APES GN 20 Scope and Extent of Work for Valuation Services

Prepared and issued by
Accounting Professional & Ethical Standards Board Limited

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Contents

1. Scope and application

1.1 Accounting Professional & Ethical Standards Board Limited (APESB) issues APES GN 20 *Scope and Extent of Work for Valuation Services* (the Guidance Note). APES GN 20 provides guidance to assist Members on the application of APES 225 Valuation Services in determining the scope and extent of work that, depending on the particular circumstances, may be appropriate for the three types of Valuation Service defined in section 2 of APES 225. This Guidance Note does not prescribe or create any mandatory requirements.

1.2 Members using this Guidance Note should refer to APESB's *Due process and working procedures for the development and review of APESB pronouncements*.

2. Definitions

For the purpose of this Guidance Note, all definitions are consistent with APES 225 *Valuation Services*.

3. Scope and extent of work for Valuation Services

3.1 When performing a Valuation Service, a Member is required by paragraph 4.5 of APES 225 to gather sufficient and appropriate evidence by such means as inspection, inquiry, computation and analysis to provide reasonable grounds that a Valuation Report and the conclusions therein are properly supported. In determining the extent and quality of evidence, the Member is required to 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. The following general guidance is to assist the Member in exercising professional judgement in determining the extent and quality of evidence to be obtained in respect of the type of Valuation Service to be performed.

Type of Valuation Service	**Extent of Work**	**Extent of evidence obtained**
Valuation Engagement	Limited to extensive use of Valuation Approaches, Valuation Methods and Valuation Procedures.	Evidence obtained for significant matters.
Limited Scope Valuation Engagement	Minimal to limited use of Valuation Approaches, Valuation Methods and Valuation Procedures.	Limited evidence obtained for significant matters.
Calculation Engagement	No to minimal use of Valuation Approaches, Valuation Methods and Valuation Procedures.	Little or no evidence obtained for significant matters.

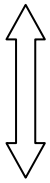
Extent of work

3.2 A Valuation under APES 225 may be of a business, business ownership interest, security, or intangible asset. For convenience, the guidance in this section is based on the assumption that the valuation is of a business, business ownership interest, or equity security.

3.3 To assist a Member to exercise professional judgement in respect of the extent of work for the applicable Valuation Service, a Member may find it helpful to consider the following four areas when performing the Valuation Service, subject to the terms of the Engagement or Assignment agreed with the Client or Employer:

(i) The external environment in which the entity operates;
(ii) Entity-specific, non-financial information (e.g. entity's operating structure and lifecycle stage);
(iii) Entity-specific, financial information (e.g. historical and future orientated financial statements); and
(iv) Valuation context and assessments (e.g. selection and application of Valuation Approaches, Valuation Methods and Valuation Procedures).

3.4 In determining the extent of work to be undertaken in each of these four areas, 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 four areas, depending on the type of Valuation Service, the availability of evidence, and subject to the terms of the Engagement or Assignment agreed with Client or Employer. The table is only provided to illustrate a typical continuum of scope of work for different types of Valuation Service and is not intended to be prescriptive of the work that needs to be undertaken in any particular Valuation Service. Moreover, there are situations where the work performed for a Limited Scope Valuation Engagement is greater than for a Valuation Engagement or the work performed for a Valuation Engagement is less in one situation than in another due to the unavailability of evidence. Refer to examples in the Appendix.

Type of Valuation Service	**External environment of the entity**	**Entity specific non-financial information**	**Entity specific financial information**	**Valuation context & assessments**
Valuation Engagement	Limited to extensive	Limited to extensive	Limited to extensive	Limited to extensive  None to minimal
Limited Scope Valuation Engagement	Minimal to limited	Minimal to limited	Minimal to limited	
Calculation Engagement	None to minimal	None to minimal	None to minimal	

Extent of evidence obtained

3.5 Where a Member is performing a Valuation Engagement, generally the Member will obtain evidence that is sufficient and appropriate to provide reasonable grounds that the Valuation Report and the conclusions therein are properly supported. This will include evidence on those matters that might reasonably be expected to have a significant impact on the Conclusion of Value for that Engagement.

3.6 Where a Member is performing a Limited Scope Valuation Engagement, generally the Member will obtain less evidence in respect of some significant matters relevant to the Conclusion of Value for that Engagement than for a Valuation Engagement, because the scope of work is limited or restricted either by the Client or the Employer or due to the circumstances of the Engagement or availability of information.

3.7 Where a Member is performing a Calculation Engagement, generally the Member will obtain less or no evidence in some of the areas referred to in paragraph 3.3 to determine a Calculated

Value than for a Valuation Engagement or a Limited Scope Valuation Engagement, because the Client or Employer does not require all the Valuation Procedures that might be required for those Engagements.

4. Selecting the type of Valuation Service

4.1 The Client or Employer is responsible for determining which type of Valuation Service to commission. In making that determination, the Client or Employer may wish to consider the relative expected benefits, costs and risks of each type of Valuation Service.

4.2 The benefits, costs and risks of each type of Valuation Service might differ because, for any given set of circumstances, the scope of work of each of the three types of Valuation Service could vary. This might arise because in a Valuation Engagement the Member is free to apply the Valuation Approaches, Valuation Methods and Valuation Procedures the Member considers to be appropriate, while in a Limited Scope Valuation Engagement the Member is limited or restricted in that freedom, and in a Calculation Engagement the Member has no freedom and must apply the Valuation Approaches, Valuation Methods and Valuation Procedures that have been agreed with the Client or Employer. As a result, it is generally the case that the scope of work of a Limited Scope Valuation Engagement is more limited than that of a Valuation Engagement, and that the scope of work of a Calculation Engagement is more limited than that of a Limited Scope Valuation Engagement. Furthermore, for any particular Limited Scope Valuation Engagement, the scope of work might change without the Engagement ceasing to be a Limited Scope Valuation Engagement, if the nature and extent of the limitations were changed.

4.3 Depending on the circumstances, the principal benefits to a Client or Employer of a limited scope of work might include:

(a) a reduced burden to provide the Member with information or access to management;

(b) a shorter period for the completion of the Valuation Service; and

(c) lower professional fees.

4.4 Depending on the circumstances, the principal costs and risks to a Client or Employer of a limited scope of work might include:

(a) the risk that a limited scope of work might be less suitable, or unsuitable, for the purpose for which the Valuation Service was commissioned;

(b) the risk that if a scope of work that was less limited or not limited had been performed the Valuation Conclusion might have been different; and

(c) the costs that might arise if either of the above mentioned risks were to materialise.

4.5 Where a Client or Employer is determining the type of Valuation Service to be commissioned and instructs or assigns the Member to assist the Client or Employer in better understanding the risk that a limited scope of work might be less suitable, or unsuitable, for the purpose for which the Valuation Service is to be commissioned, the Member should consider discussing the following matters with the Client or Employer:

(i) *Extent of reliance* – Generally, the greater the extent of reliance on the Conclusion of Value or Calculated Value the more likely it is that a scope of work that is relatively less limited or not limited will be suitable. For example, in a market transaction, a Client may seek only a general indication of value because the market of buyers has been satisfactorily canvassed and the price of a transaction will ultimately be the result of negotiation or auction. In these circumstances a limited scope of work will generally be suitable. In contrast, if an agreement on the price for a transaction is being entered into

based only on the Conclusion of Value or Calculated Value, then it will generally be suitable if the scope of work is relatively less limited or not limited.

(ii) *Significance of the matter to the Client or Employer* – Generally, the more significant the Conclusion of Value or Calculated Value is to the Client or Employer and the higher the degree of risk that it might be challenged, the more likely it is that a scope of work that is relatively less limited or not limited will be suitable.

(iii) *Preliminary nature of the matter* – In the course of an extended matter, a limited scope of work may be suitable for the purpose of the Client or Employer making a preliminary or interim assessment.

(iv) *Number of users of the Valuation Report* – Generally, if the Valuation Report will be provided to a high number of users and it would be reasonable to assume that some of those users may not understand the effect of any major limitations on scope, then a scope of work that is relatively less limited or not limited will be suitable.

(v) *Public availability* – Generally, if the Valuation Report will be disclosed, or referred to, in a public document and it would be reasonable to assume that some of the intended users may not understand the effect of any major limitations on scope, then a scope of work that is relatively less limited or not limited will be suitable.

4.6 The above mentioned matters are illustrative but not exhaustive. They are not prescriptive of the type of Valuation Service that may be appropriate in any particular circumstances.

Conformity with International Pronouncements

The International Ethics Standard Board for Accountants (IESBA) has not issued a pronouncement equivalent to APES GN 20.

Acknowledgement of the Canadian Institute of Chartered Business Valuators

APESB gratefully acknowledges the publication of the Canadian Institute of Chartered Business Valuators (CICBV) listed below which provided the basis for the development of this Guidance Note. Components of the CICBV publication have been reproduced with the kind permission of the CICBV with variations made to suit the Australian context and APES 225 *Valuation Services*.

Practice Bulletin Number 3: Guidance on Types of Valuation Reports
Canadian Institute of Chartered Business Valuators, September 2012

Appendix: Illustrative Examples

This Appendix contains some examples to assist Members determine the scope and extent of work for a Valuation Service.

Members are cautioned that the determination of the scope of work for a Valuation Service in accordance with APES 225 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 APES GN 20 and applying the pronouncements to the particular circumstances. In all of the examples presented below it is assumed that there are no unmentioned facts which would be relevant to the determination of the scope and extent of work for a Valuation Service.

Example 1: Valuation of a minority interest in equity for capital gains tax without access to the company

Facts: A Member in Public Practice is engaged by a Client who holds a minority interest in the issued share capital of a company to perform a Valuation as at today's date of that minority interest for the purpose of capital gains tax and to provide a written report to the Client. There is no restriction or limitation placed on the Member in choosing the appropriate Valuation Procedures or Valuation Approach to use. Neither the Client nor the Member has access to the management and the books and records of the company. The Member has access to the annual reports, minutes of general meetings, and other documents provided by the company to the Client as a shareholder.

Analysis: If the Member did have access to the company (i.e. to its management and to its books and records) then, depending on the circumstances, the Member might consider:

- holding discussions with management about the nature and history of, and outlook for, the company's business;
- obtaining and reviewing any management accounts and reports and asking for details of any assumptions underlying them and the basis of their preparation;
- obtaining and reviewing any strategic or business plans;
- obtaining and reviewing any forecasts or budgets and asking for details of any assumptions underlying them;
- obtaining details of any revenues, expenses, assets, or liabilities that the Member considers relevant;
- obtaining details of any borrowings;
- obtaining and reviewing any crucial contracts;
- obtaining information on any revenues and expenses reported in the financial statements that management considers to be non-recurring, abnormal, or on non-commercial terms; and
- asking for any other information that the Member considers, in the circumstances, to be relevant to the valuation.

However, in this example this information is not available to the Member because the Member does not have access to the company. The fact that the extent and quality of the information available to the Member is less than would be the case if the Member did have access does not mean that the Engagement is a Limited Scope Valuation Engagement. That is because the Member remains free to employ the Valuation Approaches, Valuation Methods and Valuation Procedures that a reasonable and informed third party would perform taking into consideration all the *specific facts and circumstances* of the Engagement available to the Member at the time – and those specific facts and circumstances include the fact that as a minority shareholder, the Client's ownership interest (being

the subject matter of the Valuation) does not entitle the Client to the access and privileges described above .

Conclusion: This is a Valuation Service. The Member has been engaged to perform a Valuation, without any restriction or limitation placed on the Member by the Client, and to provide a Valuation Report, which constitutes a Valuation Engagement.

Example 2: Relationship between Valuation Conclusions in a Limited Scope Valuation Engagement and in a Valuation Engagement

Facts: A Member in Public Practice is approached by a Client who wishes to obtain a Valuation of a portfolio of patents for financial reporting and tax purposes. The Member's report will be provided to the Client's auditors and to the Australian Taxation Office. The Member is not a tax agent or an auditor. The Client wishes to minimise the cost of the Valuation and to that end is willing for the Member to limit the amount of work that the Member would otherwise do and for the Engagement to be a Limited Scope Valuation Engagement instead of a Valuation Engagement. The Member explains to the Client that if the Member were instead to perform a Valuation Engagement then the Valuation Conclusion, which will be in the form of a range of values, might be different. The Client says that it is willing to proceed with a Limited Scope Valuation Engagement because it understands that the range of values that the Member would determine in a Limited Scope Valuation Engagement is simply wider than that which the Member would determine in a Valuation Engagement.

Analysis: The Client understands that the Valuation Conclusion might be different under a Limited Scope Valuation Engagement than under a Valuation Engagement. However, the Client appears to assume that the range of values that would result from a Valuation Engagement would fall within the range of values that would result from a Limited Scope Valuation Engagement. Whether this would be the case will depend on the facts and often it will not be possible to predict without performing the additional work involved in a Valuation Engagement. Hence, while it is possible that the range of values under a Limited Scope Valuation Engagement would fall within the range under a Valuation Engagement, it is also possible that it would not or that there would only be a partial overlap.

Conclusion: In light of the Client's apparent misunderstanding and assuming that the nature of the limitations on scope are such that it is not possible to predict whether the range of values that would result from a Limited Scope Valuation Engagement would fall within the range that would result from a Valuation Engagement, either fully, partially, or at all, the Member should inform the Client of that fact before an Engagement is entered into so that the Client is able to make an informed choice.

Example 3: Choosing between different types of Valuation Engagements

Facts: The facts are the same as for Example 2 except that (a) the Client understands that in the circumstances it is not possible to predict whether the range of values that would result from a Limited Scope Valuation Engagement would fall within the range that would result from a Valuation Engagement, either fully, partially, or at all; and (b) the Client asks the Member whether it should commission a Limited Scope Valuation Engagement or a Valuation Engagement.

Analysis: It is the Client's responsibility, not the Member's, to determine which type of Engagement should be commissioned. Many matters may be relevant to that determination and the Member may be able to assist the Client in understanding some of them. For example, the Member could assist the Client to understand how the two types of Engagement might involve different costs as well as different burdens on the Client from requests for information or access to management. The Member could also assist the Client to understand that because the Valuation Conclusion in a Limited Scope Valuation Engagement might be different from the Valuation Conclusion in a Valuation Engagement, commissioning a Limited Scope Valuation Engagement carries an additional degree of risk. Whether that risk is acceptable to the Client will depend on the circumstances, including the Client's tolerance for risk and how much weight the Client places on the perceived benefits such as lower cost and burdens. In the circumstances of this example, the determination may also depend on the attitude of the Client's auditors and of the Australian Taxation Office to a Limited Scope Valuation Engagement as well as on any relevant law or regulations.

Conclusion: The Member should inform the Client that it is the Client's responsibility, not the Member's, to determine which type of Engagement (i.e. Valuation Engagement or Limited Scope Valuation Engagement) should be commissioned in the circumstances. The Member could also inform the Client that the Member may assist the Client to understand some of the matters that may be relevant to that determination.

Example 4: Extent of evidence

Facts: A Member in Public Practice is engaged by a Client to perform a Valuation of a business, and provide a Valuation Report, for the purpose of the Client's negotiations with a third party for the sale of the business. The Valuation Report will not be provided to that third party. The Client instructs the Member to use the discounted cash flow method of valuation. But for that instruction, the Member would have used the capitalised earnings method of valuation. The Member will need more information to perform the Valuation using the discounted cash flow method than the Member would have needed to perform the Valuation using the capitalised earnings method. The additional information will include, amongst other things, long-term cash flow forecasts for the business.

Analysis: The Member is not free to use the Valuation Method that the Member believes a reasonable and informed third party would use taking into consideration all the specific facts and circumstances of the Engagement.

Conclusion: The Engagement is a Limited Scope Valuation Engagement, notwithstanding that the Member will do more work than would be required for a Valuation Engagement. It is a Limited Scope Valuation Engagement, due to the restriction placed on the Member on the Valuation Method to be used.