



Valuation Governance

WEBINAR | 15TH NOVEMBER 2017 | 10AM EST

- ◆ The valuation of private assets - whether equity, debt, real estate or the more esoteric classes of infrastructure, commodities, etc. - has always been a challenging task. Typically illiquid, and frequently complex, private asset classes usually require the deployment of sophisticated techniques and methodologies, and specialist data sets. This is not a job for the amateur!
- ◆ The sector has experienced spectacular growth over the last few years, as institutional investors search out yield for their burgeoning cash piles. Private assets under management in 2016 were close to \$5trn and this is forecast to triple in size over the next 5 years. Increasingly, traditional public asset managers are entering the sector - 66 percent of annual fundraising for technology start-ups in 2016 came from this source.
- ◆ With mom and pop's pension and the kids college fees now becoming exposed to what was previously a professionals market, the regulators are becoming increasingly active and vigilant. Valuations especially are coming under unprecedented scrutiny, and the SEC has been encouraging a process to make these more consistent, transparent and defensible.
- ◆ In response to this, Voltaire Advisors and Duff & Phelps have co-operated to produce a series of web briefings on the subject. Over three sessions we will cover some of the key topics investment funds need to be alert to, and apprised of, when it comes to complying with regulatory rules and industry best practice in private asset valuation.



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DUFF & PHELPS

Valuation Governance

November 2017

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Agenda

- Fair Value Background
- Board responsibilities
- Frequency of Valuation
- How much influence should portfolio managers have on valuation?
- Questions

Regulatory Affiliations

Duff & Phelps advises the world's leading standard setting bodies on valuation issues and best practices.



U.S. Securities and
Exchange Commission



International
Accounting Standards
Board



Financial Accounting
and Standards Board



Appraisal
Institute™
*Professionals Providing
Real Estate Solutions*

Appraisal
Institute



American Institute
of CPAs



International Valuation
Standards Council



The
Appraisal
Foundation

The Appraisal
Foundation



Institute of Management
Accountants

Portfolio Valuation Advisory Services

*Duff & Phelps assists clients with **design and implementation of best-in-class valuation policies and processes**, including on-going review of valuation procedures and conclusions to ensure best practices.*

Market Leader

- We review over **5,000 illiquid investment positions** with an aggregate value of approximately **\$225 billion** on a quarterly basis.
- Our client base consists of over **350 alternative asset fund managers and investors**, including:
 - **80% of the 10 largest** private equity firms
 - **40% of the 50 largest** hedge funds
 - **70% of the 10 largest** BDCs
 - Investors – ranging from small family offices to large public pension funds and Sovereign Wealth Funds

Thought Leader

- We are at the forefront of the industry's leading committees on valuation processes, guidelines, and regulations:
 - **IPEV** – Vice Chair
 - **ILPA** – Special Advisor
 - **AICPA PE/VC Valuation Guide Task Force** – Member
 - **FASB Valuation Resource Group** – Member
 - **Managed Funds Association** – Sustaining Member
 - **AIMA – Guide to Sound Practices For the Valuation of Investments Working Group**
- Leadership in drafting **IPEV** and **PEIGG** private equity valuation guidelines
- Author of *Private Equity Valuation – The definitive guide to valuing investments fairly*
- Development of Duff & Phelps Created Value Attribution Framework.

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David Larsen is a managing director in the San Francisco office of Duff & Phelps and part of the Portfolio Valuation service line. He has more than 30 years of transaction and accounting experience. He specializes in fair value accounting issues, and specifically in valuation, accounting, and regulatory issues faced by Alternative Asset managers and investors.

David advises leading Private Equity Managers and Institutional Investors and has advised numerous strategic and private equity acquirers in all areas of mergers, acquisitions, joint ventures, divestitures and valuation related matters. He provides valuation policy and process assistance to a number of the world's largest institutional limited partner investors and some of the world's largest alternative Investment managers. David is an advisor to and has served as Vice Chair of the International Private Equity and Venture Capital Valuations Board (IPEV), which in 2015 released updated International Private Equity Valuation Guidelines and serves as a member of the American Institute of Certified Public Accountants (AICPA) PE/VC Practice Guide Task Force. David has served as a special advisor to the Institutional Limited Partners Association; board member, project manager and technical advisor to the Private Equity Industry Guidelines Group and was instrumental in developing and drafting the Private Equity Industry Guidelines Group's Valuation and Reporting Guidelines; member of the Financial Accounting Standards Board's Valuation Resource Group responsible for providing the Board with input on potential clarifying guidance on issues relating to the application of the principles of FASB ASC Topic 820 (formerly SFAS No. 157), *Fair Value Measurements* and a member of the AICPA Net Asset Value Task Force.

Prior to joining Duff & Phelps, David was a Partner in KPMG LLP's Transaction Services practice, where he was the segment leader of KPMG's U.S. Institutional Investor practice. He served 13 years in KPMG's Seattle, Düsseldorf and Prague audit practices prior to moving full time to advisory work.

David received his M.S. in accounting from Brigham Young University's Marriott School, his B.S. in accounting from Brigham Young University. He is a certified public accountant licensed in California and Washington. David is also a member of the AICPA and the California and Washington Society of Certified Public Accountants and is a FINRA Series 7, 24 and 63 registered representative.

1.

Fair Value Background

Fair Value Definition has Aligned!

Fair Value is defined by:

- FASB ASC Topic 820 (fka SFAS 157),
- IFRS 13, and
- GASB (US Government Accounting Standards Board) Statement 72

as:

... the price that would be received TO SELL an asset or paid to transfer a liability in an ORDERLY transaction between market participants at the measurement date. (emphasis added)

Key Considerations:

- Unit of Account
- Calibration
- Market Participant Assumptions
- Orderly transaction
- How does Value Accrete?

Investment Company Valuation

Registered investment companies are governed by the definition of *value* found in Section 2(a)(41) of the 1940 Act and further interpreted in section 404.03 of the SEC's *Codification of Financial Reporting Policies*. :

- The value of securities held by registered investment companies (“funds”) is the market value when market quotations are readily available.
- When market quotations are not readily available, a fund must use fair values, as determined in good faith by the fund's boards of directors, to value its portfolio securities and other assets.

2.

Board responsibilities

Valuing in Good Faith

- The “good faith” requirement is addressed in SEC Accounting Series Release (ASR) No. 118, and in the December 1999 and April 2001 letters of the SEC Division of Investment Management regarding valuation issues.
 - ASR No. 118 recognizes that no single method exists for estimating fair value in good faith because fair value depends on the facts and circumstances of each individual case.
 - The April 2001 letter indicates that “the good faith requirement is a flexible concept that can accommodate many different considerations, and that the specific actions that a board must take will vary, depending on the nature of the particular fund, the context in which the board must fair value price, and the pricing procedures adopted by the board.”

What does Valuing In Good Faith Mean?

- The SEC staff believes that “a board acts in good faith when it “continuously review[s] the appropriateness of the method used” in determining the fair value of the fund’s portfolio securities. Compliance with the good faith standard generally reflects the directors’ faithfulness to the duties of care and loyalty that they owe to the fund.”
- There have been enforcement actions against fund directors who act with “reckless disregard for whether [the fund’s] fair value determination reflects the amount that the fund might reasonably expect to receive for the security upon its current sale.”
- The SEC staff acknowledges that “different fund boards, or funds in the same complex with different boards, when fair value pricing identical securities, could reasonably arrive at prices that were not the same, consistent with the boards’ obligation to fair value price in good faith.”
- The SEC staff believes that “a board acts in good faith when its fair value determination is the result of a sincere and honest assessment of the amount that the fund might reasonably expect to receive for a security upon its current sale, based upon all of the appropriate factors that are available to the fund.”

Takeaways from Morgan Keegan

- Fund directors must determine the methodologies to be used to fair value securities and must periodically reevaluate the appropriateness of those methodologies.
- While fund directors may engage others to assist them to calculate fair values of these securities, they continue to be ultimately responsible to determine fair value in good faith.
- The Morgan Keegan settlement found that the eight directors failed to satisfy these responsibilities.
 - Specifically, the directors delegated their fair valuation responsibility to a valuation committee without providing adequate substantive guidance on how fair valuation determinations should be made.
 - The directors then made no meaningful effort to learn how fair values were being determined.
 - They received only limited information about the factors involved with the funds' fair value determinations, and obtained almost no information explaining why particular fair values were assigned to portfolio securities.
 - The limited information provided to the directors was particularly problematic because fair valued securities comprised a significant percentage of the funds' net asset values (NAVs) - in most cases above 60 percent.
 - The valuation committee to whom the directors delegated the fair valuation responsibilities did not utilize reasonable procedures and often allowed the portfolio manager to arbitrarily set values.

Board Valuation Best Practices

- Tone at the top
 - Technical expertise
 - Questioning
 - Considering Impact of Changes in Strategy
 - Access to Valuation Specialists
 - Interaction with Employees Responsible for Valuation
- Fair Value Judgements should not be impacted by the New Liquidity Rules
 - Conservatism can mean “purposely understating”
 - Inconsistencies between valuation and liquidity disclosures may be appropriate
- How much oversight is enough?

Board Valuation Best Practices (cont.)

- Quality/Quantity of Information
 - What Information does a Board need to provide oversight?
 - Summary Reports
 - Source of Pricing
 - Exception Reports
- Private Company / Private Debt Valuations
 - Fair Value determinations are not just event driven
 - Approaches to Early Stage and Later Stage business should likely differ
 - Reflect Market Participant Views
- Pricing Services and Brokers—Are you relying blindly?

PCAOB's Stance on Pricing Services

- A5 ...The following factors affect the relevance of pricing information provided by a pricing service:
 - a. Whether the fair values are based on quoted prices in active markets for identical financial instruments;
 - b. When the fair values are based on transactions of similar financial instruments, how those transactions are identified and considered comparable to the financial instrument being valued; and
 - c. When no recent transactions have occurred for either the financial instrument being valued or similar financial instruments, or the price was developed using a quote from a broker or dealer, how the fair value was developed, including whether the inputs used represent the assumptions that market participants would use when pricing the financial instrument.
- .A6 When the fair values are based on transactions of similar financial instruments, the auditor should perform additional audit procedures to evaluate the process used by the pricing service.
- .A7 When there are no recent transactions either for the financial instrument being valued or for similar financial instruments, the auditor should perform additional audit procedures, including evaluating the appropriateness of the valuation method and the reasonableness of observable and unobservable inputs used by the pricing service.

PCAOB's Stance on Multiple Quotes

- A8 When pricing information is obtained from multiple pricing services, less information is needed about the particular methods and inputs used by the individual pricing services when the following conditions are met:
 - a. There are recent trades of the financial instrument or of financial instruments substantially similar to the financial instrument being tested;
 - b. The particular financial instrument is routinely priced by several pricing services;
 - c. Prices obtained from multiple pricing services are reasonably consistent, taking into account the nature and characteristics of the financial instrument, the methods used, and market conditions; and
 - d. The pricing information for the financial instrument is generally based on inputs that are observable.
- Note: When the above conditions are not met, the auditor should perform additional audit procedures, including evaluating the appropriateness of the valuation method and the reasonableness of observable and unobservable inputs for a representative price.

PCAOB's Stance on Broker Quotes

- .A9 When the company's fair value measurement is based on a quote from a broker or dealer ("broker quote"), the relevance and reliability of the evidence provided by the broker quote depend on whether:
 - a. The broker or dealer is free of relationships with the company by which company management can directly or indirectly control or significantly influence the broker or dealer;
 - b. The broker or dealer making the quote is a market maker that transacts in the same type of financial instrument;
 - c. The broker quote reflects market conditions as of the financial statement date;
 - d. The broker quote is binding on the broker or dealer; and
 - e. There are any restrictions, limitations, or disclaimers in the broker quote and, if so, their nature.
- Note: Broker quotes generally provide more relevant and reliable evidence when they are timely, binding quotes, without any restrictions, limitations, or disclaimers, from unaffiliated market makers transacting in the same type of financial instrument. If the broker quote does not provide sufficient appropriate audit evidence, the auditor should perform procedures to obtain relevant and reliable pricing information from another pricing source pursuant to the requirements of the appendix.

3.

Frequency of Valuation

Daily NAV = Daily Fair Value Assessment

- Fair Value is measured at each reporting date; for many funds, that means daily!
- Does the Fair Value of Illiquid or Non-traded Investments change daily?
 - Use a Market Participant View
 - Changes in Value driven by:
 - Events
 - Changes in macro market conditions
 - Changes in investment specific conditions
- How quickly can new information be incorporated into the valuation assessment?

4.

How much influence should portfolio managers have on valuation?

Independence in Valuation

- Fair Value requires the use of Market Participant Perspectives
- Fair Value based on information which is known or knowable at the measurement date
- Who has the greatest knowledge as to the status and progress of the investee company?
- With what bias, if any, do portfolio managers approach valuation?
 - Conservative
 - Optimistic
 - Prudent
- What additional procedures are in place to “keep the deal team honest”?
 - Independent Valuation Function
 - External Valuation Specialists
 - Broker’s / Pricing Services—are they sufficient?

Valuation Best Practices

1. Use most relevant & reliable inputs (may be from the portfolio manager / deal team)
2. Independence of valuation process – internal / external
3. Emerging best practices
 - Mandatory Performance Framework (MPF) – associated with CEIV (Certified in Entity and Intangible Valuation)
 - Use of qualified, experienced, external expert
 - Proposed Credential: CVFI (Certified in Valuation of Financial Instruments)
 - International Valuation Standards Council (IVSC) Guidelines
4. Using Guidelines
 - International Private Equity and Venture Capital Valuation Guidelines
 - Anticipated AICPA PE/VC Valuation Guide
 - AIMA Valuation Practices Guide

Where can we find Fair Value Guidance?

- IPEV Valuation Guidelines (www.privateequityvaluation.com)
- PEI: *Private Equity Valuation: The Definitive Guide to Valuing Private Equity*
- AICPA TIS 2220 Long Term Investments (provides guidance on using NAV for valuing an LP interest)
- AICPA TIS Section 6910:34 Application of the Notion of Value Maximization for Measuring Fair Value of Debt and Controlling Equity Positions
- AICPA TIS Section 6910:35 Assessing Control When Measuring Fair Value
- AICPA PE/VC Valuation Guide (expected publication in 2017?)
- Your Duff & Phelps service team.

QUESTIONS?

Appendix A

About Duff & Phelps

Duff & Phelps

Dedicated to Delivering Value

Valuation and Corporate Finance Advisors

- More than 10,000 engagements performed in 2015
- 5,000 clients including more than 40% of the S&P 500

2,000+ Employees in more than 70 offices globally

Advisory Capability

- Valuation Advisory
- Alternative Asset Advisory
- Compliance and Regulatory Consulting
- Disputes and Investigations
- Legal Management Consulting
- M&A Advisory
- Restructuring Advisory
- Tax Services
- Transaction Opinions

HISTORY

- **1932-1994**
Duff & Phelps founded and evolves into diversified financial services firm
- **1994**
Credit ratings business spun-off
- **2005**
Acquired Corporate Value Consulting (CVC) from Standard & Poor's
- **2007-2012**
Listed on the NYSE

Financial advisor to examiner in Lehman Brothers bankruptcy

Engaged by the Congressional Oversight Panel on the Troubled Asset Relief Program

Acquired 14 complementary businesses to expand our service offering
- **2013**
Taken private by an investor consortium led by The Carlyle Group
- **2015**
Acquired Kinetic Partners and launched Compliance and Regulatory Consulting practice
- Acquired American Appraisal, significantly enhancing our global Valuation practice
- **2016**
Acquired CounselWorks to expand Compliance and Regulatory Consulting practice

More Than 70 Offices and Affiliates Worldwide



The Americas

Atlanta	Houston	Princeton
Austin	Jacksonville	San Francisco
Boston	Los Angeles	São Paulo
Calgary	Mexico City	Seattle
Cayman Islands	Miami	Silicon Valley
Chicago	Milwaukee	Stamford
Dallas	Montreal	Toronto
Denver	Morristown	Vancouver
Detroit	New York	Washington, DC
Fredericton	Philadelphia	

Europe and Middle East

Abu Dhabi	Frankfurt	Padua
Amsterdam	Lisbon	Paris
Athens	London	Pesaro
Barcelona	Longford	Porto
Berlin	Luxembourg	Prague
Bilbao	Madrid	Rome
Birmingham	Manchester	St. Petersburg
Bologna	Milan	Turin
Channel Islands	Moscow	Warsaw
Dublin	Munich	

Asia-Pacific

Almaty	Shanghai
Bangalore	Shenzhen
Bangkok	Singapore
Beijing	Taipei
Guangzhou	Tokyo
Hong Kong	
Mumbai	
New Delhi	

Powering Sound Decisions

We Serve

62% of Fortune 100 companies

85% of Am Law 100 law firms

68% of the 25 largest Euro STOXX companies

72% of the 25 largest private equity firms in the PEI 300

72% of the 25 largest hedge funds in the Alpha Hedge Fund 100

We are the largest independent valuation advisory firm.

We Rank

#1 U.S. Fairness Opinion Provider¹

#1 Global Fairness Opinion Provider¹

#2 U.S. Middle Market M&A Advisor²

We Performed

Over **10,000** engagements in 2015 for more than **5,000** clients

Over **6,000** valuation advisory engagements in 2015 for more than **2,500** clients

Portfolio valuation advisory services for over **70%** of top-tier private equity firms in 2015

Over **1,000** Fairness and Solvency Opinions for **\$2 trillion** in deal value since 2005

1. Published in Thomson Reuters' "Full Year 2015 Mergers & Acquisitions Review." Duff & Phelps tied with Huatai Securities Co. Ltd. for #1 for Global Fairness Opinions.

2. Thomson Financial Securities Data (U.S. deals \$10M < \$250M). Full year 2015.

Enhancing Value

Across a Range of Expertise

Valuation	Corporate Finance	Disputes and Investigations	Tax Services	Compliance and Regulatory Consulting
Technical expertise and specialized support in the areas of complex valuation, alternative assets, real estate and fixed asset management	Objective guidance to management teams and stakeholders throughout restructuring, financing and M&A transactions, including independent transaction opinions	Financial analysis, consultation and expert testimony in the context of litigation, arbitration and mediation	Expertise in implementing tax solutions surrounding property tax, business incentives, transfer pricing and unclaimed property	Helping financial services firms navigate the compliance and regulatory landscape, mitigating risk throughout the business lifecycle

Our Services

Valuation

Valuation Advisory

Purchase Price Allocation
Goodwill and Intangible Asset Impairment
Impairment of Long-Lived assets
Tax Valuation
Intellectual Property Valuation
Transfer Pricing
Business Valuation
Contingent Asset and Liability Valuation
Fresh Start Accounting
Complex Securities Valuation
Strategic Value Advisory

Alternative Asset Advisory

Portfolio Valuation
Complex Asset Solutions

Real Estate Services

Real Estate Valuation and Consulting
Corporate Real Estate Services
Real Estate Restructuring
Collateral Valuation / Loan Services
Lease Renegotiation
Right of Way Appraisal
Cost Segregation
Underwriting Due Diligence

Fixed Asset Management and Insurance Solutions

Fixed Asset Inventory and Reconciliation
Property Record Outsourcing
Fixed Asset Componentization
Property Insurance Appraisal
Machinery and Equipment Valuation
IT Fixed Asset Inventory Services

Corporate Finance

M&A Advisory

Buy-Side and Sell-Side Advisory
Transaction Advisory Services
Private Placement of Debt and Equity
Financial Sponsor Coverage

Transaction Opinions

Fairness Opinions
Solvency Opinions
ESOP and ERISA Advisory
Commercially Reasonable Debt Opinions

Restructuring Advisory

Corporate Restructuring
Debt Advisory
Distressed M&A and Special Situations
Cayman Restructuring

Compliance and Regulatory Consulting

Compliance Consulting
Regulatory Consulting
Risk and Management Company Solutions
Hosted Regulatory Solution
Regulatory Tax Advisory
Business Services

Disputes and Investigations

Intellectual Property Disputes
Commercial and Shareholder Disputes
Complex Securities and Capital Markets Litigation
Fraud, Forensic and Investigative Services
M&A Purchase Price Disputes and Arbitration
Bankruptcy Litigation
Business Insurance Consulting
Monitoring Trustee Services
Forensic Technology and Analytics

Legal Management Consulting

Technology
Strategy and Operations
Information Governance

Tax Services

Property Tax Services
Business Incentives Advisory
Unclaimed Property and Tax Risk Advisory
Tax Litigation
Sales and Use Tax Services
Strategic Tax Advisory Review Services

Services Across the Transaction Lifecycle



For more information about our global locations and services, please visit:
www.duffandphelps.com

About Duff & Phelps

Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, dispute consulting, M&A and restructuring. The firm's more than 1,000 employees serve a diverse range of clients from offices in North America, Europe and Asia.

M&A advisory, capital raising and restructuring services in the United States are provided by Duff & Phelps Securities, LLC. Member FINRA/SIPC. Pagemill Partners is a Division of Duff & Phelps Securities, LLC. M&A advisory and capital raising services in the United Kingdom and Germany are provided by Duff & Phelps Securities Ltd., which is authorized and regulated by the Financial Conduct Authority.

Thank You!

- ◆ Participants will receive a copy of the slide deck and a recording of the Webinar tomorrow.
- ◆ This Webinar is part of our series with Duff & Phelps looking at issues and challenges in the valuation of private assets – more details can be found here:

<http://www.voltaireadvisors.com/voltaire-advisors-duff-and-phelps-private-assets-valuation-briefing-series.html>

- ◆ The next event is our Webinar on Valuation regulation on December 6th



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