INTERNATIONAL GOOD PRACTICE GUIDANCE

Project and Investment Appraisal for Sustainable Value Creation: Executive Summary

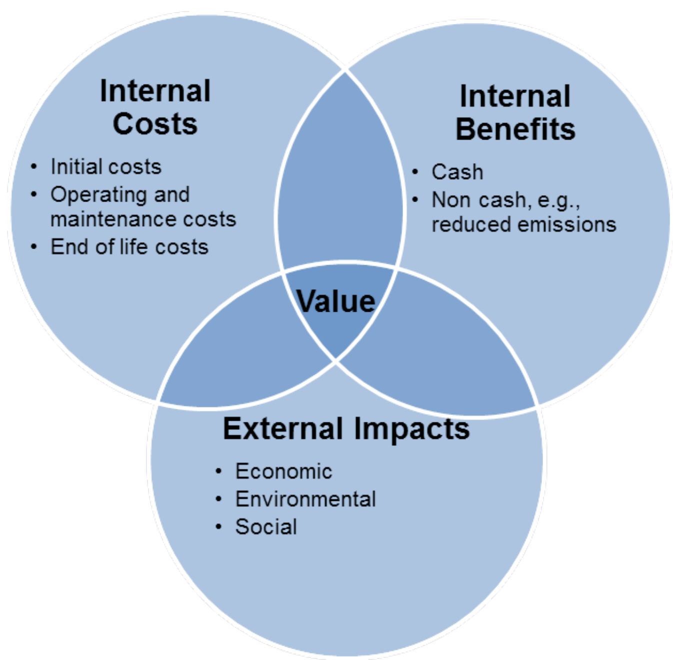
International Federation of Accountants®

Project and Investment Appraisal for Sustainable Value Creation

The International Good Practice Guidance (IGPG) *Project and Investment Appraisal for Sustainable Value Creation* highlights the critical aspects of appraising decisions to facilitate sustainable organizations, financial markets, and economies. Professional accountants have important roles to play in ensuring that organizations take into account economic, environmental, and social considerations when evaluating projects and investment decisions to support sustainable value creation.

In advocating fundamental principles, IFAC establishes a benchmark to help manage the complexities of applying a robust project and investment appraisal and ensure an organization's approach and processes are aligned with widely accepted good practice. The guidance can also be used to explain fundamental concepts and complexities to a non-accountant audience.

Key Inputs into a Decision Analysis



Investments, such as major capital spending, and strategic investments, such as product development, as well as acquisitions and divestitures that shape the future of an organization—or in the case of the public sector, large infrastructure projects—should be judged on the basis of a wide set of considerations that will incorporate both qualitative and quantitative assessments.

Evaluating projects and investments is inherently complex and involves many decision inputs and subjective factors that can affect the outcome of a decision-making process, and, ultimately, the viability of an organization. Professional accountants can help provide a strategic and operational context and estimate and analyze the many variables in a systematic and structured way involving both financial and sustainability analysis.

Project and Investment Appraisal in the Twenty-First Century

Traditionally, project and investment appraisal is taught and discussed in purely financial terms, which helps an organization focus on decisions that create the most economic value. To facilitate sustainable value creation, it is essential to also take into account additional sustainability considerations. Many strategic and operational decisions involve many elements, whether from a technical, economic, environmental, or social perspective. This guidance highlights how to incorporate wider considerations into the appraisal decision. Through a better understanding of these factors, an organization and its stakeholders will have a more complete picture of sustainable value creation, which facilitates better decision making.

The guidance helps to answer key questions, including:

- What should be my role as a professional accountant?
- Which techniques should I apply in an appraisal and decision process?
- How should an appraisal process be conducted and how should sustainability considerations be taken into account?
- How should the decision process be viewed in the context of an organization's strategy and its economic, environmental, social and competitive position, including identifying the key inputs into the decision analysis?
- How should uncertainty and application of reasoned judgment be handled, particularly where factors are difficult to predict and estimate?
- What are the accepted definitions of terminologies used in project and investment appraisal?

THE ROLE OF PROFESSIONAL ACCOUNTANTS IN THE APPRAISAL PROCESS

Professional accountants play a crucial role in promoting and explaining the key principles of project and investment appraisal in their organizations, both to encourage long-term decision making and manage uncertainty and complexity. They may do this in their roles as value creators, enablers, preservers, and reporters, which include positions outside of the finance and accounting function and in a business partnering capacity (see *Competent and Versatile: How Professional Accountants in Business Drive Sustainable Success* for additional information on the many diverse roles of professional accountants).

Professional accountants are involved in:

- recognizing the project or investment opportunity and subsequent assessment of the strategic impact and economic rationale;
- ensuring that information is used in a way that leads to the selection of the best alternative;
- aligning decisions with assessments of subsequent managerial performance; and
- reviewing whether anticipated benefits have been realized.

Principles of Project and Investment Appraisal

The principles reflect good practices in project and investment appraisal and the application of tools and techniques that all accountants have in their armory.

A. When appraising multi-period investments, where expected benefits and costs and related cash inflows and outflows arise over time, the time value of money should be taken into account in the respective period.

B. The time value of money should be represented by the opportunity cost of capital.

C. The discount rate used to calculate the net present value (NPV) in a discounted cash flow (DCF) analysis should properly reflect the systematic risk of cash flows attributable to the project being appraised and not the systematic risk of the organization undertaking the project.

D. A good decision relies on an understanding of the business and should be considered and interpreted in relation to an organization's strategy and its economic, social, environmental, and competitive position as well as market dynamics.

E. Project cash flows should be estimated incrementally, so that a DCF analysis should only consider expected cash flows that could change if the proposed investment is implemented. The value of an investment depends on all the additional and relevant changes to potential cash inflows and outflows that follow from accepting an investment.

F. All assumptions used in undertaking DCF analysis, and in evaluating proposed investment projects, should be supported by reasoned judgment, particularly where factors are difficult to predict and estimate. Using techniques such as sensitivity analysis to identify key variables and risks helps to reflect worst, most likely, and best case scenarios, and, therefore, can support a reasoned judgment.

G. A post-completion review or audit of an investment decision should include an assessment of the decision-making process and the results, benefits, and outcomes of the decision.

The Project and Investment Appraisal Decision Process

As shown below, the project and investment appraisal decision process starts with the strategic context, followed by a process of incorporating the relevant data and analysis, constructing a DCF model, interpreting results, and a subsequent post-decision review. These steps should be coupled with a review of the project or investment's strategic importance and its alignment with the strategic themes and objectives that have been outlined in a strategic plan, the acceptable level of risk, and required rate of return. Strategic imperatives and goals, such as achieving particular environmental or social goals, can influence the qualitative and quantitative data that is incorporated into the appraisal.

Establish strategic context	Incorporate data	Construct DCF model	Interpret results	Review decision
• Strategic objectives • Goals and targets • Risk management • Competitive position • Stakeholder engagement	• Internal costs • External costs • Benefits • Potential costs and benefits • Qualitative and quantative information	• Identify cash flows • Determine forecast assumptions • Forecast horizon • Estimate cost of capital	• Sensitivity analysis • Scenarios • Real options • Review of project alternatives	• Review costs/ benefits • Review assumptions • Review process

Through a better understanding of wider sustainability-related impacts and externalities, particularly around environmental and social issues, relevant additional costs and benefits can be incorporated into the appraisal to give a more complete picture of sustainable value creation.

Complementary tools and techniques, such as environmental management accounting, lifecycle assessment and costing (sometimes referred to as whole life costing), and wider enterprise risk management, can help identify and quantify costs and benefits, as well as risks and opportunities, related to both current and future strategies and operations. These tools and techniques help bring into the project appraisal additional forms of analysis, including evaluations of external impacts, social impacts (e.g., health and safety or labor practices), economic impacts of decisions (e.g., for communities and suppliers), and environmental impacts (e.g., biodiversity and pollution).

International Good Practice Guidance

IFAC's purpose in issuing principles-based International Good Practice Guidance (IGPG) is to foster a common and consistent approach to those aspects of the work of professional accountants in business and public services not directly covered by international standards. IGPGs focus on key areas of strategic importance to professional accountants in business, with the aim of guiding their thought processes and decision making and, thus, supporting the exercise of professional judgment, which is critical in their roles. IGPGs address governance, evaluation, improvement, and implementation of strategic decisions for which professional accountants in business are responsible or to which they can contribute their expertise as trusted colleagues and advisors.

The Professional Accountants in Business (PAIB) Committee has applied the extensive expertise, experience, and diversity of its members and IFAC member organizations to draw out a set of internationally accepted principles that professional accountants can apply in organizations where they work, regardless of jurisdiction, size, economic sector, or form of ownership. The principles provide a common frame of reference when deciding how to address issues and challenges, and helping organizations to achieve sustainable success.

IGPGs also help accountants to identify additional available resources by including links to the relevant work and resources of IFAC member organizations and other colleagues.

The full-length version of *Project and Investment Appraisal for Sustainable Value Creation [LINK]* includes relevant resources from IFAC, its member bodies, and other organizations. It can be downloaded free of charge at www.ifac.org/paib.

For more information please contact:
IFAC
529 Fifth Avenue, FL 6
New York, NY 10017
USA
T +1 212 471 8707
www.ifac.org

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