THE
HONG KONG
ASSOCIATION
OF
BANKS
香港銀行公會

Room 525, 5/F., Prince's Building, Central, Hong Kong
Telephone: 2521 1160, 2521 1169 Facsimile: 2868 5035
Email: info@hkab.org.hk Web: www.hkab.org.hk

香港中環太子大廈5樓525室
電話：2521 1160, 2521 1169 圖文傳真：2868 5035
電郵：info@hkab.org.hk 網址：www.hkab.org.hk

11 January 2013

By email: CommentLetters@ivsc.org

International Valuation Standards Council
41 Moorgate
LONDON EC2R 6PP
United Kingdom

Dear Sirs

IVSC Exposure Draft on Valuation Uncertainty

We refer to the Exposure Draft of the International Valuation Standards Council ('IVSC') on the proposed Technical Information Paper ('TIP') on Valuation Uncertainty published in November 2012.

We agree that robust disclosures on valuation uncertainty would provide useful information for users of the valuations and we support the IVSC's efforts to improve the transparency and disclosures of valuation uncertainty factors. We also appreciate the work by the IVSC Standards Board in considering the responses to the Discussion Paper issued in 2010, making changes and developing additional guidance in response to the feedback received.

Our comments on the specific questions raised in the exposure draft are attached. Should you have any questions, please do not hesitate to contact our Senior Business Manager, Ms Caris Wan at 2521 1855.

Yours faithfully

Boey Wong
Secretary

Enc.

Attachment

<u>**HKAB's responses to specific questions in the International Valuation Standards Council's Exposure Draft on Valuation Uncertainty**</u>

Question 1

The proposed TIP defines valuation uncertainty at para 7. Do you agree with this definition? If not, how do you think it could be improved?

The proposed definition refers to valuation uncertainty as "*the possibility that the estimated value may differ from the price that could be obtained in a transfer of the same asset or liability taking place at the same time under the same terms and within the same market environment*".

We acknowledge that para 1 of the proposed TIP states that the scope of the definition of valuation uncertainty applies to valuations that are prepared on the basis of market value as defined in International Valuation Standards ("IVS") as well as fair value as defined in International Financial Reporting Standards ("IFRS") 13. Fair value under IFRS, or the Hong Kong Financial Reporting Standards ("HKFRS") 13 is referred to as "*the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date*". We recognise that IVS and the proposed TIP are for a wider purpose and not solely for valuations for financial reporting. However, when the valuation is prepared and reported specifically to measure fair value under the accounting standards, we believe that consistent terms and definitions should be applied to avoid confusion and ambiguity. Therefore, we suggest that the IVSC could replace the term "*the price that could be obtained in a transfer of the same asset or liability taking place at the same time under the same terms and within the same market environment*" in the definition with "*the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date*" when valuation uncertainty is applied in the context of valuations for financial reporting purposes.

We also note that the proposed definition refers only to the possibility of deviation of the reported valuation. Given that the purpose of the proposed TIP is to assist practitioners in providing appropriate information on factors that may have given rise to material uncertainty in the reported valuation, we view that other than the possibility of deviation, the extent of difference under such a valuation is also vital in determining whether the deviation is significant. Therefore, we suggest that the definition of valuation uncertainty be reworded to include "*the possibility* <u>***and the extent under such a possibility***</u> *that the estimated value may differ…*".

Finally, para 6 of the proposed TIP stipulates that valuation is "*an estimate of the most probable of a range of possible outcomes based on the assumptions made in the valuation process*", and para 48 again recommends that the reported valuation be based on the most likely of outcomes. However, we note the IVS does not refer to a valuation as an estimate of the most probable of a range of outcomes. It refers to market valuation as the most probable price reasonably obtainable. The most probable price would be determined as an estimate within a range of possible outcomes, as opposed to the outcome with the highest probability. Therefore, we suggest the TIP should be reworded or clarified.

Furthermore, we would also like to point out that this most probable possibility approach as is currently stated is not necessarily consistent with IFRS / HKFRS 13 given the accounting standards use a probability weighted-average approach throughout their content (such as the determination of expected cash flow under the present value technique) which on a consistent basis would also apply to the concept of deviation as well.

Question 3

The proposed TIP provides guidance on the distinction between valuation uncertainty as defined in the paper and risk, in particular between market uncertainty and market risk. It was clear from comments received on the Discussion Paper and made elsewhere that the concepts are regularly confused. Some believe that the brief explanation of market risk in para 16 and 17 is not needed given that the focus of the paper is on uncertainty rather than risk. Others consider that the inclusion of a brief illustration of market risk helps readers understand the distinction between this and market uncertainty.

Which of these views do you support?

We support the inclusion of a brief illustration of market risk in para 16 and para 17 of the proposed TIP in order to help users to better understand the concept of market uncertainty and how it can be distinguished from market risk.

Question 6

The requirement in IVS 103 is to disclose any material uncertainty that affects the valuation. Paras 29-39 of the proposed TIP provide guidance on identifying when uncertainty is material, with reference to the requirement in IFRS 13 for valuation for financial reporting and more general guidance where valuations are for other purposes.

Do you find the guidance on materiality to be helpful? Are there any improvements or other considerations that you would suggest be included.

We share the view adopted by IVSC that the valuation report should set out clearly a description of any material uncertainty that directly affects the valuation. The assessment of whether an uncertainty is material is a matter of judgment and we agree with the proposed guidance that this judgment on materiality should be considered in relation to the significance of the impact of the uncertainty on the valuation and the relevance of the uncertainty to a user of the valuation. We note that this guidance does not contradict the concept of materiality prescribed in the accounting standards.

We do feel, however, that the explanations provided in paras 34 to 37 do not clearly articulate that under the accounting standards, valuation uncertainty arising from models and inputs primarily affect Level 3 valuations. By definition, a Level 1 valuation involves using fully observable values in an active market for identical instruments, and a Level 2 valuation involves using either fully observable values in an inactive market or unobservable values for similar instruments in an active market. Whilst both these valuation techniques would be subject to market uncertainty, because they do not involve the use of models or significant levels of unobservable inputs, they would not be significantly affected by model and input uncertainty.

Under IFRS / HKFRS, it is generally considered that valuation uncertainty is of particular concern when the valuation contains significant unobservable inputs or the use of models and we welcome the Board's approach to make reference to this concept in the TIP when the valuation is being prepared for financial reporting purposes. While the TIP has referred specifically to the disclosure requirements under IFRS 13 Para 93(h) on the sensitivity of Level 3 fair value measurements, we suggest that the other relevant disclosures prescribed in the accounting standards (e.g. transfers between Levels 1, 2 and 3 of the hierarchy, reasons for the transfer, reasons for changes in valuation techniques, description of valuation processes, quantitative disclosures about significant unobservable inputs) should also be made brought to the attention of the users of the valuation.

In addition, we suggest that the Board also include in the guidance some illustrations of situations that characterise material valuation uncertainty.

Question 7

Para 42 sets out matters that it is recommended to be included in a qualitative disclosure of uncertainty.

Do you agree that this identifies the matter that should normally be included in a disclosure of uncertainty? If not please indicate any additional matters that you consider should be included or any matters mentioned that should be excluded.

We support the proposed conclusion by the IVSC that all cases of material valuation uncertainty should be accompanied by qualitative disclosures, which are needed in order to provide useful information about the valuations.

From the list of qualitative disclosures proposed in para 42, we believe that it would be helpful to also include additional clarification or illustration on certain recommendations, such as the requirement to explain the effect the valuation uncertainty has on the market. Whilst we agree that in the case of market uncertainty, it would be useful to disclose information on the length of time that may be required for the effect of the event to be assimilated and stability to be returned to the market, we are unclear whether such information could be reasonably obtainable during the time of a market disruption, and whether the information obtained would be sufficiently reliable to be disclosed in a report to relied upon by users.

Under IFRS / HKFRS 13 para 93, entities are required to disclose specific qualitative information about assets and liabilities categorised within Level 3 of the fair value hierarchy (i.e. unobservable inputs are used in the valuation), including an explanation of the valuation technique and inputs used, a description of the valuation processes applied, and a narrative description of the sensitivity of the fair value measurement to changes in the unobservable inputs. We encourage the Board to consistently incorporate these elements into the proposal as well so that practitioners are made aware of these accounting requirements when they are involved in valuations for financial reporting purposes.

Question 8

Para 47 suggests that model and input uncertainty may be more readily measurable for financial instruments than for other types of assets.

Do you have experience of quantitative measures of valuation uncertainty for tangible or intangible assets being disclosed in reports? If so please indicate the types of asset and the techniques used to quantify the uncertainty.

We note that valuation uncertainty also arises from valuation of properties that are of highly specific or restrictive nature such that a depreciated replacement cost approach is typically adopted as there is little or no comparable transaction in the market. We suggest the IVSC consider providing guidance on ways to quantify the uncertainty and unobservable inputs used for valuation of these assets in the proposed TIP.

Question 9

Para 51 sets out proposed principles for quantitative measures of uncertainty.

Do you agree with this list? If not please indicate any additional principles that you believe should be included or any listed that you believe are inappropriate.

Under IFRS / HKFRS 13 para 93, entities are required to disclose quantitative information about assets and liabilities categorised within Level 3 of the fair value hierarchy. Specifically, para 93(d) requires the disclosure of quantitative information about significant unobservable inputs used in the fair value measurement and para 93(h) prescribes the quantitative disclosure on the sensitivity of fair value measurement to alternative assumptions of unobservable inputs. While we note that the proposed TIP contains a recommendation that is similar to the requirement of para 93(h) of IFRS / HKFRS 13, it has not, however, entirely captured the specific requirement of para 93(d) on disclosure of quantitative information about unobservable inputs, including the range and the weighted average values of unobservable inputs as illustrated in IE 63 of IFRS / HKFRS 13.

Consistent with our comment on Question 7, we encourage the IVSC to fully incorporate the quantitative disclosures of IFRS / HKFRS 13 on unobservable inputs into the TIP so that professional valuers not only acknowledge these requirements under the accounting standards when they perform valuations for financial reporting purposes, but also appreciate the potential quantitative impact of alternative assumptions on the valuation.

Question 10

It is proposed that the final TIP will include a few simple illustrative examples of uncertainty disclosures to assist readers understanding how the guidance may be applied in practice. The Board has decided not to develop these until it has received comments on the principles in this draft. The Annexe to this draft contains an indication of situations for which examples are being considered.

Do you agree with the Board's proposals to include illustrative examples of typical disclosures? If so, please indicate the situation for which you consider an example would be most useful.

We welcome the Board's proposals to include illustrative examples of typical disclosures. More practical examples on how to determine whether to disclose qualitative or quantitative information is strongly recommended. However, cautionary language should be added to remind practitioners not to use the illustrative disclosures as standard language in their reports but rather tailor the disclosures in their reports to reflect the specific circumstances applicable to the valuation.

Attachment

Other comments

- Para 21 of the TIP provides guidelines on how to measure model uncertainty where more than one valuation approach or method is used. It is suggested to provide guideline on situations where more than one valuation approach or method is used. IFRS 13.B40 can be used as a reference to one of the examples: "*If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (e.g. the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.*"

- A typo is noted in Para 36 where the word "that" has been duplicated.