

Proposed Guidance Note: APES GN 21 Valuation Engagements for Financial Reporting

Prepared and issued by
Accounting Professional & Ethical Standards Board Limited

EXPOSURE DRAFT **XX/11**
ISSUED: (XXXX 2011)

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Commenting on this Exposure Draft

Comments on this Exposure Draft should be forwarded so as to arrive by **XX XXXX 2011**.

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A copy of all submissions will be placed on public record on the APESB website:
www.apesb.org.au.

Obtaining a copy of this Exposure Draft

This Exposure Draft is available on the APESB website: www.apesb.org.au. Alternatively, any individual or organisation may obtain one printed copy of this Exposure Draft without charge until **XX XXXX 2011** by contacting:

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Reasons for issuing Exposure Draft XX/11

Accounting Professional & Ethical Standards Board Limited (APESB) proposes to issue the Guidance Note APES GN 21 *Valuation Engagements for Financial Reporting* to provide further guidance for Members on the application of APES 225 *Valuation Services* to Valuation Engagements conducted in respect of Financial Reporting.

Key requirements and guidance in ED XX/11

The proposed APES GN 21 includes guidance in respect of:

[To be completed]

Proposed operative date

It is intended that this Guidance Note will be operative from **XX XXXX 2011**.

Request for comments

Comments are invited on this Exposure Draft of APES GN 21 *Valuation Engagements for Financial Reporting*by **XX XXXX 2011**. APESB would prefer that respondents express a clear overall opinion on whether the proposed Guidance Note, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on any matter. APESB regards both critical and supportive comments as essential to a balanced view of the proposed Guidance Note.

APES GN 21 Valuation Engagements for Financial Reporting

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ISSUED: [DATE]

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1. Scope and application

- 1.1 Accounting Professional & Ethical Standards Board Limited (APESB) issues professional guidance note APES GN 21 *Valuation Engagements for Financial Reporting* (the Guidance Note).
- 1.2 APES GN 21 provides guidance to Members on the application of APES 225 *Valuation Services* to Valuation Engagements for Financial Reporting.
- 1.3 Members working in Australia should follow the guidance in APES GN 21 when they provide services to their Client or Employer.
- 1.4 Members working outside of Australia should follow the guidance in APES GN 21 to the extent to which they are not prevented from so doing by specific requirements of local laws and/or regulations.
- 1.5 The Guidance Note is not intended to detract from any preferred responsibilities which may be imposed by APES 225 *Valuation Services*, relevant legislation or regulation.
- 1.6 All references to Professional Standards and Guidance Notes are references to those provisions as amended from time to time.
- 1.7 Members need to be familiar with relevant Professional Standards and Guidance Notes when providing Professional Services.
- 1.8 In applying the guidance outlined in APES GN 21, Members should be guided not merely by the words but also by the spirit of this Guidance Note, the Code and APES 225 *Valuation Services*.
- 1.9 This proposed guidance note does not apply to Valuation Engagements performed in respect of AASB 2: *Share based payments* and AASB 139: *Financial Instruments Recognition and Measurement*.

2. Definitions

For the purpose of this Guidance Note:

Assignment means an instruction, whether written or otherwise, by an Employer to a Member in Business relating to the provision of services by a Member in Business. However, consultations with the Employer prior to such instruction are not part of an Assignment.

Australian Accounting Standards means the Accounting Standards (including Australian Accounting Interpretations) promulgated by the AASB.

Calculated Value means an estimate of value of a business, business ownership interest, security or intangible asset that results from a Calculation Engagement. A Calculated Value may either be a single amount or a range.

Calculation Engagement means an Engagement or Assignment to perform a Valuation and provide a Valuation Report where the Member and the Client or Employer agree on the Valuation Approaches, Valuation Methods and Valuation Procedures the Member will employ. A Calculation Engagement generally does not include all of the Valuation Procedures required for a Valuation Engagement or a Limited Scope Valuation Engagement.

Client means an individual, Firm, entity or organisation to whom or to which Valuation Services are provided by a Member in Public Practice in respect of Engagements of either a recurring or demand nature.

Code means APES 110 *Code of Ethics for Professional Accountants*.

Conclusion of Value means an estimate of value of a business, business ownership interest, security or intangible asset that results from a Valuation Engagement or a Limited Scope Valuation Engagement. A Conclusion of Value may either be a single amount or a range.

Employer means an entity or person that employs, engages or contracts a Member in Business.

Engagement means an agreement, whether written or otherwise, between a Member in Public Practice and a Client relating to the provision of Professional Services by a Member in Public Practice. However, consultations with a prospective Client prior to such agreement are not part of an Engagement.

Firm means (a) a sole practitioner, partnership, corporation or other entity of professional accountants;
(b) an entity that controls such parties;
(c) an entity controlled by such parties; or
(d) an Auditor-General's office or department.

Limited Scope Valuation Engagement means an Engagement or Assignment to perform a Valuation and provide a Valuation Report where the scope of work is limited or restricted. The scope of work is limited or restricted where the Member is not free, as the Member would be but for the limitation or restriction, to employ the Valuation Approaches, Valuation Methods and Valuation Procedures that are reasonable and appropriate taking into consideration all relevant facts and circumstances of the Engagement or Assignment, and it is reasonable to expect that the effect of the limitation or restriction on the estimate of value is material. A limitation or restriction may be imposed by the Client or Employer or it may arise from other sources or circumstances. A limitation or restriction may be present and known at the outset of the Engagement or Assignment or may only arise and become known during its course. Accordingly, where a Member has entered into a Valuation Engagement but during the course of performing the Valuation the Member becomes aware of a limitation or restriction that may have a material impact on the estimate of value then the Engagement will become a Limited Scope Valuation Engagement. A Limited Scope Valuation Engagement may also be referred to as a "restricted-scope valuation engagement" or an "indicative valuation engagement".

Member means a member of a professional body that has adopted this Standard as applicable to their membership, as defined by that professional body.

Member in Business means a Member employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not for profit sector, regulatory bodies or professional bodies, or a Member contracted by such entities.

Member in Public Practice means a Member, irrespective of functional classification (e.g. audit, tax or consulting) in a Firm that provides Professional Services. The term is also used to refer to a Firm of Members in Public Practice and means a practice entity as defined by the applicable professional body.

Premise of Value means an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; e.g. going concern, liquidation.

Professional Services means services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services.

Terms of Engagement means the terms and conditions that are agreed between the Client and the Member in Public Practice for the Engagement.

Valuation means the act or process of determining an estimate of value of a business, business ownership interest, security or intangible asset by applying Valuation Approaches, Valuation Methods and Valuation Procedures. A Valuation does not involve the verification of information in respect of the business, business ownership interest, security or intangible asset being valued.

Valuation Approach(es) means a general way(s) of determining an estimate of value of a business, business ownership interest, security, or intangible asset using one or more Valuation Methods.

Valuation Engagement means an Engagement or Assignment to perform a Valuation and provide a Valuation Report where the Member is free to employ the Valuation Approaches, Valuation Methods, and Valuation Procedures that are reasonable and appropriate taking into consideration all relevant facts and circumstances of the Engagement or Assignment. Where a Member has entered into a Valuation Engagement but during the course of performing the Valuation Engagement the Member becomes aware of a limitation or restriction that, if it had been known at the time the Engagement or Assignment was entered into, would have made the Engagement or Assignment a Limited Scope Valuation Engagement then the Valuation Engagement will become a Limited Scope Valuation Engagement.

Valuation Engagements for Financial Reporting means a Valuation Engagement performed for the purpose of estimating a value of an asset, liability and/or equity for financial reporting purposes in accordance with Australian Accounting Standards. Examples of different accounting purposes include measurement of the value of an asset or liability for inclusion on the statement of financial position, allocation of the purchase price of an acquired business, impairment testing, lease classification and valuation inputs to the calculation of depreciation charges in the profit and loss account. Valuation Engagements for Financial Reporting does not include Valuation Engagements performed in respect of AASB 2: *Share based payments* and AASB 139: *Financial Instruments Recognition and Measurement*.

Valuation Method(s) means, within Valuation Approaches, a specific way(s) to determine an estimate of value of a business, business ownership interest, security or intangible asset.

Valuation Procedures means the act, manner and technique of performing the steps of a Valuation Method.

Valuation Report means any written or oral communication by the Member containing a Conclusion of Value or a Calculated Value.

Valuation Service means a service provided by a Member to a Client or Employer in performance of a Valuation Engagement, Limited Scope Valuation Engagement or a Calculation Engagement.

3. Fundamental responsibilities of Members

- 3.1 Members should refer to Paragraph 3 of APES 225 *Valuation Services* when providing Valuation Services to a Client or Employer as that standard imposes mandatory professional obligations on Members who provide Valuation Services.
- 3.2 APES 225 Paragraph 3 specifies professional obligations of Members in accordance with the following sections of the Code:
- Section 100 – Introduction and Fundamental Principles;
 - Section 130 – Professional Competence and Due Care;
 - Section 140 – Confidentiality;
 - Section 220 – Conflict of Interest; and
 - Section 280 – Objectivity – All Services.

4. Scope of Valuation Engagements for Financial Reporting

- 4.1 Members should refer to Paragraph 4 of APES 225 *Valuation Services* when providing Valuation Services to a Client or Employer in respect of the scope of the Valuation Engagement. The scope of work should identify the applicable Australian Accounting Standards including the specific accounting purpose for which the valuation is required.
- 4.2 When planning the extent of the scope of work for a Valuation Engagement for Financial Reporting a Member should obtain:
- i) Sufficient understanding of the subject matter of the Valuation Engagement. Depending on the type of level of Valuation Service being provided, the Member should obtain and review material documentation, including agreements, contracts, letters of understanding, letters of intent and correspondence, which bear on the subject matter of the Valuation Service;
 - ii) Sufficient understanding of the underlying business operations;
 - iii) Sufficient financial information relating to past results, future prospects and present financial position; depending on the type of Valuation Report being provided, the information to be obtained and analysed should include prior years' operating results and cash flows, a current balance sheet, and future oriented financial information (such as budgets, forecasts and projections);
 - iv) Sufficient understanding of the relevant industry(s) in which the underlying business operates. Depending on the nature of the mandate and the type of Valuation Report being provided, this analysis might consider the following:
 - critical success factors;
 - competitors and their respective market shares;
 - industry regulations;
 - new developments;
 - environmental issues;
 - trading volumes and price ranges of publicly traded shares; and
 - comparable market transactions) and
 - v) Sufficient information relating to the general economic conditions affecting the underlying business operations. Such information might normally consist of selected rates of return, inflation rates and other general economic indicators.
- 4.3 A Member should determine the appropriate Premise of Value, Valuation Approaches, Valuation Methods and Valuation Procedures to be employed when performing a Valuation Service. The Premise of Value refers to going concern or liquidation basis, whereas the "Valuation Approach" refers to income (earnings or cash flow methods), cost (adjusted net book value method) and market (comparable transactions method).
- 4.4 A Member should consider key valuation components and assumptions. The key valuation components may include the following:
- normalising adjustments;
 - capitalisation rates;
 - income tax issues;
 - redundancy;
 - assumptions as noted above;
 - minority and other discounts or premiums; and
 - special purchasers.

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- 4.5 A Member should consider the necessity of relying upon the work of a specialist, for example real estate appraisers, engineers, or equipment valuers. If it is deemed appropriate to request the assistance of a specialist, the Member should obtain reasonable comfort in respect of the specialist's professional competence and degree of independence.
- 4.6 The appropriateness and reasonableness of assumptions and methods used by the specialist is the responsibility of the specialist. However, a Member should not accept a specialist's judgement and work in this regard where the report of the specialist, the Member's communication with the specialist, or the Member's knowledge of the business being valued, leads the Member to believe that the specialist's assumptions or methods are unreasonable in the circumstances.

5. Reporting and Disclosure obligations for Valuation Engagements for Financial Reporting

- 5.1 Members should refer to the mandatory reporting obligations set out in Paragraph 5 of APES 225 *Valuation Services* when they provide a Valuation Service to a Client or Employer.
- 5.2 Members providing a Valuation Engagement for Financial Reporting should consider disclosing the following:
- Identification and description of the primary Australian Accounting Standards pursuant to which the Valuation Report is prepared;
 - Definition of value used. The definition of value used may not be equivalent to other definitions of value as commonly used in other business valuation situations (e.g. fair value, net realisable value and recoverable amount); and,
 - Identification of the key facts and/or assumptions made in arriving at the Valuation conclusions, including information as to their source or basis to the extent possible.

Business combinations and Purchase Price allocations

- 5.3 A Member providing a Valuation Report in respect of a business combination and/or purchase price allocation should disclose the following:
- The identity of the acquiring entity;
 - The effective date for measurement;
 - Nature and amount of the purchase consideration. Where the Member has valued the purchase consideration, the basis of the Valuation as well as Valuation Approaches and Valuation Methods used;
 - If the Member was involved in identification of the assets acquired and/or liabilities assumed the Member may consider disclosing the basis for the identification thereof;
 - Key terms and phrases having a technical meaning;
 - Valuation Method(s) and reasons for selecting the particular Valuation Method; and
 - Significant or key assumptions and the basis for selecting such assumptions in the analysis of value of the assets acquired and/or liabilities assumed. Such assumptions would include, but are not limited to, the following (if applicable):
 - assumptions regarding economic life;
 - assumptions on revenue growth and business expenses;
 - assumptions regarding customer retention and attrition;
 - assumptions regarding technological change and migration;

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- assumptions regarding contract renewal;
 - assumptions made to determine tax amortisation benefits in respect of tangible and/or intangible assets;
 - “market-participant” assumptions and/or “buyer-specific” assumptions and related adjustments, analysis and/or impact on the valuation analysis;
 - assumptions regarding contributory asset charges;
 - assumptions affecting discount rates; and
 - assumptions regarding royalty rates.

Impairment of Goodwill and Intangible Assets

5.4 A Member providing Valuation Report in respect of Impairment testing of Goodwill or intangible assets should disclose the following:

- Cash generating unit(s) and/or assets which are the subject of the Valuation Report;
- Carrying value of the asset(s) and/or reporting unit(s);
- Key terms and phrases having a technical meaning;
- Valuation Method(s) and reasons for selecting the particular Valuation Method;
- Significant and/or key assumptions made and the basis for such assumptions in the analysis of the value of the cash generating unit(s) and/or identifiable intangible assets. Such assumptions would include, but are not limited to, the following (if applicable):
 - assumptions regarding economic life;
 - assumptions on revenue growth and business expenses;
 - assumptions regarding customer retention or attrition;
 - assumptions regarding technological change and migration;
 - assumptions regarding contract renewal;
 - assumptions made to determine tax amortisation benefits in respect of tangible and/or intangible assets;
 - “market-participant” assumptions and/or “buyer-specific” assumptions and related adjustments, analysis and/or impact on the valuation analysis;
 - assumptions regarding contributory asset charges;
 - If applicable, an analysis of the aggregate value of the cash generating unit(s) and/or discount/premium to market capitalization; and
 - Where assets are grouped for the purposes of performing an impairment test, when determining value or when assessing the amount of impairment, the basis upon which assets are grouped should be disclosed.

6. Documentation

6.1 Members should refer to the mandatory documentation obligations set out in Paragraph 6 of APES 225 *Valuation Services* when they provide a Valuation Service to a Client or Employer.

6.2 Members should determine the necessity of obtaining Management representations, preferably in writing, from management or other representatives of the relevant entity. Such representations may be in letter format, and should include a general representation that the Client or management:

- has reviewed a draft copy of the Valuation Report;

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- is satisfied with the Valuation Approaches and Valuation Methods adopted; and
 - does not have any information or knowledge which would reasonably be expected to materially affect the Conclusion of Value noted in the Valuation Report.

IVS 300 has application guidance which addresses:

- Fair value;
- Aggregation;
- Valuation inputs and Fair Value Hierarchy;
- Liabilities;
- Depreciation;
- Leases;
- Purchase price allocation; and
- Impairment testing.

Appropriate additional guidance can be considered for inclusion in the proposed APES GN 21.