

TECHNICAL STAFF PAPER

**Subject: ED 04/15 APES GN 21 *Valuation Services for Financial Reporting*
– Summary and Analysis of Key Issues.**

Purpose

The purpose of this paper is to provide:

- A summary of respondents' key issues and comments raised in response to APESB's ED 04/15 APES GN 21 *Valuation Services* (APES GN 21); and
- Technical analysis and proposed recommendations to address the key issues.

The respondents' comments have been classified as either general comments or specific comments.

Respondents' General Comments

1. Development of APES GN 21 as a guidance note

Analysis of respondents' comments

The Institute of Public Accountants (IPA) is of the view that based on APES GN 21's subject matter, it should have been developed as a standard rather than a guidance note.

CPA Australia (CPAA) does not support the proposed APES GN 21 as CPAA is of the view that the proposed guidance note does not offer additional guidance regarding a Member's professional and ethical responsibilities that is already included in APES 110 *Code of Ethics for Professional Accountants* (Code), APES 225 *Valuation Services* (APES 225), APES GN 20 *Scope and Extent of Work for Valuation Services* (APES GN 20) and other existing standards. CPAA is also concerned that the proposed APES GN 21 appears to be outside the scope of an APES guidance note as it:

- relates to the content of specific Valuation Reports, that is beyond 'the application of values and principles of practice' depicted in APESB's conceptual framework Due Process Document; and
- focuses on the provision of a Member's professional knowledge rather than the application of professional and ethical obligations.

Technical analysis

APES GN 21 has been developed as a guidance note rather than a standard, as it does not establish new requirements nor alter the requirements of an existing standard. It is designed to provide Valuation practitioners with guidance:

- on discharging their existing professional obligations in accordance with the Code and APES 225; and
- by providing guidance on the application of APES 225 in respect of Valuation Services of specific financial reporting engagements.

We are of the view that the proposed APES GN 21 provides guidance to Members on specific matters (i.e. Valuation Services conducted for Financial Reporting) on:

- applying professional knowledge and exercising sound judgement when performing Valuation Services for Financial Reporting; and
- understanding their professional reporting and disclosure obligations in the Code and APES 225.

Furthermore, the proposed APES GN 21 is inherently different to APES GN 20. APES GN 21 focuses on a particular segment of Valuation Services that has gained significance due to the use of International Financial Reporting Standards (IFRS), whereas APES GN 20 provides guidance in determining the scope and extent of review, analysis and corroboration in respect of all Valuation Services.

The proposed APES GN 21 is within APESB's role and mandate as:

- in accordance with paragraph 3.4 of APESB's Due Process Document, a guidance note can be issued when it is considered necessary to provide additional professional and ethical guidance on service specific matters to assist Members comply with the mandatory requirements of an existing standard;
- the subject matter covered in section 5 *Reporting and Disclosures for Valuation Services for Financial Reporting* is similar in nature to subject matter that is covered in other APES pronouncements in respect of reporting and disclosures such as APES 215 *Forensic Accounting Services* (paragraph 5.6), APES 225 (paragraphs 5.2 to 5.4), APES 315 *Compilation of Financial Information* (paragraph 10.10) and APES 350 *Due Diligence Committees* (paragraph 7.3);
- it will assist Members to exercise professional judgement, demonstrate professional competence and adhere to best practice when performing Valuation Services for Financial Reporting;
- it aligns the Australian business valuation practices with international best practices as other international standard setters (e.g. Canadian Institute of Chartered Business Valuators (CICBV) and American Institute of Certified Public Accountants) have issued similar professional pronouncements; and
- it is in the public interest and will benefit Members, users (e.g. Clients, auditors and regulators) and the public by contributing to the demonstration of professional competence of Members who perform Valuation Services in this critical area of practice.

Additionally, it should be noted that this project came about due to the request from CA ANZ's Business Valuation Group for the APESB to consider issuing guidance in respect of this segment of Valuation Services. Thus, the proposed APES GN 21 was developed. It is generally consistent with the scope of [Appendix B to CICBV Practice Standard No.110 Valuation for Financial Reporting](#)¹.

We further note that the proposed APES GN 21 will be useful for sole practitioners and small and medium practices, who may lack the requisite internal resources to generate similar guidance.

¹ Canadian Institute of Chartered Business Valuators. Appendix B to Practice Standards No.110 *Valuation for Financial Reporting*.

Respondents' Specific Comments

1. Scope and application of APES GN 21

Analysis of respondents' comments

CPAA recommends that the disclosure guidelines set out in the proposed APES GN 21 are aligned with the disclosure requirements of the relevant Australian Accounting Standards.

In addition, CPAA and IPA suggest that the proposed APES GN 21 encompass the following subject matter:

- impairment of tangible assets and valuation of assets in the public and private not-for-profit sectors;
- valuations undertaken in relation to the requirements of AASB 140 *Investment Property* and AASB 141 *Agriculture*; and
- valuations prepared for the use in pro-forma financial statements or Investigating Accountant Reports in product disclosure statements.

Technical analysis

The proposed APES GN 21 is intended to provide Members with guidance on applying their professional judgement when forming views in respect of the fair value measurements of certain assets and liabilities in financial statements. It is not intended to reproduce the disclosure requirements that are provided by the relevant Australian Accounting Standards.

A Valuation Service under APES 225 must be of a business, business ownership interest, security or intangible assets. Accordingly, the proposed APES GN 21 is based on Valuation Services for Financial Reporting that are in respect of estimating the value of business, business ownership interest, security or intangible assets. A Valuation Service performed for half-year or full year financial reporting, pro-forma financial statements or Investigating Accountant Reports will be within scope as long as it meets the definition of what is a Valuation for the purpose of APES 225.

Therefore, the proposed APES GN 21 does not apply to valuation of a subject matter that is not within the scope of APES 225 such as valuations in respect of other Australian Accounting Standards (e.g. AASB 102 *Inventories*, AASB 116 *Property, Plant & Equipment*, AASB 119 *Employee Benefits*, AASB 140 *Investment Property* and AASB 141 *Agriculture*).

2. Definitions

Analysis of respondents' comments

CPAA queried the rationale of including Australian Accounting Standards Board (AASB) definitions and the extent of reproduction in the proposed APES GN 21.

Technical analysis

Definitions are included in the proposed APES GN 21 if they appear multiple times and are relevant to a Member's understanding of the proposed guidance note's context. A Member is also required to have a detailed understanding of the Australian Accounting Standards that are relevant to the Valuation Services performed. Thus, certain AASB definitions are included in the proposed APES GN 21 and cross referred to the relevant AASB Standard.

However, the proposed APES GN 21 only includes excerpts of the relevant AASB 2 definitions (i.e. equity instrument, grant date, market conditions, measurement date and vesting conditions) in order to:

- refer a Member to applicable AASB Standards in respect of these defined terms; and
- avoid updating these definitions periodically when the AASB makes amendments to these definitions.

Therefore, a cross reference to the defined terms in AASB Standards have been included with sufficient reproduction for the reader to get an overview of these definitions.

3. Scope of Valuation Services for Financial Reporting

Analysis of respondents' comments

CPAA noted that the 'scope of work to be performed' is one of APES GN 21's objectives in paragraph 1.1 and the relevant guidance is included in Section 4 *Scope of Valuation Services for Financial Reporting*. However, CPAA is of the view that Section 4 should be deleted as it does not appear to provide any extra guidance apart from the guidance included in the existing APESB pronouncements.

Technical analysis

This section should be retained as section 4 of APES GN 21 provides guidance to a Member in determining the scope of work to be performed in respect a Valuation Services for Financial Reporting and includes additional matters that the Member should consider when performing such a service:

- identifying the applicable Australian Accounting Standards used; and
- considering regulatory issues that may impact the Valuation Service.

However, it is proposed that paragraph 4.3 is enhanced to clarify the guidance provided as follows:

4.3 Subject to the Terms of Engagement and depending on the Valuation Service being performed, a Member in Public Practice is required to refer to the mandatory professional and ethical requirements in section 3 *Professional competence and due care* in APES 225 when planning the extent of work for a Valuation Service for Financial Reporting.

~~4.3~~ 4.4 Subject to the Terms of Engagement, where a Member in Public Practice is providing a Valuation Service for Financial Reporting in respect of a Valuation Engagement, the ~~M~~matters the Member may to be considered include obtaining sufficient understanding of the:

- i) subject matter of the Valuation Service by reviewing relevant documentation which include agreements, contracts, letters of understanding, letters of intent and correspondence;
- ii) applicable Australian Accounting Standards;
- iii) characteristics, economic conditions, industry, underlying business operations and historical/forecast financial information related to the interest being valued; and
- iv) ~~contemporary and emerging~~ regulatory issues that may impact the Valuation Service.

4. Reporting and disclosures for Valuation Services for Financial Reporting

Analysis of respondents' comments

IPA is of the view that the proposed APES GN 21 lack specific guidance in relation to requirements of various Australian Accounting Standards, particularly AASB 13 *Fair Value Measurement*. IPA recommends that the following matters in respect of AASB 13 should be addressed in the proposed guidance note:

- the Valuation Report has been prepared in accordance with the requirements of AASB 13;
- the identification of market participants on which the basis of assumptions and valuation techniques have been chosen (AASB 13.22);
- the valuation techniques applied e.g. market approach, cost approach or income approach (AASB 13.61-66 and AASB 13.B5-B11);
- the level of the inputs used in the valuation (level 1-3);
- whether cost of disposal has been included as part of the valuation and the basis for its determination;
- recurring valuations using level 3 of fair value hierarchy should include the description of the sensitivity of fair value measurements (AASB 13.93(h)); and
- sufficient information to enable compliance with the disclosure requirements of AASB 13.

Technical analysis

The proposed APES GN 21's purpose is to provide guidance to Members on matters to consider in respect of the Code and APES 225 when providing a Valuation Report pertaining to Valuation Services for Financial Reporting. It is not intended to include the requirements and principles of AASB 13, nor to reproduce details of this Accounting Standard in APES GN 21.

Accordingly, the preambles to paragraph 5.4, 5.7, 5.8 to 5.10 clarify that the guidance note does not purport to include all possible disclosures that a Member should consider when providing a Valuation Report. Additionally, the guidance on a Member's professional and ethical obligations (in respect of matters noted by the respondent) are addressed in the following paragraphs of the proposed APES GN 21:

- paragraph 4.3 (ii), which provides guidance that a Member should obtain sufficient understanding of the applicable Australian Accounting Standards (e.g. AASB 13); and
- section 5, which addresses the reporting and disclosure considerations of the proposed APES GN 21.

5. Disclosure of applicable Australian Accounting Standards and definition of value used

Analysis of respondents' comments

CPAA queried the rationale of disclosing the Australian Accounting Standards in a Valuation Report and is of the view that the word identification in paragraph 5.3 'identification of the applicable Australian Accounting Standards pursuant to which the valuation report is prepared' is redundant.

CPAA also believes that the guidance to disclose the definition of value in paragraph 5.3 of the proposed APES GN 21 is vague and should be clarified.

Technical analysis

Members should consider disclosing the specific accounting purpose (e.g. measuring the carrying amount, undertaking an allocation of the purchase price following a business combination or impairment testing) for which the Valuation is required. Thus, the relevant Australian Accounting Standards under which the Valuation Service for Financial Reporting is performed should be disclosed in the Valuation Report.

However, we agree with respondent's comments in respect of removing the word 'identification' and clarifying the guidance on the definition of value. Accordingly, paragraph 5.3 will be updated as follows:

5.3 A Member providing a Valuation Service for Financial Reporting should consider disclose ~~disclosing~~ the following:

- ~~Identification of the a~~*Applicable Australian Accounting Standards pursuant to which the Valuation Report is prepared;*
- *Definition of value used and related explanations to clarify the definition of value (if applicable, a statement that the definition of value used may not be equivalent to other definitions of value as commonly used in other business Valuation situations); and*
- ~~Identification of the s~~*Source or basis of key facts and/or assumptions made in arriving at the Conclusion of Value or Calculated Value.*

6. Business combinations

Analysis of respondents' comments

CPAA is of the view that the disclosure of assumptions is a requirement in paragraph 5.2 (l) of APES 225. Thus, paragraphs 5.4, 5.7 to 5.10 of the proposed APES GN 21 should not be presented as guidance.

Whereas, IPA has recommended that the explicit requirements of AASB 3 *Business Combinations* and AASB 138 *Intangible Assets* should be addressed in paragraph 5.4 of the proposed APES GN 21 particularly:

- recognition and measurement requirements of intangible assets acquired in a business combination (AASB 138.35-37);
- assignments to carry out purchase price allocations in the context of AASB 3;
- purchase price allocations determined on a provisional basis (AASB 3.45) and that any subsequent adjustments that impact the goodwill or bargain purchase price;
- the Valuation basis and the assumptions used in determining the fair value of consideration;
- the basis for recognition and measurement of assumptions used in determining contingent consideration;
- the responsibility of the preparer to address the application of AASB 3; and
- the circumstances where the proposed treatment of the business combination is not in accordance with AASB 3.

Technical analysis

Paragraph 5.2 (l) of APES 225 requires a Member in Public Practice who prepares a written Valuation Report in respect of all Valuation Services to include the description of material assumptions applied in the Valuation and the basis for those assumptions. Whereas, paragraphs 5.4 and 5.8 to 5.10 in the proposed APES GN 21 provide guidance to Members by:

- providing matters that a Member should consider in applying APES 225 in specific circumstances; and
- elaborating on key assumptions that may vary depending on the type of Valuation Services conducted in respect of financial reporting and the applicable Australian Accounting Standards.

However, we agree with the respondent's comment that some disclosure considerations provided in these paragraphs are requirements. Accordingly, we propose to amend these paragraphs by linking them back to paragraph 5.1 of the proposed APES GN 21 as that paragraph in turn, links back to the mandatory nature of the reporting obligations in APES 225.

The proposed APES GN 21 is neither intended to include the requirements and principles of AASB 3 or AASB 138, nor to reproduce details of these Accounting Standards. Additionally, the existing paragraph 5.4 includes guidance on business combinations (i.e. that encompasses purchase price allocations).

7. Impairment of goodwill and intangible assets

Analysis of respondents' comments

IPA has recommended that the following matters should be addressed in paragraph 5.7 of the proposed APES GN 21:

- the specific requirements of AASB 136, particularly the Value in Use method of impairment testing;
- the responsibility for the determination of Cash Generating Units (CGUs) and where the responsibility lies with the preparer of the report, the basis for determining CGUs;
- the treatment of "Group"/Shared Services" assets and/or charges in CGUs;
- the basis for determining increases in working capital requirements, and
- the method for determining terminal value (i.e. perpetual growth model or exit multiple approach) and the assumptions used.

Technical analysis

The proposed APES GN 21 is not intended to include the requirements and principles of AASB 136, nor to reproduce details of this Accounting Standard. The principles of the matters noted by respondent are addressed in paragraph 5.7 (i.e. the significant or key assumptions and the basis for such assumptions in the valuation of the Cash-Generating Unit (CGU)), as well as the subject matter in paragraph 5.2 in APES 225.

8. Superannuation entities

Analysis of respondents' comments

CPAA is of the view that paragraph 5.10 of the proposed APES GN 21 (i.e. a Member should consider disclosing in a Valuation Report, the work undertaken by the Member to ensure they are satisfied with the data, tools or information provided by a manager of assets held superannuation entities, if the Member has relied on the data, tools or information) is a requirement in paragraph 5.2 (k) of APES 225.

Technical analysis

We note the respondent's comment that in principle paragraph 5.2 (k) addresses this issue. However, in this case it provides guidance in the context of the situation (i.e. manager of an asset providing information). Accordingly, no amendments are proposed.

Summary

IPA was supportive of providing guidance to Members in respect of Valuation Services for Financial Reporting and queried why this guidance note was not developed as a professional standard.

CPAA was not supportive of the proposed APES GN 21 as the respondent perceived that the subject matters covered in the proposed APES GN 21 were not within APESB's mandate and are addressed in existing APESB pronouncements.

However, as noted previously in accordance with paragraph 3.4 of APESB's Due Process Document, a guidance note can be issued when it is considered necessary to provide additional professional and ethical guidance on service specific matters to assist Members to comply with the mandatory requirements of an existing standard.

Furthermore, the subject matter addressed in the proposed APES GN 21 is within APESB's role and mandate as in nature are consistent with the subject matters covered in other APES pronouncements (e.g. APES 215, APES 225, APES 315, APES 350).

We also believe that the existence of APES GN 21 and Members adherence to it will enable Members to demonstrate their professional competence in providing Valuation Services in respect of Financial Reporting.

The marked-up APES GN 21 depicts the amended version of the proposed guidance note incorporating editorials to address the respondents' comments.