

Report Documentation: Creating Longevity for the Thought Process

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A wise person once said that the faintest ink is more powerful than the strongest memory. But realistically, reading through the findings in a dusty, year-old report won't help you recall everything you were considering at that time. Alongside the quantitative data, there also needs to be a record of your thought process within the report.

Documenting key factors and selections may take a little more time in the overall reporting process, but it's an integral and often overlooked part of creating an accurate reflection of an investment or entity, whether for a Topic 820 report or an IRC 409a. Footnotes are a great solution because they help to tell a story and add context while everything is fresh in your mind. This inclusive presentation works especially well during an audit process, where these footnotes highlight qualitative factors from one report to the next while also keeping the reviewer well informed.

One main focus of evidence presented is to elaborate on the subject company's growth, risk and profitability position as of the set report date. This support allows the preparer to create a more complete picture of the methodology selected and value determined therein. When the reviewer has a better understanding of the thought processes behind particular inputs, they are not required to make as many assumptions as they do when strictly examining the numbers.

With that said, assumptions made by the preparer during the reporting process are perfectly acceptable and should be included in the notes for better presentation.

Some of the most important general areas to highlight in a report include:

- ▶ **Source of financial inputs (including dates)**
- ▶ **Reasoning behind the methodology selection**
- ▶ **Details concerning any recent transactions completed**
- ▶ **Details about the company performance**
- ▶ **The subject company's expected time to exit and possible targeted means of exit**

- ▶ **Allocation method applied (this may be dictated by means of exit, timing of exit or both)**
- ▶ **Unique aspects of the capital structure**
- ▶ **Assumptions made for possible unknown information**

(Part 2 of this series will go into more detail to explain some standard/acceptable assumptions.)

There may be subject matter you feel unsure about when disclosing details around a particular talking point, leading you to ask: "Is this really necessary to include in the report?"

As always, it is crucial in the analysis process to have a working relationship with the subject company's management team. This enables you to remain apprised of the company's overall standpoint as of a specific date, allowing you to gain better insight into probable outcomes regarding milestones, developments and an eventual exit targeted for a future date. It is also important to be cognizant of the audience reviewing the information and reports. But when in doubt, add a footnote.

A well-rounded report directs the reviewer to the qualitative data used to serve as a track record of the company's progress over time. Qualitative information surrounding the company's operational focus, changes in management and regional or geographical factors should all be described within the report.

There is merit in reviewing older reports, if available, when constructing a report for the following period. By highlighting unique aspects of the capital structure, any custom adjustments based on those factors can be easily found. This will allow for consistent approaches over time and reduce errors from manual entries. It can also be beneficial to describe how some of the more specific terms and conditions, such as cumulative dividends or a liquidation preference based on contingencies or exit means, are reflected within the report.

Example:

A December 2016 report can be reviewed on the front end to prepare for a June 2017 update. When evidence supplied in the 2016 report is paired with a management team's most recent notes on product or platform progress as well as financial milestones, the new report will become much easier to finalize. One option to consider is asking whether any prior reports have been completed from the subject if this is a first run of a new investment, although this information may not always be available.

These notes are a fantastic tool when creating the report and tying out prior examinations of the investment, and they also serve as an invaluable resource to reduce the time spent in audit. (And who doesn't like a shorter audit process, right?) Any additional support disclosed will definitely reduce the gray area that tends to fuel some of the back and forth questions, minimize the time spent flipping through pages of a report and improve the efficiency of an audit engagement.

It is highly recommended to note any outlying areas of the report as well as some details surrounding the underlying inputs to give the auditors a head start. Documentation embedded in the report really helps to bolster an argument for selections and resulting values, but the audit teams are not mind readers: so when in doubt, add a footnote.

The integrity of a report's selections and methodology should be able to stand on its own without the examination or inclusion of any other report. At the same time, they should serve as part of a whole picture over time when more than one is completed for a specific entity. This unique position to stand independently while also presenting a complementary perspective in relation to prior indications of value further validates the importance of cogent footnotes. Liquidation preference based on contingencies or exit means are reflected within the report.

These types of details and comments serve as support for the selections, whether they relate to revenue, multiples, discounts or overall methodology. Sometimes, it's not the best option to select a market approach even when the company has generated revenue. (These types of exceptions will be covered in Part 3 of this series.) The fact of the matter is that there is no bulletproof method, but increasing the clarity of your thought process through proper documentation will aid in smooth transitions from first draft to final report.

And of course, when in doubt, add a footnote!