APESB

Accounting Professional & Ethical Standards Board

TECHNICAL STAFF PAPER

Subject: Proposed APES GN 20 *Scope and Extent of Work for Valuation Services*

Purpose

The purpose of this paper is to provide the Board with:

- a summary of key issues raised by the Taskforce regarding the appropriateness of the proposed APES GN 20 *Scope and Extent of Work for Valuation Services*; and
- Technical staff comments, views and recommendations.

A summary of the major issues raised by the Taskforce and Technical staff comments, views and recommendations on the issues raised are given below.

1. Review of Taskforce Comments

(i) APESB's mandate and constitution

Taskforce Comments

Some members of the Taskforce are of the view that APESB as the professional and ethical standards setter is acting outside of its mandate in issuing this guidance note. The Taskforce members who hold this opinion are of the view that the content of APES GN 20 includes technical valuations matters, and that another standard setter should be responsible for technical guidance in valuations. One task member suggested that the Australian Accounting Standards Board (AASB) should be responsible for technical guidance in valuations. These Taskforce views are predicated on the guidance note being based on technical guidance from the Canadian Institute of Chartered Business Valuators (CICBV), which is described by a Taskforce member as a "technical and educational body".

Technical Staff Response

The mandates or primary objects of the relevant Australian Boards referred to by the Taskforce are noted below.

<u>APESB's primary objects</u>

(a) To develop and issue in the public interest professional and ethical standards that will apply to the Membership of the Professional Bodies. Professional and ethical standards include but are not limited to;

- Code of ethics for professional accountants;
- Miscellaneous professional statements and guidance notes; and
- Such other ethical issues or similar matters of interest in respect of the accounting profession.

(b) To provide a formal and rigorous forum for the consideration, promulgation and approval of professional and ethical standards, which is performed in an open, timely, independent and proactive manner.

(c) To establish the Secretariat.

AASB's mandate

The AASB is an Australian Government agency under the *Australian Securities and Investments Commission Act 2001*. Under that Act, the statutory functions of the AASB are:

- to develop a conceptual framework for the purpose of evaluating proposed standards;
- to make accounting standards under section 334 of the Corporations Act 2001;
- to formulate accounting standards for other purposes;
- to participate in and contribute to the development of a single set of accounting standards for worldwide use;
- and to advance and promote the main objects of Part 12 of the ASIC Act, which include reducing the cost of capital, enabling Australian entities to compete effectively overseas and maintaining investor confidence in the Australian economy.

The mission of the AASB is to:

(a) develop and maintain high-quality financial reporting standards for all sectors of the Australian economy; and

(b) contribute, through leadership and talent, to the development of global financial reporting standards and to be recognised as facilitating the inclusion of the Australian community in global standard setting.

Clearly the focus of the AASB is on accounting matters as it relates to financial reporting and therefore a guidance note which addresses professional requirements and the scope and extent of work performed in respect of a Valuation Service will be outside of its mandate.

AUASB's mandate

The Auditing and Assurance Standards Board (AUASB) is an independent, statutory agency of the Australian Government, responsible for developing, issuing and maintaining auditing and assurance standards.

The mission of the AUASB is to develop, in the public interest, high-quality auditing and assurance standards and related guidance, as a means to enhance the relevance, reliability and timeliness of information provided to users of auditing and assurance services.

Clearly a guidance note on professional and ethical matters on a non-assurance service is not within AUASB's mandate.

Canadian Institute of Chartered Business Valuators

CICBV's Vision and Mission is noted below:

To lead and promote the business valuation profession.

To have the CBV recognized as the pre-eminent designation for business valuation and related financial expertise.

Further the mandate of the CICBV encompasses all requirements and it is not appropriate to say that it only addresses technical and educational matters for Canadian valuation practitioners. For example, the CICBV issues a Code of Ethics for its Members which serves to protect the profession and the public interest by:

- Setting the "minimum level of acceptable professional conduct for Members and Students. It clarifies the nature of behaviour essential to maintaining the professional reputation of CBVs and the Institute. Furthermore, the Code forms the basis of disciplinary procedures through which allegations of professional misconduct can be addressed by the Institute; and
- Providing "the public with the assurance that the Institute is imposing on its Members and Students the highest professional standards and ethics by which they are willing to be judged".

The CICBV is not simply a technical and educational body but rather a professional body akin to the professional accounting bodies in Australia. According to the CICBV website, Membership comprises more than accountants but rather "individuals with wide-ranging backgrounds including commerce, accounting, law and economics, as well as those holding accounting and financial designations such as CA, CMA, CGA and CFA".

The CICBV espouses a Code of Ethics and their Practice Standards and Practice Bulletins are similar in purpose to the APES suite of Standards and Guidance Notes, but focussed on Valuation matters. The expressed purpose of the Practice Bulletins is to "assist Members in the exercise of their professional judgment in carrying out assignments". Professional judgment is often referred to in the Code as an important aspect of a Member's behaviour that assists in complying with the fundamental ethical principles.

CICBV's Practice Standards 110-120 were reviewed when APES 225 was originally developed and some of that content is included in APES 225. This is particularly the case in respect of Practice Standard no. 110 *Valuation Report Standards and Recommendations*. CICBV Practice Bulletin 3 (upon which APES GN 20 is based) provides guidance on practice standards 110 and 120 (refer Paragraph 1 of Practice Bulletin no.3).

Summary

From this review it is clear that the issue of this guidance note is not within the AASB's or AUASB's mandate. Within the current Australian framework only the APESB or the professional accounting bodies would be able to issue a guidance note that provides guidance to Members in respect of a non-assurance service.

APESB is the appropriate body to issue professional and ethical guidance in respect of a non-assurance service and to do so is within APESB's mandate. The primary objects are also not strict but rather are defined as including "miscellaneous professional statements and guidance notes and similar matters of interest in respect of the accounting profession".

The guidance note is specifically designed to support the use of APES 225 *Valuation Services*. The other Australian accounting boards have a more specific mandate which restricts them to financial reporting and auditing matters whereas APESB has mandate to address professional and ethical matters. It is clear that APESB is acting within its primary objects in issuing a guidance note on a non-assurance service.

The only issue the Board needs to carefully consider is the issue of technical matters and not to stray in to technical valuation matters. We agree with the Taskforce member that based on the current constitution that the Board's scope is limited to professional and ethical matters.

When issuing APES 225 the Board determined that disclosures in a Valuation Report are a professional and ethical matter and hence the key aspect of APES 225 is the Valuation Report. These Valuation Report disclosures are based on CICBV Standard 110 and AICPA's Standard SSVS 1. As the CICBV Practice Bulletin 3 is providing guidance on Practice Standards 110-120 and is in respect of *Guidance on Types of Valuation Reports* it can be argued that it is appropriate for the Board to issue this guidance to support APES 225 in a similar manner to the CICBV.

(ii) Public interest

Taskforce Comments

Some Taskforce members presented the view that the guidance note is not in the public interest. There are a number of reasons presented, as follows:

- APES GN 20 does not solve any current problem and there are numerous academic sources of reference that would provide Members with the same benefits as this guidance note;
- Despite being issued as guidance, it would be considered a de facto standard by the Courts and interpreted as authoritative, therefore Members would need to justify any departures from its contents in a judicial proceeding;
- The guidance in APES GN 20 is, in specific areas, contrary to Australian practice;
- The guidance in APES GN 20 is too narrow in scope to be useful; and
- APES GN 20 provides new prescriptive requirements that are not presently in APES 225.

Technical Staff Response

APES GN 20 is in the public interest for many reasons and the arguments against it could be solved through further editorial work in addressing the specific concerns raised and in restructuring the guidance note. The following is a list of reasons why APES GN 20 is in the public interest:

- The public interest must be considered from the public, customer and Member's interest. Therefore considering the guidance note solely from the perspective of the Member and in particular the Member's ability to defend their conduct in the courts is not appropriate. One of the benefits of the guidance note is its ability to inform the Client of the scope and extent of work necessary to complete a particular Valuation Service and in assisting in communicating this to the Client and both parties having a mutual understanding of expectations of the work to be performed;

- Assuming the content in the guidance note is correct and if it contributes to better standard of work to be performed by all Members who perform Valuation Services in Australia then it can be argued that it is in the customers and public's interest for such a guidance note to exist;
- Some Members may not prefer such authoritative guidance to exist as it is not in their self-interest. Members may also perceive that such a guidance note will provide the Client with additional bargaining power in setting fees due to their increased understanding of the scope and extent of work necessary in respect of a particular Valuation Service. However, it can also be argued that this transparency of fee negotiation is in the public interest and protects consumers;
- If the guidance note provides assistance to the Member to exercise professional judgement and for the Member to demonstrate professional competence when performing an applicable Valuation Service that they adhered to best practice then it is in the public interest to issue the guidance note. Sole practitioners and Members in smaller firms or those who do not perform Valuation Services on a regular basis would especially benefit from additional guidance since they may not be able to generate such guidance internally. It also provides Clients with a consistent service offering from all Valuation practitioners across Australia;
- However, as noted by some Taskforce members, if there are elements in the current guidance note that are not accurate in all circumstances, or contrary to appropriate practice, and if this then leads to Members being hindered in exercising their professional judgement, then these concerns must be addressed and rectified prior to finalising this guidance note.

Some of the concerns the Taskforce members have are in respect of the scope and extent of work to be performed in the three different types of Valuation Engagements. Currently, these are illustrated through tables which provide practical examples.

One option for the Board to consider to address these concerns is to move these tables to an appendix (i.e. similar to the treatment of the Service Level Agreement in APES GN 30) and then including a preamble with qualifiers in the introduction to the appendix to say that the guidance does depend on the circumstances of the particular Client and the applicable Valuation Service.

(iii) Technical guidance in APES GN 20

Taskforce Comments

Some Taskforce members present the view that technical standards contain guidance on 'how' to do a valuation and that APES GN 20 is straying into that territory by presenting guidance on the scope and extent of Valuation Procedures. Further to this, the Taskforce members expressed concern that some of the provisions in the guidance note cannot be directly attributed to requirements from APES 225, notably Paragraphs 4.5 and 4.6 of APES GN 20.

Technical Staff Response

The guidance note on its own is not sufficient to show a Member on how to perform a Valuation nor does it contain any Valuation Approaches and Methods or calculations. It is designed to aid the Member in meeting one of the fundamental professional and ethical obligations of *professional competence and due care* by providing guidance on how to differentiate between the three Valuation Services through the scope and extent of procedures performed and evidence obtained. There are no specific requirements, instead general factors and ranges are used

Paragraphs 4.5 and 4.6 of APES GN 20, as noted by the Taskforce members, provide guidance for Members to assist them in meeting the requirements of paragraphs 4.5 and 5.2 (k) since these requirements relate directly to the gathering of sufficient and appropriate evidence and the reporting of the extent of reliance on that evidence by the Member. Paragraphs 4.5 and 4.6 of APES GN 20 recommend that a Member exercises their professional judgment first and foremost and then provides matters to consider in planning the scope of work and defining the engagement.

Duly noted by a Taskforce member in a letter to the Board, which is included on a confidential basis as Attachment 18(f), the first step in the valuation process commences *after* defining the assignment. This statement is attributed to a prominent academic source. Since the purpose of APES GN 20 is to assist Members in defining the scope of the engagement, it can be asserted that it does not provide technical guidance on how to conduct the valuation process, therefore is not technical in nature.

Members who wish to obtain technical guidance could refer to the standards of the International Valuation Standards Committee, the CICBV standards that are more technical in nature or the AICPA Standard.

Furthermore, an example of a standard that has technical and professional requirements is the AICPA's *Statement on Standards for Valuation Services* (SSVS 1). This is a self-contained standard and during the development of APES 225 this standard was reviewed primarily to obtain the requirements of a Valuation Report.

SSVS 1 paragraph 29 states that:

> *The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as:*
> - *Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years*
> - *Prospective financial information (for example, budgets, forecasts, and projections)*
> - *Comparative summaries of financial statements or information covering a relevant time period*
> - *Comparative common size financial statements for the subject entity for an appropriate number of years*
> - *Comparative common size industry financial information for a relevant time period*
> - *Income tax returns for an appropriate number of years*
> - *Information on compensation for owners including benefits and personal expenses*
> - *Information on key man or officers' life insurance*
> - *Management's response to inquiry regarding:*
>   - *Advantageous or disadvantageous contracts*
>   - *Contingent or off-balance-sheet assets or liabilities*
>   - *Information on prior sales of company stock*

In the context of Valuation Services it is generally understood that the technical aspects are addressed by:

- Valuation Approaches;
- Valuation Methods; and

- Valuation Procedures.

In this hierarchy, Valuation Procedures is the lowest ranked item.

It is quite evident from a detailed review of SSVS 1 that APES GN 20 does not address Valuation Approaches and Valuation Methods (Refer attached Appendix 1 and paragraphs 31 to 41 of SSVS1).

It could be argued that APES GN 20 does provide some guidance on the scope and extent of Valuation Procedures. However, it is debatable whether APES GN 20 has sufficient information for a Member to determine all the Valuation Procedures that are required in different contexts and for this reason should not be considered to be technical guidance.

Quite distinct from APES 225 or APES GN 20, the SSVS 1 provides, under the section *Development*, requirements for the 'valuation analyst' to perform specific analysis of the subject interest, obtain specific types of nonfinancial information (e.g. products, key customers and suppliers, future plans), and review specific financial information (e.g. prospective financial information, income tax returns). The SSVS 1 also names common Valuation Approaches and Methods and lists specific factors to consider in applying each approach or method. The 'valuation analyst' is also instructed to perform such activities as 'correlate', 'reconcile', 'assess' and 'determine'. This goes far beyond the guidance in the proposed APES GN 20.

One may argue that the inclusion of considerations of the economy, industry, company etc. is technical guidance. However, one of the regulatory guides issued by ASIC in 2007 is RG 111 *Content of Experts Report*. This regulatory guide addresses similar content that an expert should consider when preparing experts reports.

APES 225 paragraph 3.9 states that a Member should consider guidance issued by professional bodies and regulatory authorities. Accordingly in the context of Experts Reports in the current environment Members would be considering the economy, industry, and company specific information. This guidance would be useful for Members to consider in contexts other than Experts Reports and accordingly it can be argued that the guidance provided in paragraph 4.5 of the proposed APES GN 20 is useful for Members.

(iv) Scope of the guidance note

<u>*Taskforce Comments*</u>

Some Taskforce members are concerned that the guidance note does not benefit Members as it is restricted to only certain aspects of Valuation Services, and therefore is too narrow of scope for effective use. These Taskforce members also profess the view that the guidance note goes further than APES 225 in other respects, introducing new requirements such as that the Member should assess the sufficiency and appropriateness of the Valuation Service for the purpose of which it is intended.

A Taskforce member is also of the view that the guidance note recommends the Member perform a more comprehensive review and analysis of the economic environment for a business being valued than in current Australian valuation practice.

<u>*Technical Staff Response*</u>

The guidance note is the first pronouncement which assists Members in applying the requirements of APES 225. Another guidance note on *Valuations for Financial Reporting* is also planned. Guidance notes need not cover all of the subject matter of the standard they support, rather their very nature allows for them to apply to specific areas of focus. It is written broad enough that, despite its inclination towards the valuation of a business interest and fair market valuation, it is designed to be applied to all types of Valuation

Services. This is consistent with the scope of the CICBV Practice Bulletin upon which it is based which applies to valuations that “provide a conclusion as to the value of shares, assets or an interest in a business”.

The guidance to assess the sufficiency and appropriateness of the Valuation Service for the purpose of which it is intended relates to Paragraph 4.5 of APES 225 which requires a Member to “gather sufficient and appropriate evidence by such means as inspection, inquiry, computation and analysis to provide reasonable grounds that the Valuation Report and the conclusions therein are properly supported. When determining the extent and quality of evidence necessary the Member shall exercise professional judgement, considering the nature of the Valuation, the type of Valuation Service and the use to which the Valuation Report will be put”. Technical Staff is of the view that the guidance in the proposed APES GN 20 serves to assist the Member in complying with this requirement from APES 225.

In respect of the Taskforce member’s comment in respect of paragraph 4.6 of the proposed APES GN 20 being more stringent than current Australian practice, these requirements only relate to full scope Valuation Engagements. Based on the AICPA and CICBV standards, the expectations of those jurisdictions in the context of full scope Valuation Engagements is for valuation practitioners to perform a comprehensive review of the economic environment and there are sufficient information sources that can be accessed for this purpose.

If the current Australian practice is at a lower level than current US and Canadian practice then that by itself is not a strong argument to continue to maintain a lower standard of practice in Australia.

2. Technical Staff Recommendations/Way forward

Technical Staff recommend that the guidance in the tables in paragraphs 4.4, 4.6, 4.10 and 5.2 be moved to an appendix (refer Appendix 2 of this Technical Staff Paper) in the guidance note so as to dissuade Members and other readers from overemphasising their importance as illustrative examples; a similar approach has been used to draft examples and additional guidance in other APESB standards. Thereafter any other concerns in the body of the guidance note should be addressed so that it suits the different circumstances in which Valuation Services are performed.

As long as the guidance note addresses professional and ethical requirements, assists Members to exercise professional judgment and to demonstrate to the public that they have acted with *professional competence and due care* (one of the five fundamental ethical obligations of a Member) in performing the applicable Valuation Service, then the issuance of this guidance note is in the public interest.

Furthermore, it has the potential to benefit Members and the public interest by elevating the level of professional conduct of Members who perform Valuation Services in Australia.

Moreover, the key aspect of APES 225 is the Valuation Report. The proposed APES GN 20 is based on CICBV’s Practice Bulletin no. 3 which provides guidance on Valuation Reports and is referred back to CICBV’s Standard 110 on Valuation Reports. Accordingly it is appropriate for APESB to also consider issuing guidance on Valuation Reports to assist Members to apply the requirements of APES 225.

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Appendix 1
Extract of AICPA's SSVS 1 – Paragraphs 25-45

Analysis of the Subject Interest

25. The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable **premise of value**
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

26. In analyzing the subject interest, the valuation analyst should consider financial and nonfinancial information. The type, availability, and significance of such information vary with the subject interest.

Nonfinancial information

27. The valuation analyst should, as available and applicable to the valuation engagement, obtain sufficient nonfinancial information to enable him or her to understand the subject entity, including its:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of **equity** ownership interests and rights attached thereto
- Products or services, or both
- Economic environment
- Geographical markets
- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**
- Strategy and future plans
- Governmental or regulatory environment

Ownership Information

28. The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to:

- Determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics
- Analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest
- Understand the classes of equity ownership interests and rights attached thereto
- Understand the rights included in, or excluded from, each intangible asset

- Understand other matters that may affect the value of the subject interest, such as:
    - For a business, business ownership interest, or security: shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest
    - For an intangible asset: legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations

Financial Information

29. The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding:
    - Advantageous or disadvantageous contracts
    - Contingent or off-balance-sheet assets or liabilities
    - Information on prior sales of company stock

30. The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

Valuation Approaches and Methods

31. In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (Income-based) approach**
- **Asset (Asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (Market-based) approach**

32. The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs 33–41, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this Statement.

33. *Income Approach*. Two frequently used valuation methods under the income approach include the **capitalization of benefits method** (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows).

When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

a. *Capitalization of benefits (for example, earnings or cash flows) method*. The valuation analyst should consider the following:

- ***Normalization*** adjustments
- Nonrecurring revenue and expense items
- Taxes
- **Capital structure** and financing costs
- Appropriate capital investments
- Noncash items
- Qualitative judgments for risks used to compute discount and **capitalization rates**
- Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)

b. *Discounted future benefits method (for example, earnings or cash flows)*. In addition to the items in item a above, the valuation analyst should consider:

- Forecast/projection assumptions
- Forecast/projected earnings or cash flows
- **Terminal value**

c. *For an intangible asset*, the valuation analyst should also consider, when relevant:

- Remaining useful life
- Current and anticipated future use of the intangible asset
- Rights attributable to the intangible asset
- Position of intangible asset in its life cycle
- Appropriate discount rate for the intangible asset
- Appropriate ***capital or contributory asset charge***, if any
- Research and development or marketing expense needed to support the intangible asset in its existing state
- Allocation of income (for example, ***incremental income, residual income,*** or ***profit split income***) to intangible asset
- Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset 17
- Whether any tax amortization benefit would be included in the analysis
- Discounted multi-year excess earnings
- Market royalties
- Relief from royalty

Asset Approach and Cost Approach

34. A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

35. When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

Market Approach

36. Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are:

- **Guideline public company method**
- ***Guideline company transactions method***
- Guideline sales of interests in the subject entity, such as business
- ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are:

- Comparable uncontrolled transactions method (which is based on
- arm's-length sales or licenses of guideline intangible assets)
- Comparable profit margin method (which is based on comparison
- of the profit margin earned by the subject entity that owns or operates the intangible asset to profit margins earned by guideline companies)
- ***Relief from royalty method*** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

37. In applying the methods listed in paragraph 36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

38. The valuation analyst should set forth in the report the rationale and support for the valuation methods used (paragraph 47).

39. Rules of Thumb. Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as rules of thumb) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

Valuation Adjustments

40. During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

41. When valuing a controlling ownership interest under the income approach, the value of any **nonoperating assets**, nonoperating liabilities, or ***excess or deficient operating assets*** should be excluded from the computation of the value based on the operating assets and should be added to or deleted from the value of the operating entity. When valuing a noncontrolling ownership interest under the income approach, the value of any nonoperating assets, nonoperating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the noncontrolling interest. In the asset-based or cost approach, it may not be necessary to separately consider nonoperating assets, nonoperating liabilities, or excess or deficient operating assets.

Conclusion of Value

42. In arriving at a conclusion of value, the valuation analyst should:
   a. Correlate and reconcile the results obtained under the different approaches and methods used.
   b. Assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
   c. Determine, based on items a and b, whether the conclusion of value should reflect (1) the results of one valuation approach and method or (2) a combination of the results of more than one valuation approach and method.

Subsequent Events

43. The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a ***subsequent event***. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (paragraphs 52(p), 71(r), and 74). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

Documentation

44. Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs 25–30)
- Assumptions and limiting conditions (paragraph 18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph 19)
- Basis for using any ***valuation assumption*** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph 43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph 39)
- Other documentation considered relevant to the engagement by the valuation analyst

45. The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

Appendix 2

Proforma Extract of APES GN 20 if the Tables and Examples are moved to an Appendix

This Appendix contains tables with examples to assist Members in determining the scope and extent of work required for Valuation Services as defined in APES 225.

Members are cautioned that the determination of nature and extent of work for a particular Valuation Service is a matter to be judged based on the particular facts and circumstances. The examples contained in this Appendix are provided for illustrative purposes only and are not intended to be, and cannot be, all inclusive. The examples are not a substitute for reading the full text of APES 225 and applying it to the particular circumstances of the Valuation Service.

Each type of Valuation Service carries professional obligations specific to its purpose and therefore it is important for Members to consult APES 225 in making this determination. Members are cautioned that the determination of what type of Valuation Service is appropriate under APES 225 is a matter to be judged based on the particular facts and circumstances.

Table 1: Scope and extent of work for Valuation Services

To assist the Member exercise professional judgment in planning the scope of work for a Valuation Service, a summary table is provided below:

Type of Valuation Service	**Extent of Valuation Approaches, Methods and Procedures applied in the review and analysis of significant information**	**Extent of evidence obtained**
Valuation Engagement	Comprehensive use of Valuation Approaches, Valuation Methods and Valuation Procedures applied to the review and analysis of business and industry and all other significant information and factors.	Evidence obtained for significant information and factors.
Limited Scope Valuation Engagement	Limited use of Valuation Approaches, Valuation Methods and Valuation Procedures applied in the review and analysis of significant information.	Limited evidence obtained for significant information.
Calculation Engagement	Minimal use of Valuation Approaches, Valuation Methods and Valuation Procedures applied to the review and analysis of significant information.	Little or no evidence obtained for significant information.

Table 2: Extent of review and analysis

In determining the extent of review and analysis to be undertaken, Members should use their expertise and professional judgement. The following table provides guidance to Members on the extent of work that might be undertaken in each of the five areas, depending on the type of Valuation Service.

	External	**Internal**		**Valuation Approaches, Valuation Methods & Valuation Procedures**	
Type of Valuation Service	**Economic Environment and Industry Context**	**Company Specific Non-Financial Information**	**Company Specific Financial Information**	**Valuation Context**	**Valuation Assessments**
Valuation Engagement	Comprehensive	Comprehensive	Comprehensive	Comprehensive	Comprehensive
Limited Scope Valuation Engagement	Limited	Limited	Limited	Limited to Comprehensive	Limited to Comprehensive
Calculation Engagement	Minimal	Minimal	Minimal	Minimal to Limited	Minimal to Limited

Table 3: Extent of supporting evidence obtained

The following table provides examples of the continuum of extent of supporting evidence that might be obtained in respect of cash flow projections and guideline company analysis. This continuum goes from the highest extent of supporting evidence of information and factors to that which entails the lowest extent of supporting evidence, with the highest extent being appropriate for Valuation Engagements and the lowest to Calculation Engagements.

Information	**Extent of Evidence Obtained**	**Examples of Supporting Evidence**
Cash flow projections	Highest ↓ Lowest	In-depth comparison of assumptions, interviews of management, comparison of supporting documentation and industry benchmarks. Reliance on representations or assumptions without in-depth analysis, review, and/or assessment.
Guideline company analysis	Highest ↓ Lowest	In-depth analysis of selected information including business mix, financial performance, normalisation adjustments with comparison back to primary source documents. Use of high level comparisons without review from data aggregators (e.g. Bloomberg or Capital IQ).

Table 4: Context of a Valuation Service

The following table provides examples that may be relevant to consider in assessing the appropriateness and reasonableness of a Valuation Service within each of these contexts. The ultimate choice of the type of Valuation Service is a and the responsibility of the Client; having regard to the circumstances under which the Valuation Service is commissioned.

Context	Type of Valuation Service		
	Valuation	**Limited Scope Valuation**	**Calculation**
Evidence in dispute or litigation	Suitable	May be suitable	Likely not suitable
Assessment of litigation	Suitable	May be suitable	May be suitable
Tax purposes (outside of litigation)	Suitable	May be suitable	Likely not suitable
Shareholder agreement	Suitable	May be suitable	May be suitable
Estate succession planning	Suitable	May be suitable	May be suitable
Market transaction	Suitable	May be suitable	Likely not suitable
Financial reporting	Suitable	May be suitable	May be suitable
Independent Expert's Report	Suitable	Likely not suitable	Likely not suitable