valuation Professional Board (IVPB), a board of the International Valuation Standards Council (IVSC).

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