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Basis for Conclusions: APES 225 Valuation Services

Prepared by the Technical Staff of the Accounting Professional & Ethical Standards Board

BASIS FOR CONCLUSIONS:

APES 225 Valuation Services

This basis for conclusions has been prepared by technical staff of Accounting Professional & Ethical Standards Board Limited (“APESB”). This document has been reviewed and approved by the Board of Directors of APESB and is provided for the benefit of stakeholders to gain an understanding of the background to the development of APES 225.

The basis for conclusions **does not** form part of APES 225 Valuation Services and is not a substitute for reading the standard.

Background

APESB has issued the Standard APES 225 Valuation Services setting out mandatory requirements and guidance for Members who perform valuations.

APES 225 includes mandatory requirements and guidance in respect of:

- Independence requirements for valuation services;
- Professional competence of members;
- Confidentiality requirements;
- Professional engagement and other matters;
- Reporting;
- Documentation;
- Use of a glossary of business valuation terms; and
- Professional fees.

It is intended that this Standard will be operative for valuation engagements or assignments commencing on or after 1 January 2009.

APESB issued an Exposure Draft (ED) 07/07 of the proposed standard in December 2007 with a comment deadline of 4 April 2008. APESB received submissions from the professional bodies, two big four firms, the Business Valuation Special Interest Group of the Institute of Chartered Accountants in Australia and individual members. As a result of the comments received, APESB made a number of changes when finalising the text of APES 225 Valuation Services. The following summarises the significant issues raised by respondents, and how APESB addressed them.

Definitions and scope of Valuation Services (Section 2)¹

The ED defined three types of engagements that could be performed by a member providing valuations services. The scope of the ED was intended to specifically capture engagements or assignments performed to estimate value. This scope was communicated through the definition of valuation services which incorporates calculation, limited scope and valuation engagements.

¹Paragraph numbering reflects the numbering in APES 225 and may not reflect ED 07/07.

Valuation Services

Concern was raised by a respondent in relation to the definition of valuation services. The concern was that the wording of the standard was too broad and that some engagements may be inadvertently caught by the definition of valuation services.

Accordingly the definitions in APES 225 were revised to address this concern. A valuation service means a service provided in performance of a valuation engagement, limited scope valuation engagement or calculation engagement. The definitions of these three types of engagements and the definition of valuation were amended such that for a valuation service to exist the following three elements must be satisfied:

- the member must be engaged or assigned to perform a valuation;
- the member must determine an estimate of value of a business, business ownership interest, security or intangible asset by applying valuation approaches, valuation methods and valuation procedures; and
- the member must be engaged or assigned to provide a valuation report (which may be written or oral).

The examples set out in Appendix 1 to the Standard illustrate the application of these principles to some common situations. These examples do not encompass all situations a member may encounter in public practice or business.

Title of APES 225

The body of APES 225, through the definitions of calculated value, conclusion of value and the types of engagements or assignments, envisages that valuations which are within the scope of the standard may be of a business, business ownership interest, security or intangible asset. A respondent noted that the original title of the exposure draft APES 225 *Business Valuation* implies that the standard is only applicable to valuation of businesses. Further consideration resulted in the standard being more appropriately titled APES 225 *Valuation Services*.

Professional independence (Paragraph 3.4)

Paragraph 3.4 of APES 225 ED gave a member in public practice a reference to the relevant section of APES 110 *Code of Ethics for Professional Accountants* (the Code) to consider, when independence was required or where the member purports to prepare the valuation report on an independent basis. The ED referred to Section 290 *Application of Framework to Specific Situations* of the Code which respondents commented was confusing due to its specific application to independence in relation to assurance engagements. To address this issue a new paragraph 3.2 was inserted that states a member in public practice must comply with Section 220 *Conflict of Interest* and Section 280 *Objectivity – All Services* in the Code. Additionally paragraph 3.4 was redrafted to state that where there is an expectation of independence the member must comply with *independence* as defined in the Standard.

Professional engagement and other matters (Paragraph 4.4)

The original drafting of paragraph 4.4 provided guidance to members on the conduct of a valuation service. A respondent noted that this is inconsistent with a principles based approach, as the guidance that a particular business should be reviewed and analysed provides specific detail on how an engagement should be conducted. In response to this comment, paragraph 4.4 was redrafted in a manner consistent with a principles based approach and now creates a mandatory requirement for a member to gather sufficient and appropriate evidence to support the conclusions reached in the valuation report.

Reporting – Oral reports (Paragraph 5.1)

A respondent noted that in certain circumstances a member in public practice may issue an oral valuation report and that appropriate amendments should be made to APES 225 to allow this. Paragraph 5.1 was redrafted accordingly. In addition a new mandatory requirement was introduced in paragraph 5.3 for the member in public practice to appropriately document the oral communication and the work performed when an oral valuation report is provided to a client.

Use of a glossary of business valuation terms (Paragraph 7.1)

Respondents raised concern in relation to the guidance in APES 225 to define valuation terms and the reference to use the *International Glossary of Business Valuation Terms* as far as practicable. One respondent questioned the reference to the international glossary due to potential inconsistencies of definitions of valuation terms contained in the specified glossary and those commonly used in Australia. APESB has addressed this issue by redrafting paragraph 7.1 to create a mandatory requirement for a member to define valuation terms used in the valuation report and then moving the guidance which refers to the *International Glossary of Business Valuation Terms* to a separate paragraph (7.2). Paragraphs 7.1 and 7.2 together now allow the member to use his or her judgement to appropriately define terms contained within the valuation report.