AICPA guidance focuses on measuring fair value of portfolio companies

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As record amounts of capital continue to be raised and deployed by private equity and venture capital funds, the level of scrutiny these investments have garnered among regulators, policymakers, investors and other stakeholders has forced these funds to place greater emphasis on their valuation processes and controls, particularly the methods used to account for their investments.

In an effort to provide a conclusive source of guidance to the industry, on May 15, 2018, the AICPA's PE/VC Task Force (Task Force), along with the Financial Reporting Executive Committee (FinREC), released a working draft of an accounting and valuation guide, *Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies* (the PE/VC Guide or the Guide)[1]. The Guide was closed for comments on Aug. 15, 2018, and is scheduled for final review by FinREC during winter 2018-2019 with an anticipated official release during spring 2019.

Despite its nearly 650 pages in length, the Guide's key focus is on best practices for the valuation of, and accounting for, fund investments in portfolio companies, specifically accommodating the key concepts of fair value for financial reporting purposes. RSM's private equity industry practice played an instrumental role in the initial development of the Guide, and has reviewed and synthesized the subsequent draft in order to provide insights that are more succinct to our middle market clients and prospects.

1 While The PE/VC Guide is not meant to be authoritative, nor is it meant to replace any existing guidance, it was developed to provide best practices and assist in interpreting and applying existing fair value concepts for investment companies that invest in equity and debt instruments of portfolio companies consistent with ASC 820, *Fair Value Measurements*.

The following excerpts, some paraphrased and others taken directly from the Guide, provide brief summaries of some of the key topics that may be of significant interest to our middle market readers, such as options for the allocation of equity values, or that may not be widely known but are critical for the accurate reporting of fair value investments, such as backtesting or the treatment of transaction costs. We've organized the topics by subject, and where appropriate, we have cited paragraph numbers and other references to aid in further research.

Treatment of transaction costs

Actual transactions in a portfolio company's securities (either recently completed or contemplated) typically provide the best indications of fair value from a market participant perspective, but certain adjustments may be necessary. In particular, transaction costs should be excluded from the fair value of the investment, meaning the fair value may not be equal to the total cost to purchase, or net proceeds received upon the sale of, the investment. Frequently, we observe the following errors in the derivation of fair value estimates:

- Fair value = purchase price + transaction costs (typically observed upon acquisition of an interest in a portfolio company, where incremental costs (such as legal, due diligence and other costs) are often incurred in order to consummate the transaction.
- Fair value = sale price – transaction costs (typically observed upon sale of an interest in a portfolio company, where sales transaction costs (such as investment bank fees, legal fees, third-party valuation fees and other costs are often incurred to close the transaction.

"Transaction costs are capitalized at initial recognition and, therefore, impact the unrealized and realized gains and losses from investments reported in the statement of operations of the investment company at each subsequent measurement date" (paragraph 12.04). Chapter 12 of the Guide provides guidance and examples on the initial recording of a transaction at paragraphs 12.04—12.08, and upon exit at paragraphs 12.09—12.10, and a number of illustrative examples at paragraphs 12.11—12.16.

Valuation of debt instruments

Chapter 6 of the Guide provides guidance on the valuation of debt instruments or debt-like preferred stock, both from the perspective of investors who hold the debt or debt-like instruments and where they are the subject of measurement, and from the perspective of the equity investor where the debt or debt-like investment is held by a third party, and its value is considered as an input in valuing the investor's equity interests. This is an area where we have seen some confusion in practice, and the Guide is helpful in differentiating the proper perspectives of fair value and the valuation inputs that should be considered and used in each case.

Fair value of debt instruments

If the debt was originally issued at fair value, the best practice is to benchmark the original implied yield to the debt market and then calibrate that yield as of the measurement date by assessing both: (i) changes in credit quality (e.g., company performance) and (ii) changes in spreads (e.g., debt market). Although the guidance uses synthetic credit spread analysis as an example, the guidance is open to other ways to assess changes in credit spreads. Please note that calibration does break down when there has been a change in the business model or the debt was issued to avoid default or bankruptcy.

The expected time horizon by the market participant is a critical assumption. Although the debt may have a prepayment penalty of 103, the debt may not necessarily be written up to 103 if the expected time horizon exceeds this penalty period. The guidance stresses the key importance on what the time horizon would be for a market participant.

If the debt instrument that the fund holds in the portfolio company is traded, the traded price as of the measurement date may be the best estimate of fair value, assuming the transaction is determined to be orderly in an active market. When a traded price as of the measurement date is not available or is deemed to not be determinative of fair value, the typical valuation technique to estimate the fair value of the debt is to use a discounted cash flow analysis, and then discounting the cash flows at the market yield.

Quotes in an inactive market may not be binding in nature and may not necessarily corroborate or provide contradictory evidence. Management is responsible for understanding the context behind the quotes such as whether the quote is based on the broker/dealer's primary market; whether there is a wide dispersion of quotes; whether the quote is based on current information; the disclaimers behind the quote; whether the quote is binding; and level of interest for the debt instrument. It is management's responsibility to understand the information behind the quote.

Value of debt for the purpose of valuing equity

Very often, the approach used by funds and investors for valuing the equity interests they hold in portfolio companies is to first estimate the company's enterprise value and then subtract the value of debt.[2] The value of debt for the purpose of valuing equity will typically be estimated using the same valuation methodologies used for estimating the fair value of debt. However, investors need to realize that the value of debt used in estimating the fair value of equity may be different than the fair value of debt considered independently because market participants transacting in a company's equity may make different assumptions than market participants transacting solely in its debt. Chief among these differences are the assumptions equity investors may make about the timing of a company's liquidity event, or other value drivers, as a result of the superior information they may receive about the company's strategies through their due diligence process, or the fact that equity investors would consider the impact of all of a company's debt on their equity investment, whereas debt investor's may focus solely on the debt instrument they hold.

Beyond the potential differences in assumptions that equity and debt investors may assume, it is worth noting the different measures of debt value that are often seen in practice. Funds valuing equity interests may use the par value, face value, book value or payoff amount as a proxy for measuring the value of debt for the purpose of valuing equity. These proxies provide a lower and upper bound on the value of equity, with the fair value falling somewhere within these bounds. Judgment is required to estimate the value of debt for the purpose of valuing equity within this range, considering the facts and circumstances.

For example, equity value measured based on the enterprise value less the payoff amount may be regarded as a lower bound on the value of equity, because the equity holders could redeem the debt for this price. Equity value measured based on the enterprise value less the fair value of debt may be regarded as an upper bound on the value of equity, because the equity holders would recognize that the company ultimately would be responsible for redeeming all of the company's debt. When debt is impaired, using the fair value of debt may overvalue the equity (as debt will be well below book value); whereas, using the book value of debt, may under value the equity. The guidance suggests that the debt used to estimate the fair value of the equity may, in fact, be somewhere between the fair value and book value of debt. Although the guidance provides a number of examples of qualitative factors that would determine where the debt would be within that range, professional judgement is required. Paragraphs 6.21 – 6.31 provide numerous examples and considerations for determining which proxy may be most appropriate under the circumstances.

2 Chapter 7 of the Guide provides a discussion of approaches for valuing the enterprise for the purpose of valuing the equity interests in the enterprise.

Valuation of equity interests in complex capital structures

In our experience, perhaps one of the most controversial subjects encountered is the choice of approach used by equity investors to allocate overall company equity value among its various equity or equity-linked securities. There has been much debate over the years among fund finance professionals and their auditors as to the proper approach, and the Guide devotes an entire chapter (Chapter 8) to this decision. The following paragraphs summarize some of the key elements and considerations.

When estimating the fair value of a fund's investment, the fund should determine how each class of equity would participate in future distributions from a sale or other liquidity event, and the implications for the fair value of each class of equity. Estimating the value of the different classes of equity in a portfolio company requires an understanding of the rights associated with each class.

While neither the Guide, nor FASB ASC 820, prescribe a required method for valuing and allocating overall equity among securities, the Guide does outline four valuation/allocation methodologies for estimating the fair value of an equity interest in a complex capital structure:

- Scenario-based method: A forward-looking method that considers one or more possible future scenarios. This method includes simplified scenario analysis and relative value scenario analysis, which tie to the fully diluted (post-money) equity value, as well as full scenario analysis, also known as the probability-weighted expected return method (PWERM).
- Option pricing method (OPM): A forward-looking method that considers the current equity value and then allocates that value to the various classes of equity considering a continuous distribution of outcomes, rather than focusing on distinct future scenarios.
- Current Value Method (CVM): Allocates the equity value to the various equity interests in a business as though the business were to be sold on the measurement date.
- Hybrid method: A combination of scenario-based methods and OPM.

Each one of these methods is described in further detail within the Guide (paragraphs 8.20–8.66). While no single method for valuing equity interests appears to be superior in all respects and circumstances over the others, each method has its own merits and challenges, and there are trade-offs in selecting one method over another. The level of complexity also differs from one method to another.

One of the most frequently asked questions we hear about the choice of method is, "can I simply use the CVM?" The answer to this question continues to be, "it depends." The Task Force believes that the usefulness of CVM is limited primarily to two types of circumstances:

- When a liquidity event in the form of an acquisition or a dissolution of the portfolio company is imminent, and expectations about the future of the portfolio company as a going concern are virtually irrelevant.
- When the fund's position to be measured has seniority over the other classes of equity in the portfolio company and the investors who hold this class of equity have control over the timing of exit. In this case, the investors could sell the portfolio company on the measurement date, and their position would realize the allocated value from the CVM (e.g., the value of the fund's position cannot be lower than the CVM value).

This would suggest that for fund investments that do not closely align with these specific circumstances, the CVM is likely not appropriate. Paragraphs 8.54 – 8.59 describe application of the CVM, and paragraphs 8.75 – 8.77 and Q&A question 14.51 provide illustrative examples where CVM may not be appropriate.

Ultimately, the Task Force recommends that when selecting a method for the valuation of equity interests, the following criteria should be considered:

- The method reflects the going concern status of the portfolio company, and that the value of each class of instruments reflects the expectations that market participants investing in those instruments would make about future economic events and the amounts, timing and uncertainty of future cash flows to be received by the holders of each instrument.
- The method assigns some value to the junior instruments, unless the portfolio company is being liquidated and no cash is being distributed to the junior instruments.
- The results of the method can be either independently replicated or approximated by other valuation specialists using the same underlying data and assumptions.
- The complexity of the method is appropriate to the portfolio company's stage of development.

Control and marketability

Chapter 9 of the Guide addresses the concepts of control and marketability in establishing the fair value of a fund's investments in a portfolio company. Generally, the Task Force believes that control premiums should not be applied as separate adjustments in arriving at fair value, while it does consider the application of discounts for lack of marketability in specific circumstances and to specific instruments.

The controlling and minority interests discussed in Chapter 9 of the Guide are considered from the perspective of the holder, reflecting the degree of influence that a market participant, transacting in the interest, would have over the portfolio company's strategy and operations. The following sections provide additional details.

Controlling versus minority interests

Very often, funds begin their investment valuation process with a portfolio company's enterprise value, determined using the methods discussed in Chapter 5 of the Guide. The Task Force believes that it is not appropriate to include a control premium or an acquisition premium in the enterprise value used in valuing the fund's interest in the portfolio company because market participants typically expect that the investors, who, in aggregate, have control of the business, will continue making improvements to the business and executing the strategy that attracted them to the investment, until the business has reached a position where investors could achieve a favorable liquidity event. Rather, it is recommended that funds evaluate the instruments in each portfolio company, considering the improvements to the business that an investor in the fund's interest would expect under existing ownership as modified, given the degree of influence that the buyer would have over those plans, considering the nature of the interest acquired. It would not be appropriate to add an additional control premium when estimating fair value since this value would be directly incorporated into the cash flows and calibrated required rate of return assumptions or calibrated market multiples used in the analysis.

In cases where investors employ calibrated models in their valuation process, control or acquisition premiums were often paid and embedded into the original transaction price when a portfolio company was acquired, and these premiums would have been taken into account in calibrating valuation inputs. If the fund is appropriately employing the concepts of calibration (see discussion of calibration in this article) to subsequent measurement dates, then the calibrated inputs, adjusted for any changes in the company and for the current market conditions, generally would incorporate the value associated with control. Again, it would not be appropriate to add an additional control premium when estimating fair value since this value would be directly incorporated into the cash flows and calibrated required rate of return assumptions or calibrated market multiples used in the analysis.

Marketable versus nonmarketable interests

In the case of portfolio companies with simple capital structures, where investors' interests have the same rights (tag along, information rights, etc.) and same principal exit market, the value of the instruments would be the same for all investors. However, if the fund has a different principal exit market or additional restrictions on their interest that other investors do not, it may be appropriate to apply a discount for lack of marketability to these specific instruments in order to capture the differences in desirability of one instrument over the other.

In the case of portfolio companies with complex capital structures, certain investor interests or management interests, such as common stock or profits interests, may be less marketable than the instruments held by the investors who, in aggregate, have control of the business.

The Task Force believes that after allocating the equity value to the various instruments within the portfolio company or assessing the discount rate for an instrument considering its economic rights, it might be appropriate to apply a discount for lack of marketability to certain instruments, to the extent needed to capture the incremental rate of return, if any, that investors would demand given the information rights and other noneconomic rights associated with these instruments. Such a discount should initially be supported via calibration, and would typically not apply in situations where the position includes information rights and the investors' interests are aligned.

Appendix B, paragraphs B.08.01–B.08.08, provide an overview of the empirical data, studies, and quantitative models typically used in supporting and calculating discounts for lack of marketability. The three (3) foundational quantitative methods include the:

- Protective put
- Longstaff
- Quantitative marketability discount model (QDRM)

However, the Task Force believes that the Longstaff method generally does not provide a reasonable estimate of the discount for lack of marketability, and the QDRM is more applicable for directly valuing funds' interests in companies with simple capital structures. Therefore, the most widely accepted of these methods is the protective put method. Two widely used examples of this method are:

- Finnerty model
- Asian protective put

These methods are described in paragraphs B.08.05 (a) and (b), respectively.

Calibration: Valuation implications of observed transactions

According to the Guide, "Calibration is the process of using observed transactions in the portfolio company's own instruments, especially the transaction in which the fund entered a position, to ensure that the valuation techniques that will be employed to value the portfolio company investment on subsequent measurement dates begin with assumptions that are consistent with the original observed transaction as well as any more recent observed transactions in the instruments issued by the portfolio company" (paragraph 10.02).

Calibration to the transaction price is required when the initial transaction for an investment represents fair value, and is also used when there are observed transactions in the portfolio company's instruments at later dates. Calibration ensures that the valuation technique reflects current market conditions, and it helps a reporting entity to determine whether an adjustment to the valuation technique is necessary. In determining whether a transaction price (an entry price) represents fair value at initial recognition, it is important to consider the characteristics of the transaction and the unit of account.

Even when the transaction price does not reflect fair value at initial recognition, it is a best practice to compare the estimated fair value with the transaction price and reconcile the differences, giving consideration to the reasons that the transaction price was not considered to be fair value and explaining the day one gain or loss.

Calibration: Relevance of calibration as time passes

Calibration is most relevant when the measurement date is close to the transaction date. However, even if a substantial period has passed, calibration can be used to ensure the consistency of the unobservable assumptions about the transaction price as of the transaction date, and to make sure that the evolution of those assumptions (changes in market conditions and changes in the company's performance and expectations) over time is reasonable. In addition, calibration can be used to ensure that the movement in the valuation between measurement dates is reasonable, even in the absence of a recent transaction, unless there was a significant change in the circumstances as to warrant a change in the valuation methodology.

Calibration: Consistency with other valuations performed for the portfolio company

The concept of calibration may also be used when considering the similarities and differences between valuations performed for different purposes. In many cases, portfolio companies may perform their own, independent valuations for purposes of complying with financial reporting requirements related to testing for goodwill impairment, issuing stock-based compensation, valuing other financial instruments or for taxes. To the extent that investors have access to these valuations and/or the assumptions that were used in their derivation, the Guide indicates that it is a best practice for investors to understand the valuation methodologies and assumptions used in these valuations and to reconcile them, to the extent possible, with those being used by the fund in valuing its investments. Nonetheless, investors must still perform and support their own valuations on the measurement date.

Backtesting

Chapter 11 of the Guide introduces a concept that is not entirely new, but isn't widely adopted by funds in the middle market. Simply stated, backtesting is the process of reviewing and comparing the results, methods and assumptions of recent or prior valuations conducted for a fund's investments with the ultimate valuation realized when the fund sells or liquidates its investment. The primary purpose of backtesting is to assess and improve the fund's or investment company's process for developing its fair value estimates with the benefit of hindsight. It is not meant to highlight mistakes or to correct a prior valuation estimate; rather, backtesting provides ongoing feedback that should help to enhance the fund's valuation processes and contribute to its system of internal control over financial reporting practices.

"By comparing results from actual transactions to prior estimates in a consistent and structured manner, investment companies can evaluate and if necessary, modify or improve, their valuation methodologies and overall valuation process" (paragraph 11.07).

Paragraph 11.11 of the Guide provides a succinct list of important elements of the backtesting process:

- Determine what information and factors were known or knowable as of the measurement date
- Assess how well those factors were considered in developing the fair value measurement
- Identify whether there were factors that were relevant to the valuation as of the event date that were not considered or given weight as of the measurement date

"Backtesting allows the fund to improve valuation processes by assessing whether the factors that appear to have contributed to the actual result were consistent with those previously identified in the valuation." Paragraph 11.21 further elaborates on the factors to consider when performing backtesting, and the chapter concludes with nine (9) illustrative examples beginning at paragraph 11.24.

Factors to consider at or near a transaction date

Chapter 12 of the Guide addresses some of the considerations that funds may encounter when utilizing details of recent or contemplated transactions in supporting fair value estimates. "In estimating fair value at or near a transaction date (e.g., a recent purchase or contemplated exit), an investor evaluates circumstances involving the acquisition transaction and facts which may be known about a contemplated sale." While such recent or anticipated transactions may be good indicators of fair value, adjustments may be necessary to properly reflect market participant assumptions. For instance, in a purchase transaction, there may be a significant time delay between the initial pricing and ultimate closing, or in a sale transaction, there may be uncertainty about the buyer's ability to close the deal at the agreed upon price due possibly to financing, regulatory or other unforeseen issues. In addition, as mentioned earlier, transaction costs are excluded from fair value measurements (see Transaction costs, discussed earlier).

Paragraphs 12.04—12.08 cover considerations to be addressed upon initial recognition of an investment. These consist primarily of the issue of transaction costs and several examples are given to distinguish the treatment of such costs. Paragraphs 12.09—12.10 address considerations as to how fair value estimates should be adjusted to reflect expected transaction costs at or near an exit event.

Paragraphs 12.11—12.16 provide discussion and illustrative examples that address some of the other issues and considerations surrounding fair value, including differences between transaction price and fair value arising from changes in the company's performance from the transaction date to the first reporting period, or the risks inherent in the closing of a transaction at the agreed upon price due to performance, financing or due-diligence related issues, among others.

Lastly, the issue of transaction costs is revisited in the context of calibration (see Calibration, discussed earlier). For the sake of consistency, transaction costs must be reflected consistently from initial recognition to subsequent measurement dates.

Financial information used in the valuation analysis

Many questions have arisen as to the suitability of portfolio company and/or guideline public company financial information used in the fund's valuations and fair value reporting procedures, particularly with regard to potential lags in reported information. Answers to these questions can be found in Chapter 14, Frequently Asked Questions, Q&A 14.18 and 14.32.

The Guide indicates that it is most appropriate to utilize and apply the best information available to market participants on the measurement date. In most instances, this would include quarterly or monthly financial information of the portfolio company, or quarterly financial information for guideline public companies immediately preceding the measurement date. For instance, the use of Sept. 30 or Nov. 30 financial information for a Dec. 31 measurement date would be perfectly acceptable if that information is the most current information available to market participants.

Similarly, when deriving market multiples using guideline public companies, it would be reasonable to use Sept. 30 financial information if that information was the most current available to market participants. Note that multiples would be based on Dec. 31 market values using financial information with a one quarter lag. Since market participants would likely utilize the most recent financial information available for the portfolio company (which could be monthly through Nov. 30), it may be necessary to adjust the financial metrics for the portfolio company and selected multiples to be consistent with market participant expectations.

Special topics

Chapter 13 of the Guide introduces a number special topics that warrant separate coverage outside of the business valuation, debt valuation, and allocation techniques covered in the other chapters of the Guide. While there are numerous topics, we have highlighted a few that are likely relevant to the middle market funds and investment companies we serve.

SPECIAL TOPICS

Topic	Fair value considerations
P * Q Rule	▪ There are limited circumstances where a fund may conclude that a quoted price for a traded security may not be indicative of fair value, examples include: – If the market is not active and additional analysis indicates that the price does not reflect the price at which market participants in the principal market for the fund's interests would transact (i.e., when there has been a significant decrease in trading volume or activity and the market is no longer active) – When significant events (i.e., transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date
Underwriter lockups and SEC Rule 144A	▪ An underwriter lockup is an agreement that prohibits the investors from selling or hedging their investment for a period of time, typically 180 days, following the IPO. ▪ The Task Force believes that it is appropriate to consider the restriction to be a characteristic of the asset irrespective of the form of the restriction, as the fund is prohibited from selling shares through the public markets for a given period of time. ▪ When evaluating an assumed transfer of a position, any buyer of the position typically would be subject to the same restrictions, either via direct transfer of the restriction (for legal or regulatory restrictions), or because the counterparty would require that the buyer accepts the same restrictions (for contractual restrictions). ▪ Another adjustment often considered in some valuation analyses (for purposes other than financial reporting) is an adjustment for blockage. However, as the blockage is a function of the size of the position, rather than a characteristic of the asset itself, these adjustments may not be considered in estimating fair value for financial reporting purposes (per FASB ASC 820-10-35-36B).

Topic	Fair value considerations
Significant decrease in volume or activity or distressed transactions	▪ As indicated in FASB ASC 820-10-35-54F, if there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. ▪ When weighting indications of fair value resulting from the use of multiple valuation techniques, a reporting entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.
Indicative offers	▪ During the process of negotiating the sale of a business, investors may receive an indication of value in the form of an indicative offer from a potential acquirer or acquirers. Since this process may take a considerable amount of time, and span one or more measurement dates, the challenge for investors is how to incorporate any indicative offers into the fair value measurement. ▪ Indicative offers are not observable market prices; rather, they represent the buyers' starting point for negotiations. Prospective buyers may enter into negotiations at higher or lower values, depending on their perceived positions and negotiating strategies. Therefore, the fund's valuation would typically consider an adjusted indication of value based on a combination of the indicative offers and consideration of other fair value inputs and assumptions. ▪ When considering the degree of reliance to place on any indicative offers, it is important to consider several factors, such as: – Range of the offers – Amount of due diligence that has already been done – Reputation of the prospective buyers and their track record for completing transactions – Proposed terms of the transaction – Extent of financing contingencies – Regulatory approvals or shareholder approvals required for the transaction to close ▪ To estimate the value of equity based on an indicative offer, the fund must first adjust the offer price to reflect any differences between the indicative price and market participants' assumptions regarding the expected closing price after the negotiations are complete. ▪ The fund would also consider other indications of value to support its concluded fair value for its position.
Insider financing rounds	▪ The price from a recent transaction in the portfolio company's instruments is often a reliable indication of the fair value of those instruments. However, when a financing round is funded entirely by insiders, the transaction price may be at fair value, but the fund should consider the transaction dynamics to understand the negotiations and make the determination as to whether the transaction is at fair value. ▪ Paragraph 10.31 of the Guide lists a number of factors to consider in determining whether an insider financing round represents fair value, including the proportion of insiders to new investors in the round, the level and depth of negotiations surrounding pricing, and whether existing investors participated pro-rata thus avoiding any significant accretion or dilution in the value of their positions.

Topic	Fair value considerations
Early stage companies with no recent financing rounds	▪ The valuations of companies which have yet to produce revenue or income can be particularly challenging, especially for those which have not had a recent round of funding, because traditional valuation methods are rendered ineffective. ▪ Valuations of these entities are often based on transactions in their equity instruments, such as financing transactions where the company sells shares directly to investor(s) and secondary transactions where existing shareholders sell shares. ▪ As discussed earlier in this article, calibration can be used to establish and model the value of the overall business enterprise and the interests in the enterprise, based on the original transaction price. For subsequent valuations, the model inputs can be revised to capture the impact of interim value events on revenue and cash flow projections and risk expectations for the entity. ▪ In such situations, the best option will involve a technique that rolls forward the value obtained from a previous (now stale) financing round that reflected fair value at initial recognition, by employing the model used to calibrate to that transaction and updating its key assumptions and inputs. ▪ Before pursuing this course of action or before relying solely on this technique, a variety of factors should be considered. The Guide highlights the following considerations listed in paragraph 13.42: – Was a calibrated valuation model developed at the time of the previous financing? – Is the entity performing in accordance with its business plan? – Have any significant value events (internal or external) occurred since the previous financing round? – Does the entity need additional financing to survive a successful exit event? – Is the entity attempting to raise additional financing as of the measurement date?

The PE/VC Guide was developed to provide guidance, examples and case studies for preparers of financial statements, independent auditors, management and boards of directors of investment companies, professionals who prepare valuation analyses, and other interested parties regarding the accounting for and valuation of portfolio company investments of venture capital and private equity, and other investment companies. We're hopeful that this article has helped to provide some additional clarity around many of the topics of interest to our middle market fund clients and prospects.

As the Guide could be subjected to further revisions before being finalized in the spring of 2019, we will provide updates on the development of the Guide through this article and on our website. For more information, please contact any of the members of our financial services practice, and join us for several planned live educational sessions and webcasts across the country as we discuss the topics highlighted above in further detail. To stay up to date on all the latest financial reporting insights, please subscribe to our newsletter.

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