Appendix 1: Extract of Potential Guidance Note for Valuation for Financial Reporting and existing Canadian guidance.

4 General

4. 1 Members may be engaged to assist management of a reporting entity in determining the fair value of assets, liabilities and/or equity for financial reporting requirements. The values so determined may be reviewed and/or tested as part of an Assurance Engagement and may also be subject to review by various regulatory authorities.

4.2 This guidance note applies to Engagements where a Valuation Report that contains a Conclusion of Value in respect of any asset, liability and/or equity and that is prepared for financial reporting purposes. These Engagements are herein after referred to as Valuations for Financial Reporting (VFR)

4.3 VFR are to be prepared in accordance with the Australian Accounting Standards and financial statement requirements. If the applicable Australian Accounting Standards are in conflict with accepted valuation practice and/or methods, the applicable Australian Accounting Standards should prevail in VFR Engagements. Accordingly, Members undertaking VFR Engagements should have an understanding of the accounting concepts and principles underlying the relevant Australian Accounting Standards.

4.4 This GN clarifies and expands the guidance provided in the context of VFR and is not intended to replace relevant Australian Accounting Standards and/or requirements or the report disclosure standards and recommendations for disclosures as set out in APES 225 *Valuation Services*.

4.5 In preparing VFR reports, Members should use their professional judgement in considering whether disclosures, scope and process is adequate under APES 225. This guidance note provides a framework against which Members can exercise their professional judgment.

4.6 The guidance set out in this GN relate to report disclosures and do not relate to matters concerning financial accounting treatment or financial statement disclosures.

4.7 This GN is organized to review (i) disclosures, (ii) scope and documentation for VFR Engagements.

5 Disclosures

Fundamental disclosures

5.1 In addition to the requirements of APES225, VFR Reports may disclose the following information:

- A statement that the VFR Report has been prepared for financial reporting purposes;

- Identification and description of the particular assets, liabilities and/or equity that are the subject of the VFR Report;

- The specific parties that are the intended users of the VFR Report;

- A statement restricting the use of the VFR Valuation Report to the persons for whom the VFR Valuation Report was prepared, and only for the stated purpose;

- Identification and description of the primary Australian Accounting Standards pursuant to which the VFR Report was prepared;

- Definition of value used. Note: 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 key facts and/or assumptions made in arriving at the Valuation conclusions, including information as to their source or basis to the extent possible.

Business Combinations and Purchase Price Allocation

5.2 Purchase price allocations and Valuation of tangible and intangible assets are typically required to be performed in circumstances such as: (i) an arm's length acquisition; and (ii) as part of an impairment test analysis.

5.3 VFR Valuation Reports prepared in the context of purchase price allocations generally provide a conclusion of fair value of acquired tangible and/or intangible assets and/or liabilities assumed.

5.4 In addition to the disclosure of fundamental information, VFR Reports for business combinations and purchase price allocations may information such as:

- Identity of the acquiring entity;

- The effective date for measurement;

- Nature and amount of purchase consideration. Where the Member has valued the purchase consideration, the basis of the Valuation as well as approach and methods used, and key assumptions employed would benefit from disclosure;

- If the Member was involved in identification of the assets acquired and/or liabilities assumed the Member may consider disclosing the basis for the identification thereof;

- Key terms and phrases having a technical meaning should be defined or explained;

- Valuation method(s) and reasons such method was selected; and,

- Significant or key assumptions made and the basis for selecting such assumption in the analysis of value of the assets acquired and/or liabilities assumed. Such assumptions would include, but are not limited to, the following (if relevant):

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

Impairment of Goodwill and Intangible Assets

5.5 For financial reporting purposes, the accounting value (generally referred in accounting literature as carrying value or net book value) of goodwill and intangible assets is typically tested for impairment annually, or at other intervals required by applicable Australian Accounting Standards.

5.6 VFR Valuation Reports prepared in the context of impairment testing generally provide a conclusion of fair value of cash generating units and/or intangible assets. In addition to the required disclosure of fundamental information, VFR Reports in respect of Impairment may disclose relevant information such as:

- Cash generating unit(s) and/or assets which are the subject of the VFR Report;
- Carrying value of the asset(s) and/or reporting unit(s);
- Definition or explanation of Valuation and other terms and/or phrases having a technical meaning;
- Valuation method(s) and reasons such method was selected;
- Significant and/or key assumptions made and the basis for such assumptions in the analysis of the value of the cash generating unit(s) and/or identifiable intangible assets. Such assumptions would include, but are not necessarily limited to, (if relevant):
    - assumptions regarding economic life;
    - assumptions regarding customer retention or attrition;

- assumptions regarding technological change and migration;
- assumptions regarding contract renewal;
- assumptions made to determine tax amortisation benefits in respect of tangible and/or intangible assets;
- "market-participant" assumptions and/or "buyer-specific" assumptions and related adjustments, analysis and/or impact on the valuation analysis; and,
- assumptions regarding contributory asset charges;
- If applicable, an analysis of the aggregate value of the cash generating unit(s) and/or discount/premium to market capitalization; and
- Where assets are grouped for the purposes of performing an impairment test, when determining value or when assessing the amount of impairment, the basis upon which assets are grouped should be disclosed.

6 Scope

6.1 In performing VFR Engagements, the following procedures are not mandatory, but encouraged.

General Guidance

6.2 Member obtains clear instructions from the person requesting the Valuation Service.

6.3 The work be performed by a Member having adequate technical training and proficiency in financial analysis and/or business valuation concepts, principles and techniques, with due care and with an objective state of mind.

6.4 The work be adequately planned and properly executed. If staff are employed, they need to be properly supervised.

6.5 Sufficient evidence be gathered by such means as inspection, inquiry, computation and analysis to ensure that the VFR Report and the conclusion contained therein are properly supported. When determining the extent of evidence necessary to support the VFR Report, Members shall exercise professional judgement, considering the nature of the valuation, the type of Valuation being provided (ie Valuation, Limited Scope Valuation and Calculation Engagements) and the use to which the Valuation Report will be put. It would be generally expected that the scope of review will be more comprehensive for a Valuation and progressively less comprehensive for a Limited Scope Valuation and a Calculation of Value. It is a matter of professional judgment as to the amount of review appropriate for the type of Valuation Report being provided.

6.6 When access to essential information is denied by the Client or some other party, or is otherwise unavailable to the Member, any conclusion expressed by the

Member in respect of such valuation shall be qualified and the limitation{s} on the scope of work clearly set out in the VFR Report.

Specific guidance

6.7 The following specific guidance relates to Valuation and Limited scope Valuations. Members should consider applying the guidance to Calculations of Value.

6.8 When planning the extent of the scope of work for a particular Engagement, the Member may obtain:

i) Sufficient understanding of the subject of the Valuation including depending on the type of level of Valuation being provided, the Member should obtain and review material documentation, including agreements, contracts, letters of understanding, letters of intent and correspondence, which bear on the subject of the Valuation;

ii) Sufficient understanding of the underlying business operations;

iii) Sufficient financial information relating to past results, future prospects and present financial position; Depending on the type of VFR Report being provided, the information to be obtained and analysed will include prior years' operating results and cash flows, a current balance sheet, and future oriented financial information such as budgets, forecasts and projections);

iv) Sufficient understanding of the relevant industry(s) in which the underlying business operates. Depending on the nature of the mandate and on the type of Valuation Report being provided, this analysis might consider the following:

- critical success factors;
- competitors and their respective market shares;
- industry regulations;
- new developments;
- environmental issues;
- trading volumes and price ranges of publicly traded shares; and
- comparable market transactions) and

Sufficient information relating to the general economic conditions affecting the underlying business operations. Such information might normally consist of selected rates of return, inflation rates and other general economic indicators.

6.9 In performing a Valuation Service, the Member shall determine the appropriate valuation basis, approach methods and procedures to be employed. The “valuation basis” refers to going concern or liquidation, whereas the “Valuation Approach” refers to income (earnings or cash flow methods), cost (adjusted net book value method) and market (comparable transactions method). Method refers to the manner in which one of the above methods are carried out and procedures refer to the elements of the valuation method.

6.10 The Member shall consider key valuation components and assumptions. The Explanatory comment: the key valuation components might include the following:

- normalising adjustments;
- capitalisation rates;
- income tax issues;
- redundancy;
- assumptions as noted above;
- minority and other discounts or premiums; and
- special purchasers.

6.11 The Member shall consider the necessity of relying upon the work of a specialist, for example real estate appraisers, engineers, or equipment valuers. If it is deemed appropriate to request the assistance of a specialist, the Member should obtain reasonable assurance concerning the specialist's reputation for competence and degree of independence. The appropriateness and reasonableness of the assumptions and methods used by the specialist are the responsibility of the specialist. Ordinarily, the Member may accept the specialist's judgement and work in this regard unless the report of the specialist, the Member’s communication with the specialist, or the Member’s knowledge of the business being valued, leads the Member to believe that the specialist's assumptions or methods are unreasonable in the circumstances.)

6.12 The Member shall determine the necessity of obtaining Client representations in writing and, if possible, management representations from management or other representatives of the underlying business. Such representations may be in letter format, and would normally include a general representation that the Client/management:

- has reviewed a draft copy of the Valuation Report;
- is satisfied with the Valuation concepts and approaches adopted; and
- does not have any information or knowledge which would reasonably be expected to materially affect the conclusion noted in the VFR Report.)