

APES 225 – Valuation Services

The Accounting Professional & Ethical Standards Board (“APESB”) issued professional standard APES 225 Valuation Services in July 2008. This standard was revised in May 2012 (effective from 1 September 2012)

A copy of the standard can be obtained at www.apesb.org.au.

The standard sets out defined terminology and refers to three types of valuation services.

It states that a *Valuation Service* means a service provided by a Member to a Client or Employer in performance of a:

- Valuation Engagement
- Limited Scope Valuation Engagement or
- Calculation Engagement.

Valuation Engagement refers to an engagement or assignment to perform a Valuation and provide a Valuation Report where the Member determines an estimate of value of:

- A business
- Business ownership interest
- Security
- Intangible asset

using one or more Valuation Methods and Valuation Procedures.

Limited Scope Valuation Engagement refers to an engagement or assignment to perform a Valuation and provide a Valuation Report where the scope of work is limited or restricted. Also referred to as “indicative valuation” engagement.

Calculation Engagement refers to an engagement or assignment to perform a Valuation and provide a Valuation Report where the Member and the Client or Employer agree on the specific Valuation Approaches and Methods that the Member will use and the extent of the Valuation Procedures the Member will perform to estimate the value of a business, business ownership interest, security or intangible asset. It generally does not include all of the Valuation Procedures required for a Valuation Engagement.

Valuation Procedures refer to the act, manner and technique of performing the steps of a Valuation Method.

Valuation Method(s) means, within Valuation Approaches, a specific way(s) to determine an estimate of value of a business, business ownership interest, security or intangible asset.

Valuation Approach(es) means a general way(s) of determining an estimate of value of a business, business ownership interest, security or intangible asset using one or more Valuation Methods.

Valuation Report is a written or oral communication by the Member containing a Conclusion of Value or a Calculated Value.

Conclusion of Value means an estimate of value of a business, business ownership interest, security or

Inside this Issue • Revised APES 225 – Valuation Services • Recent Matters
• Factors Impacting on what Valuation Earnings Multiple to Apply to SMEs
• Typical Information Required to Undertake a Business Valuation

APES 225 – Valuation Services ...continued

intangible asset from a Valuation Engagement or a Limited Scope Valuation Engagement . It can be a single amount or a range.

Calculated Value is an estimate of value from a Calculation Engagement. Again, it can be either a single amount or range.

Key points of the standard include:

- Professional Independence
 - in providing a Valuation Service, a Member shall not act as an advocate in respect of a Valuation Service which requires independence or purports to be independent.
- Professional Competence & Care
 - in providing a Valuation Service, a Member shall maintain professional competence and take due care.
- Confidentiality
 - in providing a Valuation Service, a Member must respect the confidentiality of information acquired in the course of his or her work and must not disclose any such information to a third party without specific authority or unless there is a legal duty to disclose it.
- Professional Engagement and Other Matters
 - A Member must ensure that there is a clear understanding between the client and the Member regarding the terms of engagement to provide a Valuation Service.
 - A Member shall gather sufficient and appropriate evidence by such means as inspection, inquiry, computation and analysis to ensure that the Valuation Report and the conclusions therein are properly supported.
- Reporting - a member in public practice preparing a Valuation Report in respect of a Valuation Service, should communicate in the report the following:
 - The name of the engaging party.
 - A description of the business, business ownership interest, security or intangible asset being valued.
 - The date at which the valuation has been determined, the date the Valuation Report has been issued.
 - The purpose for which the Valuation Report has been prepared.
 - The name & qualifications of the members responsible for the Valuation.
 - The scope of the Valuation, including any limitations or restrictions.
 - The basis of the Valuation.
 - A statement whether the Valuation was undertaken by the Member acting independently or not.
 - The Valuation Approaches adopted and how they have been applied.
 - The specific information on which the Member has relied and the extent to which it has been reviewed.
 - A description of the material assumptions applied in the Valuation and the basis for those assumptions.
 - A Conclusion of Value or Calculated Value (depending on type of Valuation Service).
 - All qualifications that materially affect the Conclusion of Value or Calculated Value.
 - For a Limited Scope Valuation Engagement, a statement that if a Valuation Engagement had been performed the results may have been different.

APES 225 – Valuation Services ...continued

- o For a Calculation Engagement, a statement that if a Valuation Engagement had been performed the results may have been different.
- o Where a Member has prepared a Valuation Report that requires Independence or purports to be independent, a statement that the compensation to be paid to the Member is not contingent on the conclusion, content or future use of the Valuation Report.
- o A statement that the Valuation Report was conducted in accordance with APES 225.

In addition to the above, a Member in Public Practice should consider including the following information in a Valuation Report, as appropriate:

- o A description of other Valuation Approaches and Valuation Methods considered and the reasons why they were not considered relevant for the Valuation.
- o Sufficient details of the Valuation calculations to allow a reader to understand how the Member determined the Conclusion of Value or Calculated Value.
- o A summary of relevant financial information
- o A summary of the relevant industry.
- Professional Fees
 - o A Member in Public Practice shall not enter into a Contingent Fee arrangement for a Valuation service which requires independence or purports to be independent.
- Valuation Terminology
 - o When issuing a Valuation Report, a Member shall clearly define the Valuation terms used.
 - o In providing a Valuation Service, Members are encouraged to adopt the definitions set out in *the International Glossary of Business Valuation Terms*.

APES 225 does not refer to specific valuation methodology which should be considered. This may be the subject of further valuation standards in the future.

The APESB also issued an exposure draft *APES GN 20 Scope and Extent of Work for Valuation Services* (the Guidance Note) in September 2012. This provides guidance to Members on the application of *APES 225 Valuation Services* in determining the scope and extent of review, analysis and corroboration that is appropriate for the applicable Valuation Service.

The draft Guidance Note provides the following table that includes examples to assist in assessing the appropriateness and reasonableness of a Valuation Service within various contexts.

Context		Valuation Service Type	
		Limited Scope	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	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	May be suitable
Financial reporting	Suitable	May be suitable	May be suitable
Independent Expert's Report	Suitable	Likely not suitable	Likely not suitable

Factors Impacting on what Valuation Earnings Multiple to Apply to SMEs

The valuation method most commonly applied in valuing profitable Small Medium Enterprises (SMEs) is the capitalisation of maintainable earnings method.

This valuation method was discussed in MW Forensic Issue 20 dated September 2011.

Typically most SMEs are valued with earnings before interest and tax multiples of 1 to 5 times, with most between 2.5 and 4.0.

The earnings multiple reflects the risks associated with the assessed maintainable earnings stream. The higher the risk, the lower the multiple.

There are internal risk factors specific to the business being valued and external risk factors relating to the economy, industry trends, etc.

The business valuer must make a professional judgement in determining the appropriate earnings multiple range to apply to value the business.

Different industries have different multiples. For example the printing industry has experienced declining revenue in recent years. Multiples in this industry are therefore likely to be relatively low. Whereas in industries with expected growth, higher multiples may apply.

Businesses in the same industry can also have different applicable earnings multiples.

A valuer needs to assess the business and its risks, understand broad industry multiples in order to assess the applicable earnings multiple for the business being valued.

Factors affecting applicable earnings multiples include:

- The financial track record of the business will impact on the multiple. A business showing growing revenue and profit is less riskier than a business with an erratic trading history.
- The owner's role in the business and the dependency the business has on him or her. A business with a good management team, good systems and procedures is likely to have a higher multiple than one dependent on the owner's knowledge and relationships with referrers and key customers.
- A trend in the industry the business is in will effect the earnings multiple. Is the industry slowing, growing or steady and mature?
- The customer concentration will impact on the multiple. For a business with 3 main clients there is greater risk than a business with an even spread of clients.
- The source of income should be considered. Are customers repeat clients, that is, does it exhibit an annuity type of income, such as a tax accounting practice? Or is its income more transactional based where the business is constantly hunting for new customers.
- Are there major barriers to entry or can someone set up quickly and cheaply? The more barriers the less risk of new competition.

As a guide, BizExchange produces a quarterly report which shows broad industry earnings multiples for business with revenue in the ranges less than \$1 million, \$1million to \$5 million and \$5 million to \$15 million.

We subscribe to this publication to obtain some indication of current EBIT multiples for SMEs in the broad industry and revenue ranges.

Typical Information Required to Undertake a Business Valuation

In order to value a business, a valuer may require reviewing the following information (depending on the industry the business is operating in and the purpose of the valuation):

- Brief history of the business, when established, acquired, locations, services.
- Organisation summary – key staff, roles.
- Resume of the owner.
- Details of owners salary, superannuation and other benefits (including MVs) for last 3 to 5 years.
- Confirm corporate / entity structure.
- Current ownership of the legal entity being valued.
- Details of recent transfer of ownership in the entity: date, number of shares, consideration.
- Financial statements for last 3 to 5 years, including detailed profit and loss statement, balance sheets, notes to accounts.
- Year to date management accounts (profit and loss and balance sheet) if available or else BAS statements.
- Budget for year ahead, if available.
- Current business plan, if available, or else the directors' perceived strengths, weaknesses, opportunities and threats of the business and details of main competitors in locations operated.
- Analysis of sales last 2 years – top 10 customers in sales pa.
- Aged debtors listing.
- Details of key suppliers – purchasers per annum last 2 years.
- Depreciation schedule.
- If plant and equipment, investments are major assets of the business, they may need be independently valued.
- Details of any major capital expenditure required in the short to medium term.
- Details of lease of premises – term, options, rent pa. If the business premises is owned by related party, assessment of commercial rental on property.
- Details of any un-booked employee entitlements (many SMEs do not accrue for employee entitlements).
- Details of any un-booked Work in Progress.
- Details of any carry forward tax losses.
- Details of any contingent liabilities (eg current or pending legal proceedings).
- Details of any long-term commercial contracts.
- Details of required licenses, permits and registrations.
- Details of intellectual property held by the entity.
- Details of borrowing facilities in place.
- Industry information (available from IBISWorld, ATO Benchmarks, etc.).
- Details of any unusual or one-off transactions in last 3 to 5 years.
- Recoverability of loan accounts due to the entity.
- Any other information considered relevant to the valuation.

Recent Matters

In the past 8 months we have been involved in numerous matters including:

- Expert determination concerning assessment of reasonable management fees at a Club.
- Expert report for shareholder dispute in a property development project.
- Solvency review.
- Report to assist with an insurance claim for an alleged fraud of \$1.9 million by the internal accountant.
- Expert report in relation to a loss of profits claim for fire damage to a Country Golf Club
- Numerous loss of earnings assessments for people diagnosed with mesothelioma.

Valuations of:

- Large IT software and consulting businesses.
- Vocational educational business.
- Motor vehicle dealership.
- Speciality oil manufacturer.
- Property consulting business.
- New media advertising business.
- Cafe / restaurants.
- Painting / Maintenance business.
- Bin hire business.
- Hotel leasehold.
- Legal practice.
- Accounting practice.
- Transport company.
- Car parts retailer.
- Accounting and Business software providers.
- Wine bar / Liquor shops.
- PVC pipe manufacturer.
- Food industry consultancy.
- Panel beater.
- Patents.
- Numerous business valuations and loss assessments for the Valuer General Victoria in respect of businesses affected by the Regional Rail Link project.



Munday Wilkinson

Chartered & Forensic Accountants



Munday Wilkinson

Our Aim

Munday Wilkinson is a boutique business valuation and forensic accounting firm established in June 2000.

We offer the legal profession, and others, a quality, personalised, time efficient and cost-effective service.

All our professional staff are subscribed members of the Business Valuation and Forensic Accounting Special Interest Groups of the Institute of Chartered Accountants in Australia.

Our Services

We are well experienced in:

- Business, share and other equity valuations
- Quantification of economic loss
- Loss of earnings assessments /reviews
- Family Law – Single Expert Reports, review of Single Expert Reports, investigations, advising on tax and refinancing issues for proposed settlements
- Fraud Reviews and Financial Investigations
- Due Diligence Reviews
- Professional Negligence matters concerning accountants and directors
- Compulsory Acquisitions – claims assistance
- Due Diligence services
- Expert Determinations
- Expert Witness

We can provide forensic accounting services for a wide variety of dispute related matters from the small to the large.

Further Information

If you would like further information regarding this newsletter or our services, please contact us:

Munday Wilkinson Pty Ltd **Chartered & Forensic Accountants**

Level 10, 470 Collins Street
Melbourne Vic 3000

Ph: 9621 1622 Fax: 9621 1522

Email: advice@mwforensic.com.au www.mwforensic.com.au

Liability limited by a scheme approved under Professional Standards Legislation

Disclaimer

Although every care has been taken in preparing "MW Forensic", no responsibility is accepted by Munday Wilkinson Pty Ltd for errors or omissions. Professional advice should be sought before applying the information to particular circumstances.