
EXPOSURE DRAFT

Disclosure Framework for the Valuation of Financial Instruments and the Certified in Valuation of Financial Instruments (“CVFI”) Credential

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Prepared by the AICPA for comment from those whose duties involve the valuation of financial instruments, securities, and investments for regulatory reporting purposes.

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PREFACE

The purpose of this document is to provide a framework for the valuation professional, regarding performance requirements when engaged (in the case of independent third-party professionals) or assigned (in the case of internal professionals employed by a reporting entity) to provide fair value and other measurements of financial instruments and components thereof.

The Need for the Financial Instruments Framework

Global accounting standards, as well as requirements promulgated by other standard-setting bodies, increasingly call for measurements and disclosures that comply with a defined measurement objective. For example, fair value and “fair value-based” requirements promulgated by the FASB and IASB have particularly impacted the following areas:

- Financial instruments
- Share-based compensation
- Portfolio investments

Other regulatory bodies have contributed to this growing body, including:

- SEC: accounting and auditing
- PCAOB: auditing
- IAASB: auditing
- Basle: capital adequacy

Separately, there has been a long-term trend toward more complexity in the terms, conditions, and structure of financial instruments themselves, for many reasons:

- Financial institutions transacting in complex securities to facilitate customer/counterparty needs, as well as for their own account.
- Operating companies issuing complex instruments related to financing needs, compensation, hedging activities, and other purposes.
- Development stage and underperforming companies raising capital and issuing compensation with sophisticated structures that conserve cash.

This combination – increasing requirements with respect to a variety of measurement objectives, plus increasing complexity in the financial instruments themselves – leads to increasing measurement risks for reporting entities and auditors and increasing uncertainty for third-party investors who rely on the resulting financial information. Reporting entities, auditors, and valuation professionals operating in this environment must address the following concerns:

- Reporting entities
 - What instruments, and components thereof, must be measured/remeasured in compliance with a measurement objective?
 - What is the appropriate level of aggregation/disaggregation?
 - When may certain instruments or features be netted?
 - What disclosures must be made each reporting period?
 - What are the governance procedures and controls with respect to the valuation process?
 - What expertise is required to satisfy these requirements?
 - From internal specialists
 - From the independent audit firm
 - From third-party specialists
- Auditors
 - What are current best practices in valuation techniques?
 - What are the governance procedures and controls with respect to the valuation process?
 - What expertise does the audit team need?
 - What is the appropriate level of support required for measurements and disclosures?
 - What expertise does the client need to have or obtain?
- Valuation professionals
 - What is the regulatory environment for the measurement of financial instruments?
 - What are current best practices in valuation techniques?
 - What are the governance procedures and controls with respect to the valuation process?
 - What expertise does the valuation team need to have or obtain?
 - What is the appropriate level of support required for measurements and disclosures?
 - In the deliverable
 - In the workpapers

To repeat and further clarify, the purpose of this document is a subset of the concerns listed above: to provide a framework for the valuation professional, whether an employee of the reporting entity or a third-party specialist, regarding performance requirements when engaged to provide other measurements of financial instruments and components thereof. To distinguish the “performance” aspect of the valuation professional’s responsibilities from other requirements, the following definitions are employed:

Professional standards. Standards that encourage professional behavior. Examples are codes of ethics and codes of conduct that require acting competently, independently, objectively, and transparently. These can also be considered standards that define the qualities of a professional: ethical, independent, objective, having requisite

skills, educated, experienced, tested, trained, and credentialed or licensed. Professional standards focus on characteristics of individual professionals and their conduct.

Technical standards. Standards that address the how to of work that must be done to prepare a professional work product. These standards address the technical correctness of the work product by considering appropriate input factors, application of methods and techniques, and reporting guidelines. Both mandatory standards and voluntary guidance have been developed around technical issues in valuation in general and, to a lesser extent, around fair value and other measurement objectives.

Financial Instruments Framework. Contains requirements that cover how much work should be performed in order to prepare a professional work product. The Financial Instruments Framework addresses scope of work, extent of documentation and analysis, consideration of contrary evidence, and documentation in both the report and the supporting working papers. Alternatively, the Financial Instruments Framework establishes the extent to which valuation professionals perform their work in terms of depth of analysis and documentation. This aspect of a valuation professional’s responsibilities is defined as the “Disclosure Framework” herein.

Structure of the Disclosure Framework for the Valuation of Financial Instruments (DF-FI) and the Application of the DF-FI Sections

- Disclosure Framework
 - DF-FI section 1, Preamble, provides an overview of the framework’s scope and purpose (that is, who must adhere to it and when must it be followed).
 - DF-FI section 2, Valuation Engagement Guidance, establishes the parameters of the documentation requirements that valuation professionals must adhere to. For third-party valuation professionals, this includes the fundamental engagement considerations and scope of work that manifest themselves within the engagement letter, the extent of documentation requirements, and the professional skepticism required in the valuation process and in the reporting of any conclusions. For internal valuation professionals employed by reporting entities, the requirements related to engagement letters are replaced with requirements to document the nature and scope of the valuation assignment
 - DF-FI section 3, Disclosure Framework Glossary, sets forth definitions of terms that may be unique to the framework and, when necessary, defines their meaning within the context of the framework.
 - DF-FI section 4, Authoritative and Technical Guidance, includes a list of accounting standards, auditing standards, valuations standards, and certain technical literature applicable to the guidance presented in the framework:
 - The measurement objective standards are issued by regulators and accounting standard setters and are mandatory for their respective purposes.
 - The valuation standards issued by the valuation organizations (“VOs”) are mandatory only for their respective members. Nonmembers who practice in certain jurisdictions, specialty subject interests, or both should be aware that they may be required by national, state, or local laws or regulations to adhere to specified valuation standards promulgated by VOs or by non-membership organizations (for example, The Appraisal Foundation and the International Valuation Standards Council).

- The technical literature is nonauthoritative; however, these publications are prepared by professionals with in-depth knowledge of the topics and were broadly vetted by preparers and users of valuations and by auditors.
- Application of the Disclosure Framework for the CVFI (separate document)
 - Application of DF-FI section A1, General Valuation Guidance, applies the framework to selected areas of professional valuation practice that are misapplied or insufficiently supported or documented (or all) in valuations prepared in compliance with specific measurement objectives.
 - Application of DF-FI section A2, Financial Instrument Valuation Guidance, identifies and applies the framework to the most common components of an engagement in which the valuation professional provides a conclusion of value of a financial instrument. This section governs the scope of work and extent of documentation for selected areas associated with the valuation of financial instruments that are prepared in compliance with specific measurement, valuation, operational, regulatory, or commercial objectives. Specifically, this section addresses matters that need
 - greater consistency in the application of valuation approaches and methods,
 - support for issues that require the application of professional judgment, and
 - documentation of inputs.

These sections will continue to evolve and expand to cover a broader spectrum of subject matter topics and professional practice trends in the valuation profession.

By design, the framework and the Application of the DF-FI do not provide illustrative examples that might otherwise be interpreted as requirements for how to perform a valuation. The purpose of the framework is to provide valuation professionals with guidance on how much documentation is required when performing valuation services for financial reporting and other purposes. However, in certain circumstances, the Application of the DF-FI may provide some how-to discussion in order to complement the usability and application of the framework.

Scope of Adoption and Adherence by Valuation Professionals

The framework and the Application of the DF-FI were designed to be used by all valuation professionals who provide valuation services subject to one or more measurement objectives.

An overview of the scope of adoption and adherence by valuation professionals follows:

- Valuation professionals with the CVFI credential. It is mandatory for valuation professionals who have earned the CVFI credential to adhere to the framework and the Application of the DF-FI (collectively referred to as 'DF-FI documents') when engaged (or assigned if an employee) by (a) an entity required to submit registration statements or filings to a national regulatory authority (e.g. US SEC, UK PRA, etc.), (b) a privately held entity that prepares and issues financial statements in accordance with an accounting or regulatory standard, to perform a valuation of a financial instrument or component thereof used to support management's assertions made in financial statements or other reports .

- Valuation professionals without the CVFI credential. As noted previously, the framework and the Application of the DF-FI were designed for use by all valuation professionals. Although only those valuation professionals who have the CVFI credential are required to adhere to the DF-FI documents, the Financial Instruments Task Force believes that adhering to the DF-FI documents should be considered **best practice** by valuation professionals who do not have the CVFI credential and who perform valuations of financial instruments or components thereof used to support management assertions made in financial statements or other reports.

Important: All Financial Instruments Framework requirements that are specific to CVFI credential holders will be identified as such throughout the framework.

Conclusion

Valuations for financial reporting and other purposes completed in a professional manner require adherence to a consistent set of professional, technical, and ethical standards as well as a set of guiding principles that help define how much work is necessary in order to provide supportable and auditable measurements that serve as the basis for management's preparation of financial statements for financial reporting and other purposes.

1. FRAMEWORK INTRODUCTION

1.1 The Financial Instruments Disclosure Framework (DF-FI or framework) is a document for valuation professionals that provides guidance on how much support, in terms of scope of work and documentation, should be prepared or obtained when designing, implementing, and conducting valuations of financial instruments used for management assertions made in financial statements or other reports issued for financial reporting or other purposes.

1.2 Financial statements issued for financial reporting purposes include, but are not limited to, financial reports issued by the following:

1.2.1 entities required to submit registration statements or filings to the SEC or similar international regulatory authorities

1.2.2 privately held entities that prepare and issue financial statements in accordance with United States generally accepted accounting principles (U.S. GAAP) or IFRS

1.2.3 any other engagement where the individual is performing services as a valuation professional

Important: If a CVFI credential holder is engaged by a privately held entity that does not issue financial statements or other reports in accordance with U.S. GAAP, IFRS or other global standards (for example, financial statements issued in accordance with special purpose frameworks), the CVFI credential holder **should** follow the DF-FI documents for the engagement or assignment; however, if the CVFI credential holder elects not to follow the DF-FI documents, this fact and rationale must be prominently displayed in the final valuation report.

1.3 The primary goal of the framework is to provide valuation professionals with parameters of how much work should be performed and how to effectively and efficiently identify valuation documentation requirements in order to meet the changing needs of clients, employers and other potential stakeholders, mitigate engagement or assignment risk, and support and document sound decision making. This framework is a set of interrelated and interacting elements that valuation professionals can use in conjunction with relevant valuation standards and technical guidance to promote quality, consistency, and auditability. The framework is not intended to address valuation theory or to be a how-to guide regarding valuation steps.

1.4 Written documentation within the engagement file that supports a final conclusion of value (referenced in the framework as working papers) and the final valuation report will be referenced collectively as the **work file** unless otherwise specified.

1.4.1 The framework 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 or assignment could review and understand the significant inputs, analyses, and outputs and how they support the final conclusion of value

1.4.2 The valuation professional should include sufficient documentation to support a conclusion of value as identified in DF-FI section 1.4.1 within the final valuation report.

1.4.3 The framework sets forth minimum scope of work and documentation requirements for valuation professionals. Circumstances in which a valuation professional has agreed to comply with more stringent scope of work and documentation requirements are not restricted or negated by this framework.

1.5 CVFI credential holders who perform **valuation services** for their clients or employers, or as part of another engagement, are required to adhere to the framework for financial reporting or other regulatory purposes.

Important: CVFI credential holders who are employees of an entity that is required to prepare financial statements issued for financial reporting or other purposes (subsequently referenced as a reporting entity), and who are responsible for preparing conclusions of value that provide support for information included in the financial statements and accompanying footnotes, are required to comply with this framework. However, for such situations, certain administrative matters such as formal letters of engagement (LoE) are excluded, and the communication of value conclusions **may** not include a formal valuation report.

If a CVFI credential holder who is an employee of a reporting entity concludes that a section (or sections) of the framework is (or are) not applicable because of his or her employment at the reporting entity, the valuation professional may elect not to comply with the identified sections of the framework. The valuation professional **must**, however, document in the work file which sections of the framework were not complied with and the rationale for the noncompliance.

1.6 The valuation profession uses a broad spectrum of approaches and methods when conducting a valuation. Therefore, in circumstances in which the extent of research and analysis, documentation, or both, related to a valuation approach or method is not addressed by the framework, the valuation professional should look to the framework for analogous guidance considered to be the most appropriate for the engagement's or assignment's relevant facts and circumstances.

1.7 For the valuation professional, this framework provides the following:

1.7.1 A method to align a valuation engagement or assignment with procedures that will meet the needs of the client/employer and other potential stakeholders in response to the greater focus by regulators on valuations subject to one or more measurement objectives

1.7.2 A resource to help identify and mitigate ineffective, inefficient, or incomplete valuation procedures that result in insufficient support for, and auditability of, the final conclusion of value

1.7.3 A resource for the valuation review process

1.8 For the reporting entity's management, auditors, and external stakeholders, the use of the framework promotes the following:

1.8.1 Greater confidence in the valuation professional's ability to assist the company in meeting the entity's internal and external reporting requirements

- 1.8.2 Greater confidence in the valuation professional's application of an acceptable process of evaluation, analysis, and documentation of measurements that may serve as a basis for management's financial statement or other assertions
- 1.8.3 Greater understanding of the valuation professional's use of judgment, estimates, and industry knowledge
- 1.8.4 Greater consistency in how much documentation is prepared among valuation professionals

Applicable FI Valuation Standards

1.9 As the valuation profession has grown, so too has the need for augmented consistency and quality in the profession. The valuation standards identified in the following list represent standards that are voluntary in nature to the extent that valuation professionals elect to abide by these standards through the types of engagements or assignments they undertake and the organizations they align with. Valuation organizations are referenced in the framework as VOs.

Relevant Accounting and Audit Standards Applicable to Financial Instruments Valuation

1.10 Due to the interrelated nature of valuation engagements and accounting standards, valuation professionals must, where applicable and necessary, understand the relevant accounting standards that may dictate the scope of work to be performed.

This includes instances in which international accounting standards issued by the International Accounting Standards Board (IASB) and other global standard setters may be incorporated into financial statements prepared for financial reporting purposes. Both U.S. and international accounting standards can impact the nature, timing, and scope of a valuation professional's work.

Valuation professionals must also be aware of auditing standards that the audit profession uses as guidance when conducting an audit of financial statements prepared for financial reporting.

A list of important accounting and auditing standards relevant to the valuation of financial instruments is provided in DF-FI section 4, Authoritative and Technical Guidance.

Scope of the Disclosure Framework

1.11 The term **engagement or assignment to estimate value consistent with a specified measurement objective** refers to any engagement, assignment, or part thereof that involves estimating the value of financial instruments (subsequently referenced individually or collectively as **subject interest**) to serve as a basis for management's preparation of financial statements or other reports consistent with one or more measurement objectives. An engagement or assignment to estimate value consistent with a measurement objective culminates in a written conclusion of value.

1.12 Valuation professionals should be aware of any governmental regulations and other professional standards applicable to engagements or assignments to estimate value (or applicable to valuation professionals when they are performing such engagements or assignments). Compliance is the responsibility of the valuation professional.

Exceptions to the Disclosure Framework

1.13 If any part of this framework conflicts with a published governmental, judicial, or accounting authority, then the valuation professional should follow the applicable published authority or stated procedures with respect to the part applicable to the valuation in which the valuation professional is engaged or assigned. The other parts of this framework continue in full force and effect. If a published governmental, judicial, or accounting authority differs in that it simply requires less than this framework, then the requirements of this framework still must be met.

2. VALUATION ENGAGEMENT GUIDANCE

Overview

2.1 As the valuation profession has evolved, valuation firms and VOs have developed various engagement processes and procedures for engagement acceptance, many of which are applicable to valuations prepared for financial reporting purposes (see DF-FI section 1.2 for definition).

2.2 The following sections will address the framework's requirements for third-party valuation professionals engaged to perform valuations that are prepared to serve as a basis for management's financial statement or other assertions. Many of these requirements will also be applicable to internal valuation professionals ("IVP") assigned to perform valuations for employers; specific requirements that are not applicable to such assignments will be identified.

Documentation Requirements for Valuation Engagements

2.3 The valuation professional must conduct and document each engagement or part of an engagement to estimate the value of a subject interest in compliance with one or more measurement objectives in accordance with the applicable guidance within this framework.

Composition of Valuation Documentation

2.4 Documentation is the written record within the final valuation report, supporting working papers, or both, used to support a valuation conclusion used by management in their assertions of value and their preparation of financial statements or other reports.

2.5 Appropriate documentation provides evidence that the valuation engagement was completed in accordance with this framework.

2.6 Written documentation may include paper, electronic files, or other forms of recorded media. Examples include, but are not limited to, letters of engagement (not applicable to IVPs), correspondence with clients or employers (for example, email, recordings of calls, voice messages), client- or employer-provided documents, representation letters, field notes, electronic spreadsheets, and internally prepared memoranda to the work file.

2.7 Documentation comprises two key components:

2.7.1 **Source documents** include, but are not limited to, data and information (including interview notes)

collected from both company sources and external third-party data accumulation resources relating to the company, its financial position, its competitors, the industry it competes in, its customers and suppliers, the state of the economy, financial markets, and risk factors.

2.7.2 **Analysis documents** include, but are not limited to, exhibits, schedules, and working papers that numerically set forth the analysis that was performed, and memos to file or other narratives that document and explain the valuation professional's reasoning behind such matters as the selection of methods, selection of inputs used in applying methods, and judgments made regarding valuation assumptions.

2.8 Source documents should be included in the work file to the extent that they provide evidential support to an input, process, or output required to arrive at a conclusion of value.

2.8.1 Identification of source documents, data, and/or specific selection criteria used to identify information used to support the final valuation report (or valuation conclusion in the case of an IVP not issuing a formal report) is appropriate when inclusion of source documents in the work file is not feasible or practicable (for example, all 10K filings for a particular industry, historical risk free rates for the last 30 years).

2.8.2 Source documents that are relevant to the analysis and indicate contrary evidence to the conclusion of value, along with the valuation professional's explanation of how this information was considered, should be included in the final valuation report. This section is inapplicable to IVPs that are not issuing a formal report) (and such source documentation should be identified in accordance with DF-FI section 2.8.1 if not included in the work file because not feasible or practicable to do so).

2.9 Analysis documents generally fall into two subcategories:

2.9.1 Computational analysis (for example, spreadsheets, database use). To the extent that this type of analysis provides evidential support (or contradictory indications) to an input, process, or output, it is required to be included in the work file (that is, supporting work papers, final valuation report if applicable). This analysis demonstrates "what" the valuation professional did and how they did it.

2.9.2 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 the following (this list is not all-inclusive):

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

Extent of Documentation Requirements

2.10 The valuation professional must support the conclusion of value with sufficient detail to provide a clear and well-organized link from the data and information gathered to the final conclusion of value. An experienced professional (note: who may or may not be a valuation professional) reviewing the final valuation report or conclusion who has no involvement with the engagement or assignment must be able to do the following:

2.10.1 Identify subject financial instrument(s) and/or components thereof.

- 2.10.2 Understand the standard of value.
- 2.10.3 Understand the purpose, nature, extent, and results of the valuation procedures performed.
- 2.10.4 Understand all approaches and methods used in the valuation analysis and, if applicable, understand why commonly used approaches and methods were not used in the valuation analysis.
- 2.10.5 Understand the inputs, judgments, and assumptions made and the rationale for their use.
- 2.10.6 Identify relevant market information used (trades, broker quotes, comparable transactions, indices, etc.)
- 2.10.7 Understand key risk factors considered (credit risk, exposure and controls, sensitivity testing, etc.)
- 2.10.8 Determine who performed the work and their qualifications (for example, valuation professional, subcontractor, management).
- 2.10.9 Identify the intended users of the valuation report or conclusion.
- 2.10.10 Identify the sources and supporting data for the inputs, judgments, and assumptions made.
- 2.10.11 Identify the measurement date.

2.11 When considering the extent of documentation to support a conclusion of value, the valuation professional should consider the following:

- 2.11.1 The significance the data or information has on the conclusion of value
- 2.11.2 The risk of management bias affecting the conclusion of value
- 2.11.3 The risk that insufficient documentation may result in a misunderstood conclusion of value
- 2.11.4 The degree of judgment required by the valuation professional to prepare information used to estimate the conclusion of value
- 2.11.5 The reasonableness or appropriateness of the approaches and methods used to estimate the value of the subject interest in compliance with the specified measurement objective

Professionalism and Professional Competence

2.12 A valuation professional, prior to accepting an engagement or assignment, must conclude that he or she can reasonably expect to complete the engagement or assignment with professional competence that includes adherence to the framework.

A valuation professional must be able to demonstrate, at a minimum, the fulfillment of the following criteria:

- 2.12.1 The appropriate academic and professional qualifications demonstrating technical competence
- 2.12.2 The appropriate level of experience, including specific industry and measurement objective

valuation experience, to identify the problem to be addressed

2.12.3 The appropriate level of experience in valuing the subject interest and in completing engagements or assignments for a similar purpose

2.12.4 Recognition of and compliance with applicable local laws and regulations that apply to the valuation engagement/assignment or valuation professional

2.12.5 For CVFI credential holders, professional competence also includes compliance with the CVFI requirements for education, qualifications, and quality control, and adherence to the framework and the Application of the DF-FI.

2.13 If a valuation professional determines prior to accepting an engagement/assignment, or during the course of an engagement/assignment, that he or she does not have the required level of subject interest expertise to competently complete the engagement/assignment, the following steps should be considered:

2.13.1 When possible, assemble and use appropriately competent and qualified subject interest specialists within the professional's firm or company.

2.13.2 Retain an appropriately competent and qualified subcontractor.

2.13.3 Do not accept the engagement/assignment, or withdraw from the engagement/assignment if already accepted.

2.14 Subcontractors. A subcontractor is defined as a third party outside of the organization of the valuation professional contracted to perform work in support of the valuation. If a subcontractor is used to either (a) assist with work the valuation professional is professionally competent to do but unable to do (for example, because of time or geographic constraints) or (b) assist with work the valuation professional is not professionally competent to do (for example, because he or she is an expert in a niche field or very technical subject matter), the valuation professional must do the following:

2.14.1 Provide written notification to and obtain written approval from the client (for example, this may be done within the LoE, in an addendum to the LoE if the need for a subcontractor identified after the initial LoE is executed, or by email). This is not applicable to IVPs.

2.14.2 Document in the report or conclusion the level of responsibility, if any, being assumed by the primary valuation professional and, if applicable, the subcontractor.

2.14.3 Assemble and evaluate relevant information from the retained subcontractor and retain such relevant information and interpretation in the work file. Whether or not the valuation professional is professionally competent to do the work of the subcontractor will determine the level of responsibility assumed by the valuation professional and the amount of documentation required by the framework. These requirements are as follows:

1. Valuation professionals who retain subcontractors must evaluate all such subcontractors' contributions (see DF-FI sections 2.10 and 2.11). If necessary, the valuation professional should prepare supplemental documentation and analysis to complement the subcontractor's work product to ensure the valuation professional's work file complies with the framework.

2. Valuation professionals who retain subcontractors to perform valuation services the valuation professional responsible for the valuation engagement or assignment (or his or her firm) is not professionally competent to do must not take responsibility for the subcontractor’s work and must provide adequate disclosure of subcontractor participation in the final valuation report or conclusion (see “The Valuation Report” at DF-FI section 2.24 and “Content of the Final Valuation Report” at DF-FI section 2.27)

Important: The valuation professional who retains a subcontractor to assist with work the valuation professional is professionally competent to do but is unable to do is responsible for all aspects of the subcontracted valuation that will be included in the work file. Furthermore, the valuation professional who retains a subcontractor in this capacity must retain the subcontractor’s report and, to the extent possible, the subcontractor’s work papers in the work file.

Valuation professionals who retain subcontractors to assist with valuation services outside of the valuation professional’s area of expertise must establish a reasonable basis for the decision to rely on the subcontractor’s work. This includes evaluating and concluding that the subcontractor performing the work is competent. For example, the valuation professional may use the criteria in DF-FI section 2.12 to evaluate the subcontractor’s professionalism and professional competence and DF-FI sections 2.10 and 2.11 to determine if the subcontractor’s work product is sufficiently documented to support his or her conclusion of value.

2.15 The framework’s requirements for professionalism and professional competence are adhered to when the valuation professional taking responsibility for the analyses and conclusion of value ensures that all contributing valuation professionals have followed the framework and Application of the Disclosure Framework for Financial Instruments.

Important: CVFI credential holders who sign the final valuation report (if applicable) must comply with reporting requirements required by DF-FI section 2.27.22.

Professional Skepticism

2.16 Professional skepticism is an attitude that includes a questioning mind and critical assessment of valuation evidence. The valuation professional uses the knowledge, skill, and ability called for by the valuation profession to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence.

Every valuation professional must exercise professional skepticism during each engagement or assignment where the valuation professional is providing a conclusion of value that will be used to support management’s assertions in financial statements or other reports issued in compliance with a measurement objective.

2.17 Professional skepticism requires that the valuation professional have an attitude that emphasizes the following:

- 2.17.1 **Evidential skepticism.** Valuation professionals must exercise due professional care by regularly

questioning and critiquing all information and data with the appropriate level of skepticism. The level of skepticism should be based on the potential for bias within the information and data (for example, multiple sources of external corroboration versus a management-generated estimate with no external corroborating support).

Important: When evaluating management-generated and management-provided information, the valuation professional must consider the experience of management and the sufficiency of the documentation and analyses provided by management throughout the valuation engagement. The valuation professional should not presume management is biased; however, the valuation professional should not accept and rely on less-than-persuasive evidence because the valuation professional believes management is unbiased. This requirement extends to third-party specialists retained by management, their competence, and the sufficiency of their work product.

2.17.2 **Self-skepticism.** The valuation professional must regularly monitor his or her own client- or employer-based presuppositions that could detract from evidencing skepticism as a result of comfort level or familiarity with the client/employer, industry, or both.

2.18 Each valuation professional must implement a degree of professional skepticism with the expectation that the conclusions reached will be subjected to review (for example, by the client, external auditors, regulators).

Code of Ethics

2.19 All financial instrument valuation professionals must follow the AICPA code of ethics.

Types of Engagements (Third-Party Valuation Professionals and Assignments (IVPs))

2.20 In general, valuation engagements and assignments include analyses that are either (a) complete or (b) limited as it relates to the extent of research and analysis included in the valuation report or conclusion. Also, valuation reports (not applicable to IVPs) can be very detailed or quite brief.

A **complete valuation analysis** results in a conclusion of value by the valuation professional after having considered and evaluated all relevant factors. The valuation professional uses **professional judgment** to determine which valuation approaches and methods, and what amount of documentation, are appropriate based on the facts and circumstances of each engagement or assignment.

Engagements or assignments performed for purposes of compliance with one or more measurement objectives must include a complete valuation analysis that conforms to the framework requirements, but the report type can vary according to the requirements of the engagement. As discussed herein, IVPs are not required to issue formal reports; however, the requirements in the following sections that are separable from reporting requirements, such as the extent of the valuation professional's analysis or the contents of the work file, apply to IVPs.

2.20.1 For each engagement, valuation professionals must prepare either a **comprehensive valuation report** or an **abbreviated valuation report**. Valuation professionals must prepare a valuation report that is sufficiently detailed to serve as a basis for management's assertions with respect to the relevant measurement objective, with the

understanding that the sufficiency of the conclusions reached in the report may be subject to regulatory scrutiny and subject to audit procedures in accordance with generally accepted auditing standards within the context of an overall audit of the entity's financial statements.

2.20.2 In order to enhance auditability, the valuation professional must prepare the work file in alignment with the framework to ensure sufficient detail exists to support the conclusion of value. Therefore, the valuation professional must determine, based on the facts and circumstances of the engagement to estimate fair value, whether to prepare

- a comprehensive valuation report that provides sufficient information for the intended users or expected recipients of the report to identify the data, analyses, assumptions, models and rationale used by the valuation professional in order to arrive at a conclusion of value as prescribed in DF-FI section 2.27; or
- an abbreviated valuation report that condenses the requirements of a comprehensive valuation report based on criteria agreed upon by the client and the valuation professional. Although an abbreviated valuation report may not contain sufficient details for the intended users or expected recipients to understand all of the data, analyses, assumptions, models and rationales used to support the conclusion of value, valuation professionals must conduct a complete valuation analysis

Regardless of the type of valuation report that will be issued, the valuation professional must include the analysis and accompanying explanatory narrative for all internally prepared analyses, findings, and conclusions within the work file. This documentation may take the form of internally prepared memoranda or a narrative that will be used to develop the valuation report.

2.20.3 If the valuation professional has reason to believe the results of a limited analysis or calculation engagement (or assignment in the case of an IVP) will be inappropriate for management's intended use of the analyses and report, the valuation professional must either:

- A) Indicate to the client or management that the calculation will be inappropriate to the intended use of the analysis, and agree with the client or management to create a report that would be appropriate to the intended use (either in addition to or in the place of the original report, as agreed), or
- B) Decline the engagement, or
- C) Prominently note the reason(s) for believing the report will be inappropriate for the intended use.

Important: If a valuation professional accepts a client engagement or employer assignment that will result in a limited analysis or calculation engagement/assignment, the LoE and final valuation report (this includes any work product intended for client use) must *prominently state that the analyses and final valuation report (if applicable) do not meet the requirements of the framework and the Application of the DF-FI and specifically identify the scope of the engagement or assignment.* This includes identifying which sections of the framework and Application of the DF-FI have not been complied with. In these circumstances, valuation professionals must use the criteria presented in DF-FI sections 2.27.11 and 2.27.12 (and 2.27.13 when applicable) for purposes of disclosures within the final valuation report (if applicable).

2.20.4 As part of the complete valuation analysis, valuation professionals may retain subcontractors to assist with outsourced components of their analyses. Such components may be complete or limited analyses, or calculations that the valuation professionals will specify as such and then incorporate into their complete valuation analysis, conclusions of value, and final valuation report. The valuation professional who retained the subcontractor must adhere to the professionalism and documentation requirements in DF-FI sections 2.14 and 2.27, respectively.

Engagement Letter (Applies to External Engagements)

2.21 When valuation professionals are engaged by an entity, firm, or individual **other than their employer** (that is, for engagements other than internal engagements) they must obtain a signed LoE for every engagement that results in the valuation professional providing a conclusion of value. The LoE establishes the nature, timing, and scope of the agreed-upon valuation assignment. The facts and circumstances of each valuation engagement will dictate the content of the LoE. An executed LoE between the valuation professional and the client must contain the following components (to the extent they are applicable):

2.21.1 Identification of the client. The LoE must identify the client that has contracted for the valuation services. If there are several clients (that is, more than one), the LoE must identify all clients to the engagement.

2.21.2 Type of report. The LoE must clearly state the type of report that will be prepared for the engagement (see DF-FI section 2.20 for description of the most common reports, and refer to valuation standards for specific report types).

2.21.3 Scope of work. The LoE must clearly state the scope of work to be completed by the valuation professional in compliance with this framework. This includes, but is not limited to,

- whether the report will be prepared in accordance with the DF-FI and Application of the DF-FI;
- using the appropriate level of professional judgment to avoid errors of omission; and
- limiting or omitting otherwise relevant components of a typical scope of work by agreement with the client (for example, accepting management's estimate of volatility).

2.21.4 Client responsibility. The LoE must establish identifiable and actionable client responsibilities when those responsibilities have a significant impact on the valuation professional's procedures and conclusion of value. For example, client responsibilities might include providing complete and accurate financial records and data; appropriate and sufficient access to the client's personnel and records; appropriate and sufficient access to the client's facilities, to the extent it is relevant for the valuation procedures; and well-documented and supported prospective financial information.

2.21.5 Identification of the intended use of the report. The LoE must clearly state the intended use of the valuation analysis and report that will be prepared by the valuation professional. The report is valid only for that stated purpose or use (for example, additional support for management’s fair value disclosures in the entity’s financial report).

2.21.6 Identification of the intended users and expected recipients. The intended user of the report will generally be the client of record and may include other parties specifically identified as addressees in the LoE and the subsequent report. The client may share the LoE and report with additional expected recipients of the report including its advisers (for example, auditors or attorneys) in conjunction with the client’s intended use of the valuation as specified within the LoE. Additional non-clients may subsequently be added as intended users based on a contractual agreement between the valuation professional and client.

2.21.7 Measurement date for the valuation engagement. The LoE must clearly state the measurement date (also known as the “valuation date,” “as of date,” or “effective date”) for the valuation engagement (if known by the client when the LoE is presented to and signed by the client). If the measurement date is not known with certainty when the LoE is presented to and signed by the client, the LoE may state that the measurement date is to be determined.

2.21.8 Standard of value. The LoE must include the applicable standard of value and its definition. This aligns client expectations with the nature and extent of valuation services to be performed.

2.21.9 Premise of value, if applicable.

2.21.10 Description and (if relevant) listing of the financial instruments and components thereof that are to be valued. The LoE must identify and describe the financial instruments and components thereof that are expected to be valued. It is acceptable for the LoE to state that modifications to the identified subject interests may be made as the modifications are identified during the engagement as additional information becomes known.

2.21.11 Fee, timing, and deliverable. The LoE should address the fee, timing of the valuation, delivery of any interim or draft conclusions, and the delivery of a final valuation report. (Note: The timing of the engagement should include adequate time for the valuation professional to conduct the appropriate scope of work; this should include time to access members of management for interviews and in-person meetings [see section 2.23], and should allow for sufficient time for self-review, internal review, and auditor review.)

2.21.12 Known assumptions or limiting conditions. To the extent that any known and relevant assumptions, including extraordinary or hypothetical assumptions, or limiting conditions will be used in the valuation, they must be included in the LoE to make the client aware of the potential impact on the engagement (for example, conclusions that might otherwise be different). For any known and relevant assumptions, extraordinary or hypothetical assumptions, or limiting conditions that are developed during the engagement, the valuation professional must receive from or provide to management written confirmation of the new or modified information and disclose this information in the written report.

2.22 In addition to the required elements of an LoE, the valuation professional should consider

supplementing the LoE with components that further improve the understanding with the client. Examples include the following:

2.22.1 Approach and method. The LoE may contain a description of the valuation approach(es), method(s), or both that will be considered and applied to each of the subject interests during the valuation engagement.

2.22.2 Firm-specific terms and conditions. Valuation professionals may incorporate their firm-specific contractual terms and conditions that address various risk management matters such as indemnification, and so forth.

Although the requirements described above with respect to engagement letters do not directly apply to the assignments of IVPs, a number of these items should be documented in the work file:

- Scope of work (and any employer-related limitations)
- Intended use and users of valuation conclusions
- Measurement date, standard, and premise of value
- Description of subject financial instruments and components thereof
- Known assumptions or limiting conditions

Management Interviews

2.23 The valuation professional should conduct management interviews with the appropriate parties. The valuation professional should document the following (at a minimum):

1. The date of the interview
2. Who conducted the interview
3. Which members of management were interviewed (and the role or responsibility of each person interviewed, time, and location of each interview)
4. Notes regarding the questions and related responses (field notes)
5. Which facilities were visited (if applicable) and their locations
6. Any other relevant content discussed and observations made during the interview

The Valuation Report (Applies to External Engagements)

2.24 The final valuation report represents the planning, execution, and conclusion of the valuation professional's services for a client. For purposes of the framework, valuation professionals must prepare their work file, which includes the final valuation report, in accordance with the guidance provided in this section for all engagements to estimate fair value used to support management assertions made in financial statements issued for financial reporting purposes.

2.25 This section provides valuation professionals with a threshold for the minimum amount of information

required in their final valuation report to the extent the components are applicable and relevant. The substance and style of valuation reports may differ substantially depending on the specific requirements of an engagement, the purpose or intended use of the valuation, and whether the report is prepared for an otherwise unrelated client or prepared internally for or by management.

2.26 The final valuation report should be organized and written so that the intended users and other expected recipients can readily understand the analyses, narrative-based documents, and any exhibits that are included in the final valuation report.

Important: As noted in DF-FI section 2.20.2, if the valuation professional is engaged to provide valuation services and prepare a valuation report with supporting analyses and documentation that do not comply with the framework and Application of the DF-FI, the valuation professional must prominently state in the final valuation report that the analyses and final valuation report do not meet the requirements of the framework and the Application of the DF-FI and specifically identify the scope of the engagement. This includes identifying which sections of the framework and Application of the DF-FI have not been complied with. In these circumstances, valuation professionals must use the criteria presented in DF-FI sections 2.27.11 and 2.27.12 (and 2.27.13 when applicable) for purposes of disclosures within the final valuation report.

Content of the Final Valuation Report

2.27 In order for a comprehensive valuation report to be prepared in accordance with this framework, the valuation professional must, at a minimum, include the following components, where relevant, within the final valuation report:

2.27.1 Client identification. The valuation report must clearly identify the client.

2.27.2 Purpose and intended use of the valuation report. The valuation report must clearly state why the valuation is needed and how the valuation report will be used (for example, “The valuation report was prepared to assist the client with its financial reporting requirements pursuant to ASC 815 as of the measurement date.”). It is not acceptable for the purpose to be devoid of the intended use of the valuation (note: an example of this is, “The purpose of the valuation report is to estimate the fair value of the identified assets.”).

Important: If a CVFI credential holder elects not to adhere to the DF-FI documents, this fact must be prominently disclosed in the final valuation report.

2.27.3 Intended users of the valuation report. Each intended user that will have authorized access to use, review, or rely on the contents of the final valuation report for its intended use must be clearly identified within the report. When the intended user is an entity, the term intended users may include the company’s executives, board of directors, and management. In addition, the entity’s external advisers with respect to the intended use of the valuation report may be expected recipients (for example, the entity’s external auditors and legal counsel).

2.27.4 Measurement date. The measurement date (also known as the “valuation date,” “as of date,” or “effective date”) is the point in time used by the valuation professional to estimate the subject interest’s value in compliance with the measurement objective. This is not the same as the “valuation report date,” or “date of report issuance,” that is typically subsequent to the measurement date.

2.27.5 Valuation report date. This is the date the final valuation report is signed and issued by the valuation professional or firm and delivered to the client.

2.27.6 Identification of the subject interest. The description of the subject interest must be specific enough for the intended users of the valuation report to easily identify the subject interest being valued. This description should include any significant legal rights, restrictions, or entity obligations associated with the subject interest.

2.27.7 Sources of information. The valuation report must identify sources of information with sufficient detail to allow an experienced professional to independently identify all relevant sources of internal and external, client or non-client information used to estimate the value of the subject interest.

2.27.8 Client-prepared information. Valuation professionals must use their professional skepticism and judgment to assess the relevance and reliability of any client-prepared information and the extent to which they will rely on the information in the assessment of fair value. Valuation professionals must describe the information they relied on and the rationale for the reliance (Note: the description of the client-prepared information may be very general, such as “all interest rate swaps,” or very specific, such as “schedule of expected future preferred stock financing dates and amounts”).

2.27.9 Valuation approaches, methods, and techniques. Each valuation approach and related valuation method considered and used must be clearly described along with a corresponding rationale for the selection of the method used. This should include a clear description of the valuation professional’s consideration of each valuation approach and why (or why not) it was (or was not) selected. This should also include, where appropriate, the rationale for deviation from common practice within the valuation profession and why the more common approach and method were not chosen.

2.27.10 Limitations on the scope of research and analysis. In circumstances in which the valuation professional does not have access to information that is significant and relevant to a conclusion of value, the valuation professional must determine whether to continue with the engagement or withdraw from the engagement. The valuation professional should assess whether the imposed limitations are significant enough that they result in a change of scope for the engagement. If the valuation professional determines a change in scope for the engagement has, in fact, occurred he or she must evaluate the impact based on the criteria in DF-FI section 2.27.13.

Important: An example might include direction by the client to not utilize secondary market transactions. If such transactions would normally result in an adjustment to the concluded value, the valuation professional should advise the client of this during the engagement contracting process. If the client insists that secondary market transactions be ignored, the valuation professional must decide whether to (a) withdraw from the engagement or (b) prominently

disclose in the report that the scope was limited at the direction of the client, and had the secondary market transactions been given appropriate weighting, this would affect the fair value of the other subject interests.

2.27.11 Disclosure of limitations. If the valuation professional elects to continue with the engagement, he or she must clearly disclose in the valuation report, at a minimum:

1. the limitations placed on the extent of research and analysis and the circumstances for the limitations and
2. a statement that the limitation might have affected the conclusion of value, and the possible directional impact on that conclusion if known.

2.27.12 Disclosure of scope changes. The valuation professional must prominently disclose a change of scope that reduces the level of service as compared to what was agreed upon in the executed LoE (for example, an engagement to perform a complete valuation analysis reduced to a limited-scope engagement or calculation procedures), and the valuation professional's conclusion of value will still be used to support management assertions made in financial statements issued for financial reporting purposes.

The valuation professional must evaluate the impact of the reduced level of service to the client and whether the valuation professional is able to conduct the engagement in accordance with the framework requirements. In circumstances in which the valuation professional believes the reduced level of service precludes him or her from complying with the framework and Application of the DF-FI requirements, the valuation professional must either

- a. withdraw from the engagement or
- b. continue providing valuation services to the client and
 - i. obtain a new LoE or amend the original LoE and
 - ii. issue a report (this includes any work product intended for client use) that prominently states the analyses and report do not meet the requirements of the framework and Application of the DF-FI.

2.27.13 Financial information adjustments. When the valuation professional adjusts or changes the client's financial information (for example, restated historical financial statements, PFI), he or she must disclose in the final valuation report, at a minimum,

1. the amount (e.g. in currency units, basis points, volatility, etc.), as a level and/or as a percentage, of each adjustment or change and
2. the rationale for the adjustment or change.

2.27.14 Significant assumptions and estimates—documentation requirements. For the valuation report to be prepared in accordance with this framework, the valuation professional must ensure that the valuation documentation identifies (a) each significant assumption, (b) the person, persons, or firm responsible for developing the assumption, (c) the rationale for using the assumption, and (d) how the assumption supports the conclusion of value.

Important: The decision to categorize an assumption or estimate as significant must be based on professional judgment and communication with management and, where appropriate, communication and input from subcontractors (retained by valuation professional) or third-party specialists (retained by management).

2.27.15 Subcontractors with subject interest expertise retained by valuation professional. When a subcontractor has been retained by a valuation professional because the valuation professional does not have the required level of subject interest expertise to competently complete the engagement, the valuation professional must identify the subcontractor's work and conclusions in the final valuation report. In addition, the final valuation report must indicate that the valuation professional has relied on the subcontractor's work but has not assumed any responsibility for the work due to the professional's lack of subject interest expertise.

Important: For subcontracted valuation assignments outside of the valuation professional's area of expertise, the valuation professional must establish a reasonable basis for the decision to rely on the subcontractor's work. This includes evaluating and concluding that the subcontractor performing the work is competent. For example, the valuation professional may use the criteria in DF-FI section 2.12 to evaluate the subcontractor's professionalism and professional competence and DF-FI sections 2.10 and 2.11 to determine whether the subcontractor's work product is sufficiently documented to support his or her conclusion of value.

2.27.16 Third-party specialist retained by client. When a client retains a third-party specialist to separately value certain assets (for example, common stock) the valuation professional may include the third-party specialist's conclusion by reference or include the report of the third-party specialist in the written report of the valuation professional (with the third-party specialist's consent).

2.27.17 Reliance on conclusions of third-party specialist retained by client. When the valuation professional relies on other client-provided information (this includes information prepared by third-party specialists retained by the client) and does not assess or evaluate it for reasonableness (for example, does not have the subject matter expertise to evaluate and does not retain a subject matter expert to evaluate), the valuation professional must clearly describe in the valuation documentation the information he or she relied on and the rationale for the reliance.

Important: Valuation professionals should use professional judgment to determine if the work provided by the third-party specialist requires review and evaluation by a subcontractor with subject matter expertise if the valuation professional is not professionally competent to review and evaluate the third-party specialist's work.

2.27.18 Conclusion of value. The final report must include a conclusion of value that is consistent with the stated purpose of the engagement.

2.27.19 Valuation report representation and signature for valuation professionals who do not have the CVFI credential. The final valuation report that is delivered to the client must contain the signature of at least one valuation professional who will take responsibility for the reported analyses and conclusions of value. The final valuation report should include the following:

1. A professional summary (for example, academic background, professional experience, subject matter expertise, credentials held) of valuation professionals who have undertaken or contributed to the valuation engagement
2. A representation that the final valuation report and supporting analyses and underlying documentation was prepared in compliance with this framework and the Application of the DF-FI
3. Signatures of all valuation professionals who take full responsibility for elements of the analyses, conclusions of value, and final valuation report

2.27.20 Valuation report representation or certification for valuation professionals with the CVFI credential who have adhered to the DF-FI documents. CVFI credential holders who take responsibility for the final valuation report must include in the final report a representation or certification that includes the following:

1. A representation that the credential holder signing the report is in good standing with the educational, training, quality control, and ethical requirements of the AICPA
2. A list of CVFI credential holders who have contributed to the work file
3. A representation that each credential holder who has contributed to the engagement has complied with the educational, training, quality control, and AICPA requirements
4. A representation that the final valuation report and supporting analyses and underlying documentation was prepared in compliance with this framework and the Application of the DF-FI;
5. Signatures of all valuation professionals who take full responsibility for elements of the analyses, conclusions of value, and final valuation report
6. Any additional representations or certifications required by the AICPA

Although the requirements described above with respect to formal reports do not directly apply to the assignments of IVPs, a number of these items should be documented in the work file with respect to the conclusion of value:

- Purpose and intended use of the valuation conclusion
- Intended users of the valuation conclusion
- Measurement date
- Identification of the subject interest
- Sources of information
- Valuation approaches, methods, and techniques
- Limitations on the scope of research and analysis
- Financial information adjustments
- Significant assumptions and estimates
- Subcontractors with subject interest expertise retained by valuation professional
- Third-party specialist retained by employer

3. FINANCIAL INSTRUMENTS FRAMEWORK GLOSSARY

Note to the reader: This glossary sets forth definitions of terms that may be unique to the framework, or defines their meaning within the context of the framework. Words or terms defined in the glossary are set in **bold** type the first time they are applied in proper context within this framework.

Abbreviated valuation report. Compared to a comprehensive valuation report, an abbreviated report condenses the requirements of a comprehensive valuation report based on criteria agreed upon by the client and the valuation professional. The final valuation report might not contain sufficient details for the intended users or expected recipients to understand the data, analysis, and rationale for the value conclusions (for example, an abbreviated valuation report includes fewer details within the report in order to comply with a client’s request or focus the reader’s attention toward specific content). Although the content of the report may be less detailed than a comprehensive valuation report, valuation professionals must conduct a complete valuation analysis that applies their own analyses and reasoning. Furthermore, valuation professionals must prepare the work file in alignment with the framework to ensure sufficient detail exists to support the conclusion of value.

Analysis documents. These generally comprise two types of documents:

1. Computational analysis. Examples of these analyses may include spreadsheets or database analyses. This documentation and analysis demonstrates “what” the valuation professional did.
2. Narrative-based documents. Examples of this type of analysis may include narratives within the report, footnotes, and memoranda to the work file. This documentation and analysis demonstrates “why” the valuation professional elected certain methods, inputs, or judgments within the actual analyses.

Best practices. Within the context of this framework, a best practice is a task, technique, procedure or method that would typically be performed by any valuation professional even without specific instruction to do so because experience has shown it leads to a reliable and high-quality end result.

Calculation engagement. This type of engagement requires the valuation professional to adhere to the instructions of the client and requires reduced professional judgment to calculate the value of the subject interest.

CVFI credential holder. A valuation professional who conducts valuation services for financial reporting purposes and is in good standing with the educational, training, quality control, and ethical requirements of the AICPA.

Complete valuation analysis. This results in a conclusion of value by the valuation professional after having considered all relevant factors to determine and complete the appropriate scope of work for the purpose or intended use of the valuation engagement. The valuation professional uses professional judgment to consider and apply the valuation approaches and methods deemed appropriate for the facts and circumstances.

Comprehensive valuation report. The various VOs use different names for valuation reports. Within the context of the framework, a comprehensive valuation report is one that contains sufficient content for the intended user or expected recipient to gain a complete understanding of the engagement’s purpose and the valuation professional’s analysis, reasoning, and support for the conclusions presented. It is still possible, however, that additional supporting information will be contained in the supporting work papers.

Engagement to estimate fair value. This encompasses any engagement or part of an engagement that involves estimating fair value of a subject interest to support management’s assertions in their preparations of financial statements for financial reporting purposes. There are two general classifications of an engagement to estimate fair value: (1) a valuation engagement that can be either comprehensive or limited (this refers to the scope of work and documentation prepared not the report issued) and (2) a calculation engagement.

Evidential skepticism. Evidential skepticism requires valuation professionals to continuously question and critique information and data provided by management for bias or misstatement, or both, taking into consideration the experience of management and the sufficiency of the documentation and analyses provided by management throughout the valuation engagement.

Experienced professional. A professional who has sufficient experience in preparing, reviewing, or auditing valuation reports issued for financial reporting purposes (for example, valuation professionals, management, auditors, attorneys, and so forth).

Financial instrument. Cash, evidence of an ownership interest in a company or other entity, or a contract that does both of the following:

1. Imposes on one entity a contractual obligation either:
 - a. To deliver cash or another financial instrument to a second entity
 - b. To exchange other financial instruments on potentially unfavorable terms with the second entity.
2. Conveys to that second entity a contractual right either:
 - a. To receive cash or another financial instrument from the first entity
 - b. To exchange other financial instruments on potentially favorable terms with the first entity.

Financial Instruments Framework. Contains requirements that cover how much work should be performed in order to prepare a professional work product. The Financial Instruments Framework addresses scope of work and extent of documentation and analysis, consideration of contrary evidence, and documentation in both the report and the supporting working papers. Alternatively, the Financial Instruments Framework addresses the depth of analysis and documentation professionals are expected to perform and provide.

Financial reporting purposes. Within the context of this framework, financial reporting purposes encompasses all audited financial statements that include fair value measurement disclosures for financial instruments.

Disclosure Framework (framework). A set of interrelated and interacting elements that valuation

professionals must use to establish quality objectives and establish best practices that are needed to ensure the framework is followed and its objectives are achieved. The framework delineates requirements that govern the scope of work and extent of documentation.

May Within the context of this framework and when used in conjunction with identified tasks, techniques, or procedures, the word *may* indicates that the valuation professional is required to consider performing the indicated task, technique, or procedure, but the action itself is not required. Facts and circumstances will affect the valuation professional's decision as to how to proceed.

Measurement objective. A standard of value that is promulgated by an authoritative body, usually comprising a definition, and accompanying guidance regarding valuation inputs, processes, and outputs. For example, "fair value" is a measurement objective promulgated by the FASB and IASB.

Must Within the context of this framework, and when used in conjunction with identified tasks, techniques, or procedures, the word *must* indicates a mandatory or binding requirement that has to be implemented and applied as appropriate in order for the valuation professional to be in compliance with the framework.

Professional judgment. Within the context of this framework, this refers to the process of making informed and reasonable decisions that are based on the cumulative experiences of the valuation professional. This is a skill that evolves over time and results in decisions that reflect best practices of the valuation profession.

Professional standards. Standards that encourage professional behavior. Examples are codes of ethics and codes of conduct that encourage acting competently, independently, objectively, transparently. These can also be considered standards that define the qualities of a professional: ethical, independent, objective, having requisite skills, educated, experienced, tested, trained, and credentialed or licensed. Professional standards focus on characteristics of individual professionals and their conduct.

Self-skepticism. Self-skepticism is the awareness of and monitoring of one's own client-based presuppositions that could detract from evidencing skepticism as the result of comfort level or familiarity with the client, industry, or both.

Should. Within the context of this framework, and when used in conjunction with identified tasks, techniques, or procedures, the word *should* indicates a best practice that is presumed mandatory; however, in rare circumstances, the valuation professional can elect an alternative option.

Source documents. These include, but are not limited to, data and information (including interview notes) collected from both company sources and external third-party data accumulation resources relating to the company, its financial position, its competitors, the industry it competes in, its customers and suppliers, the state of the economy, financial markets, risk factors, and so forth.

Subject interest. Refers collectively or individually to any or all financial instruments and components thereof being valued for financial reporting purposes.

Technical standards. Standards that address the “how to” of work that must be done to prepare a professional work product. These standards address the technical correctness of the work product by considering appropriate input factors, application of methods and techniques, and reporting guidelines. Both mandatory standards and voluntary guidance have been developed around technical issues in valuation in general and, to a lesser extent, around fair value measurement.

Valuation professional. Within the context of this document, an individual who conducts valuation services for financial reporting purposes.

Valuation organization (VO). A not-for-profit membership organization that sponsors and supports valuation credentials with qualification requirements, quality controls, education, and codes of ethics.

Valuation services. Valuations used to support management assertions made in financial statements issued for financial reporting purposes.

Work file. Written documentation within the engagement file that supports a final conclusion of value (note: this includes information that is relevant to the analysis and indicates contrary evidence to the conclusion of value and the valuation professional’s explanation of how this information was considered). This includes working papers (documentation not included in the final valuation report but that is retained by the valuation professional that supports the final valuation report) and the final valuation report. Within the context of this framework, this documentation is collectively referred to as the work file. Documentation may include paper, electronic files, or other forms of recorded media.

4. AUTHORITATIVE AND TECHNICAL GUIDANCE

In addition to the accounting and valuation standards that affect valuation engagements for financial reporting, various technical guidance has been published by the VOs. These publications are included in this section and represent the best practices for the valuation of financial instruments and components thereof for financial reporting. Additional relevant technical guidance from VOs is also included in this section. Valuation professionals will also have developed their own body of knowledge from various other source materials and authors about topics pertaining to valuations of financial instruments and components thereof that may be relevant but not referenced within the framework. Although they are likely relevant to the practice of valuation, the framework does not cite or endorse the publications or views of individual authors.

AICPA VALUATION STANDARDS

- SSVS1
- SSCS1

RELEVANT ACCOUNTING STANDARDS:

- IFRS 13 – Fair Value Measurements
- ASC 820 – Fair Value Measurements
- IFRS 9 – Financial Instruments
- ASC 825- Financial Instruments
- ASC 718 – Stock Based Compensation
- ASC 815 – Derivatives and Hedging
- ASC 320 – Investments – Debt and Equity Securities

RELEVANT AUDITING STANDARDS:

- ISA 540 – Auditing Accounting Estimates, including Fair Value Estimates
- PCAOB AS 1210, Using the Work of a Specialist
- PCAOB AS 2501, Auditing Accounting Estimates
- PCAOB AS 2502, Auditing Fair Value Measurements and Disclosures
- PCAOB AS 2601, Consideration of an Entity's Use of a Service Organization
- AICPA AU-C Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, & Related Disclosures
- AICPA AU-C Section 620, Using the Work of an Auditor's Specialist
- AICPA Audit Guide *Special Considerations in Auditing Financial Instruments*
- Additional guidance may be available in other Audit and Accounting Guides (Depository & Lending Institutions, Investment Companies, Brokers and Dealers in Securities, etc.), including levels of assurance in fair value measurements & examples of typical audit questions for a valuation specialist

The standards and technical literature cited herein are meant to provide direction to relevant guidance and resources that address a particular subject interest; they are not meant to be an all-inclusive list of references. All references are current as of the framework's publication date; however, the reader should not assume these references have been updated contemporaneously with any changes to the standards or guidance and, thus, should verify all references using a proper resource.