Work File Checklist for Growth Rate and Terminal Value

The requirements under the new credential for fair value for financial reporting should be considered best practices to anyone doing this type of work. Holders of the Certified in Entity and Intangible Valuations (CEIV) credential will have a work file reviewed within the first year they receive the credential and then periodically after that. The new requirements are contained in the Mandatory Performance Framework (MPF), which is designed to make sure that the valuation expert adequately documents his or her work and thought processes.

Practice aid. A handy tool to use for compliance is a work file checklist of what the MPF requires for all the different aspects involved in fair value measurement. In past issues of *Business Valuation Update*, we presented checklists for a number of valuation areas. In this issue, we give you a checklist for how to document your work on growth rates and the terminal value, and it is based on what is contained in the two MPF documents, which you can download from a special website set up for the CEIV credential (www.ceiv-credential.org). ◆

Work File Checklist: Minimum MPF Requirements for Documenting Growth Rates and Terminal Value

Growth Rates

- ☑ The rationale, support, and reasonableness assessment for the selected growth rate(s) used in the analysis.
- ☑ The rationale for all inputs that comprise the terminal or long-term GR.
- ☑ When estimating the value of an entity, the rationale for selection of the terminal period when cash flows are capitalized into perpetuity. For example, if company management provides a five-year forecast, the valuation professional should not assume the period after the forecasted period should be the point where cash flows are capitalized into perpetuity without performing additional analysis.
- ☑ When estimating the value of an entity, the rationale for selection of the GR to be used for capitalization of cash flows into perpetuity. For example, if company management provides a five-year forecast, the valuation professional should not assume the terminal-period GR is appropriate after the forecasted period for capitalizing cash flow into perpetuity without performing additional analysis.
- ☑ Rationale for the use of other models (for example, the H-model, also referred to as the “fading growth” model) when growth at the end of the projection period is not expected to be sustainable.

Terminal Value Multiple Methods and Models

- ☑ The rationale for selecting the appropriate terminal value methods or model (can include one or more of the existing models, including the Gordon growth model, H-model (fading growth model), two-stage model, terminal exit multiples, key value driver formula, or other, such as salvage value or disposal costs).
- ☑ The rationale and support for each key assumption used in the terminal value method or model such as, as applicable:
  - o The discount rate;
  - o Terminal or perpetual growth rate;
  - o Second-stage or high-growth growth rate for the H-model and two-stage model;

Checklist continued on next page

- o High growth stage duration or life for the H-model and two-stage model;
- o Return on invested capital (ROIC); and
- o Terminal market multiple (exit multiple).

☑ If more than one terminal value method or model is used, the rationale for the selected weighting assigned to each terminal value method or model and to reconcile the various indications of terminal values.

In future issues, we will provide other checklists that will go into specifics of the documentation requirements for other methods, inputs, and assets/liabilities.

(Source: This checklist is derived from the document "Application of the Mandatory Performance Framework for the CEIV." The information in this checklist has been summarized and adapted. See the actual document for additional explanation and requirements at www.ceiv-credential.org.)

Ask the Experts

Q: *What is "pure" personal goodwill?*

A: This is relatively new territory in the realm of goodwill, and it has the potential to evolve into a very important issue. "Pure" personal goodwill is that portion of personal goodwill that is not transferable (salable). Under this concept, total goodwill is split out into three components: enterprise, transferable personal goodwill, and nontransferable personal goodwill. In a court context, only one case acknowledges that some personal goodwill is salable and transferable: the *McReath* case in Wisconsin (*McReath v. McReath*, 2011 WL 2706249 (July 12, 2011)), which allowed salable personal goodwill to remain in the marital estate. Wisconsin had been one of many states that excluded personal goodwill from the marital estate, but this case ushered in the distinction between transferable (salable) and "pure" personal goodwill.

Of course, this case cannot serve as a precedent in other states or jurisdictions, but it may be used in arguments over whether transferable (salable) personal goodwill should be included in the marital estate in a divorce.

Source: Enterprise vs. Personal Goodwill: Case Studies With Legal Insights, BVR webinar, March 2017 (www.bvresources.com/pastevents).