

APES GN 21 Valuation Services for Financial Reporting

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Accounting Professional & Ethical Standards Board Limited

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Conformity with International Pronouncements

1. Scope and application

- 1.1 The objective of APES GN 21 *Valuation Services for Financial Reporting* is to provide guidance on the application of APES 225 *Valuation Services* in relation to a Member's professional and ethical obligations in respect of:
- the provision of a Valuation Service for Financial Reporting to a Client or Employer;
 - the scope of work to be performed; and
 - matters to be disclosed in a Valuation Report.
- 1.2 Accounting Professional & Ethical Standards Board Limited (APESB) issues professional guidance note APES GN 21 *Valuation Services for Financial Reporting* (the Guidance Note) which is effective from the date of issue.
- 1.3 APES GN 21 provides guidance to assist Members on the application of APES 225 *Valuation Services* (APES 225) to Valuation Services conducted in respect of financial reporting. This Guidance Note does not prescribe or create any mandatory requirements or consider the requirements of applicable Australian Accounting Standards.
- 1.4 Members using this Guidance Note should refer to APESB's *Due process and working procedures for the development and review of APESB pronouncements* (APESB's Due process document), to APES 225 for the mandatory requirements when Members provide Valuation Services and to APES GN 20 *Scope and Extent of Work for Valuation Services* (APES GN 20) for guidance on the application of APES 225 in determining the scope and extent of work that, depending on the particular circumstances, may be appropriate for the three types of Valuation Services defined in section 2 *Definitions* of APES 225. The APESB's Due process document provides the meaning of the term 'should' used in this Guidance Note.¹
- 1.5 In this Guidance Note, unless otherwise specified, words in the singular include the plural and vice versa, words of one gender include another gender, and words referring to persons include corporations or organisations, whether incorporated or not.

2. Definitions

In addition to the definitions contained in APES 225, for the purposes of this Guidance Note:

AASB means the Australian statutory body called the Australian Accounting Standards Board that was established under section 226 of the *Australian Securities and Investments Commission Act 1989* and is continued in existence by section 261 of the *Australian Securities and Investments Commission Act 2001*.

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

Cash-Generating Unit means the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets, as defined in AASB 136 *Impairment of Assets*.

Equity Instrument means a contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities, as defined in AASB 2 *Share-based Payment*.

Grant Date means the date at which the entity and another party (including an employee) agree to a share-based payment arrangement, as defined in AASB 2 *Share-based Payment*.

¹ Accounting Professional & Ethical Standards Board Limited. *Due process and working procedures for the development and review of APESB pronouncements: Section 5 Drafting Approach*, Paragraph 5.2 (f).

Market Conditions means a performance condition upon which the exercise price, vesting or exercisability of an Equity Instrument depends that is related to the market price (or value) of the entity's Equity Instruments, as defined in AASB 2 *Share-based Payment*.

Measurement Date means the date at which the fair value of the Equity Instruments granted is measured, as defined in AASB 2 *Share-based Payment*.

Reload Feature means a feature that provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash, to satisfy the exercise price, as defined in AASB 2 *Share-based Payment*.

Valuation Service for Financial Reporting means a Valuation Service 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 statement of profit or loss.

Vesting Condition means a condition that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or Equity Instruments of the entity, under a share-based payment arrangement, as defined in AASB 2 *Share-based Payment*.

3. Fundamental responsibilities of Members

- 3.1 Members are required by section 3 *Fundamental responsibilities of Members* in APES 225 to comply with the following mandatory professional obligations of the Code when performing a Valuation Service:
- Section 100 – *Introduction and Fundamental Principles*;
 - Section 130 – *Professional Competence and Due Care*;
 - Section 140 – *Confidentiality*;
 - Section 220 – *Conflicts of Interest*; and
 - Section 280 – *Objectivity – All Services*.

4. Scope of Valuation Services for Financial Reporting

- 4.1 Members are required to refer to section 4 *Professional Engagement and other matters* of APES 225 when determining the scope of work to be performed in respect of a Valuation Service for Financial Reporting. Matters to be addressed in the scope of work include identifying the applicable Australian Accounting Standards and the specific purpose for which the Valuation Service is required.
- 4.2 A Member in Public Practice should refer to section 3 *Scope and extent of work for Valuation Services* and section 4 *Selecting the type of Valuation Service* in APES GN 20 when assisting the Client to determine the scope of the Valuation Service to be undertaken and whether it is appropriate for the circumstances.
- 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.

- 4.4 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 matters the Member may consider 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) regulatory issues that may impact the Valuation Service.

5. Reporting and Disclosures for Valuation Services for Financial Reporting

- 5.1 Members are required by section 5 *Reporting* of APES 225 to comply with the mandatory reporting and disclosures of a Valuation Report when providing a Valuation Service.
- 5.2 The content and disclosures of a Valuation Report should communicate sufficiently to a user (e.g. Client, auditor or regulator) the basis of the Valuation (e.g. subject matter, rationale and basis of assumptions or inputs in the Valuation Method) and to assess the reasonableness of the Conclusion of Value or Calculated Value.
- 5.3 A Member providing a Valuation Service for Financial Reporting should consider disclosing the following:
- 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
 - Source or basis of key facts and/or assumptions made in arriving at the Conclusion of Value or Calculated Value.

Business combinations

- 5.4 Subject to paragraph 5.1, a Member should consider disclosing the following matters, amongst other things, when providing a Valuation Report in respect of a business combination:
- Identity of the acquiring entity;
 - Effective Measurement Date;
 - Nature and amount of the purchase consideration;
 - Definition of key Valuation terms² used in performing the Valuation Service;
 - Valuation Methods considered and reasons for selecting the particular Valuation Method;

² Members are encouraged to use as far as practicable terms that are in general use for Valuation Services. Members are referred to the *International Glossary of Business Valuation Terms* which are included in the valuation standards of the American Institute of Certified Public Accountants and the Canadian Institute of Chartered Business Valuators.

- Significant or key assumptions and the basis for such assumptions in the Valuation of the assets acquired and/or liabilities assumed. Such assumptions may include, but are not limited to:
 - economic life;
 - revenue growth and business expenses;
 - customer retention and attrition;
 - technological change and migration;
 - contract renewal;
 - tax amortisation benefits in respect of tangible and/or intangible assets;
 - market-participant and/or buyer-specific assumptions and related adjustments, analysis and/or impact on the Valuation;
 - contributory asset charges;
 - discount rates; and
 - royalty rates.

5.5 Where a Member has valued the purchase consideration, the Member is required by paragraph 5.2 (j) of APES 225 to disclose the basis of the Valuation, Valuation Approaches and Valuation Methods used.

5.6 Where a Member was involved in identification of the assets acquired and/or liabilities assumed, the Member should consider disclosing the basis for the identification.

Impairment of goodwill and intangible assets

5.7 Subject to paragraph 5.1, a Member should consider disclosing the following matters, amongst other things, when providing a Valuation Report in respect of impairment of goodwill or intangible assets:

- Cash-Generating Units and/or assets which are the subject of the Valuation Report;
- Impairment test date;
- Carrying value of the assets and/or reporting units;
- Definition of key Valuation terms² used in performing the Valuation Service;
- Valuation Methods considered and reasons for selecting the particular Valuation Method;
- Significant or key assumptions and the basis for such assumptions in the Valuation of the Cash-Generating Units and/or intangible assets. Such assumptions may include, but are not limited to:
 - economic life;
 - revenue growth and business expenses;
 - customer retention or attrition;
 - technological change and migration;
 - contract renewal;
 - cost of capital;
 - terminal value;
 - tax amortisation benefits in respect of tangible and/or intangible assets;
 - market-participant and/or buyer-specific assumptions and related adjustments, analysis and/or impact on the Valuation analysis;
 - contributory asset charges;

- an analysis of the aggregate value of the Cash-Generating Unit(s) and/or discount/premium to market capitalisation; and
- the basis upon which assets are grouped for the purposes of performing an impairment test when determining the value or assessing the impairment.

Share-based payment

5.8 Subject to paragraph 5.1, a Member should consider disclosing the following matters, amongst other things, when providing a Valuation Report in respect of share-based payments:

- Equity Instruments which are the subject of the Valuation Report including the terms of issue, exercise prices (where applicable) and Vesting Conditions;
- Valuation or Measurement Date, including reference to the Grant Date of the Equity Instruments;
- Premise of Value adopted for the Valuation;
- Terms of issue conditions included in the Valuation (e.g. Market Conditions) and excluded from the Valuation (e.g. non-market Vesting Conditions or Reload Features);
- Valuation Method(s), model(s) and reasons for selecting the Valuation Method or model (e.g. Black-Scholes-Merton, Binomial or Monte Carlo); and
- Significant or key assumptions and the basis for such assumptions in the Valuation of the share-based payments. Such assumptions may include, but are not limited to:
 - discounts applicable on post-Vesting Conditions of the shares;
 - dividends expected on the Equity Instrument;
 - effective life of the option, having regard to both the contractual life of the option and the propensity for early exercise for non-European options, including allowance for the behaviour of different cohorts of Equity Instrument holders;
 - expected volatility of the share price;
 - risk-free interest rate for the life of the Equity Instrument;
 - market price of the underlying Equity Instrument;
 - other factors allowed for by knowledgeable, willing market participants; and
 - dilution effects relating to the issue of the share-based payments.

Financial instruments

5.9 Subject to paragraph 5.1, a Member should consider disclosing the following matters, amongst other things, when providing a Valuation Report in respect of financial instruments:

- Instruments which are the subject of the Valuation Report, including value and relevant terms of issue;
- Valuation or Measurement Date;
- Premise of Value adopted for the Valuation Report (e.g. fair value);
- Fair value hierarchy (i.e. quoted price in an active market, or use of a Valuation Method);
- Where a Valuation Method is used:
 - the rationale and evidence for the Member's choice of the Valuation Method (e.g. representative of current market practice);

- the extent to which the Member has calibrated the Valuation Method by comparison to quoted market prices of other Equity Instruments using equivalent inputs to those used for the subject security; and
- significant or key assumptions and the basis for such assumptions, including but are not limited to:
 - discount rates;
 - credit risk;
 - foreign exchange rates;
 - commodity prices;
 - equity prices;
 - volatility;
 - prepayment or surrender risk; and
 - servicing costs.

Superannuation entities

5.10 Subject to paragraph 5.1, a Member should consider disclosing the following matters, amongst other things, when providing a Valuation Report in respect of assets held in superannuation entities:

- Ownership structure, co-investors and the rights of the owner that influence the value;
- Effective Measurement Date;
- Valuation Methods considered and reasons for selecting the particular Valuation Method;
- Significant or key assumptions and the basis for selecting such assumptions in the Valuation of the assets acquired and/or liabilities assumed;
- The level of work undertaken by the Member with respect to the significant or key assumptions; and
- If the Member has relied on data, tools or information provided by a manager of the asset, the work undertaken by the Member to ensure they are satisfied with the data, tools or information.

Conformity with International Pronouncements

The International Ethics Standards Board for Accountants (IESBA) has not issued a pronouncement equivalent to APES GN 21.