Guide to Fair Value Under IFRS

— A complete guide to applying the complex valuation requirements of the IFRS
— Fully compliant with the Certified Valuation Analyst curriculum
— Includes examples based on actual cases
— Provides solutions to special problems such as employee share options and derivatives
— Discusses documentation required by auditors
— Offers tips and approaches to the preparation of proposals and documents useful for all steps of the valuation proceedings

Edited by
James P. Catty

Your one indispensable guide to all the Fair Value requirements of IFRS

A complete guide to the complex requirements of IFRS, this book includes chapters on theoretical and practical applications, with extensive examples illustrating the required techniques for each application.

Appropriate for anyone involved professionally with finance—managers, accountants, investors, bankers, instructors, and students—this guide draws on a stellar panel of expert contributors from fourteen countries who provide international coverage and insight into a diverse range of topics, including:

- Fair Value in implementing IFRS
- Market Approach
- Income Approach—Capitalization and Discounting Methods
- Economic and Industry Conditions
- Cost of Capital
- Financial Statement Analyses
- Impairment Testing
- Intellectual Property Rights (patents, copyrights, trademarks)
- Projecting Financial Statements
- Liabilities
- Customer Relationships
- Share-based Payment
- Plant and Equipment

Guide to Fair Value Under IFRS is the first international valuation book of its kind. Fully compliant with the Certified Valuation Analyst curriculum, it provides detailed guidance as to how fair value is to be determined and fills numerous gaps in common understanding of IFRS requirements.
Guide to Fair Value under IFRS
Egibi & Co., Babylonian Bankers (c. 600 BC–435 BC)
The First Client
and
Sir Tim Berners-Lee (1955–)
Founder of the World Wide Web
That makes modern business possible
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Today’s expanding global business environment demands that all professionals responsible for financial information have to work together and rely on each other. Accountants, auditors and appraisers (valuators) must ensure that stakeholders in an entity—management, shareholders, creditors, and regulators—receive reliable, up-to-date financial information, enabling them to make the right decisions in fulfilling their duties and responsibilities. Errors in incorrectly recording, valuing, and auditing data at any stage will lead to wrong, possibly even damaging results. With the expansion of International Financial Reporting Standards (IFRS) throughout the world, the roles of the accountants and auditors are becoming harmonized, with appraisers supplying the basis for many conclusions. Now is the era of the appraiser; this book is a start.

To generate profits and run efficiently, management has to know in detail the costs involved in producing, selling, and distributing the entity’s various goods and services. In addition, it has to ascertain that there is enough cash available for capital expenditures, for working funds, and to pay shareholders the dividends that ensure continuing investment. Finally, such information, both financial and operational, allows management to demonstrate to regulators that the entity is in full compliance with all laws and regulations.

Shareholders need such material to decide whether to buy or sell securities, to establish trading prices and, in particular, as a measure for portfolio performance and stability. Today investors have many choices; to make wise and advantageous decisions, they need reliable financial information.

Lenders and creditors, including banks and suppliers, use such know-how when deciding to make new loans, extend existing ones, or enhance lines of credit, and also to gauge a firm’s ability to pay its bills and properly service both its short- and long-term debt. It is also of importance to vendors, who rely on it to grant trade credit and enter into long-term contracts.

Last, but not least, regulators insist on reliable financial information as part of their duty to protect the public trust. To supply this accurately requires the combined talents of the three separate sets of interrelated professionals: accountants, auditors, and valuers, each of whom relies on data from both the others. Their interaction is illustrated by Exhibit F.1.

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1 Based on a speech in Beijing to the International Network of Auditors & Accountants (INAA) in May 2007.
Accountants deal mostly with the present, recording on a daily basis the activities of every entity involved. Auditors, who are also accountants, deal with the past, confirming that the accounts they had been given present “fairly” the results of preceding activities, while appraisers, among whom I have the honor to serve, look to the future, calculating what someone will pay now for benefits that are yet to come.

Based on information and data from the entity’s accountant and advice from its auditors, we perform our services and reach our conclusions. Those may encompass numerous steps, including determining: the fair value of the whole firm; an individual division, subsidiary, or department; specific financial, physical, or intangible assets; or a potential acquisition target.

Valuing individual assets, especially intellectual property, is essential to the impairment tests, which since 2003 have been required by IFRS at least once a year. To conduct such an engagement properly, valuators must be able to rely on accurate financial information, continuously and freely provided as required by management through its accounting staff. The quality of any valuation is adversely affected by inaccurate or inadequate inputs. Valuators then deliver to the accountant and management their conclusions to be incorporated into the entity’s records for confirmation by the auditors. Similarly, the auditors have to rely on the professional efforts of both the accountant and the valuator.

The close business ties between eastern and western economies and global financial interaction over the past decades have led Africa, Asia, and Australia to adopt IFRS and its related fair value accounting. This in turn caused all valuators to become much more aware of approaches, methods, and techniques developed in North America and Europe. With contributors from six continents, this book offers a thorough grounding in all of those approaches.
PREFACE

JAMES P. CATTY

UNITED KINGDOM

For some years, the world has experienced accelerating globalization that has exceeded any commercial interchanges of previous centuries by an order of magnitude. Common sense dictates that such networks require an equally universal approach to accurately valuing interrelated holdings, following the same worldwide accounting principles; this is under way, as, by 2011, approximately 150 countries will have adopted International Financial Reporting Standards (IFRS). This book offers thorough assistance in such an undertaking, creating a unified language and giving advice concerning relevant methodologies.

While there are many national valuation textbooks, mainly in the United States, there are no international ones. To fill this void, our book is a collaboration of over 30 participants from 14 countries; it was written during an unprecedented downturn in the world economy and sets out best practices in many segments of valuation, for good times and bad. The concept is also to assist readers to react quickly to the new normal when it arrives.

When, as chairman of the International Association of Consultants, Valuators and Analysts (IACVA), I signed the contract with John Wiley & Sons, Inc., in October 2008, the world stock markets had been in virtual free fall for a month; I thank Wiley for its courage in taking on this project. After that, values continued to decline, in the United States a further 33%, before, in early March 2009, staging a remarkable resurrection. Now most indexes are back to or above their October levels, as massive, stimulative government policies are taking effect.

This has been the greatest turmoil in the markets since I first became involved in valuations more than 50 years ago. During the long period of Goldilocks economies, which lasted until 2007, risk premiums for virtually every feasible asset were low, reflecting comparatively limited recent losses. In 2008, a combination of repricing of risk, and fears that the financial world, as we knew it, was coming to an end changed everything and gave rise to the continuing worldwide crisis.

Recent Bubbles

Most investors profited from 1995 to 2007; that was a period of asset bubbles in many stock markets, most commodities (oil, copper, nickel, iron ore) and real estate; unfortunately, nearly everyone lost in the subsequent multiple collapses. Worldwide share and commodity value declined, following the huge decreases in home prices in many countries, principally: Australia, Britain, Spain, and the United States. The result was the greatest destruction of fortunes since the Dirty Thirties. According to some commentators, over one-third of worldwide wealth vanished in the last 12 months. Each bubble had four phases.

Stealth. “Smart funds” get in quickly, quietly, and cautiously; asset prices gradually increase, but the general population remains unaware.

Awareness. Price increases get attention; there is some profit taking, but selling is short-lived, as investors treat the dips as opportunities to buy more.

Mania. Masses peg relevant investments, first Internet shares, then real estate, as “the opportunity of a lifetime”; phrases like “prices can only go up” are passed around as indisputable facts but turn out later to be nasty viruses. More unsophisticated money pours in, as “smart funds” begin to unwind their position.