Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically via email

29 July 2016

International Valuation Standards Council
1 King Street
London
EC2V 8AU
United Kingdom

Dear Sir/Madam,

Exposure Drafts on IVS 104 *Bases of Value*,
IVS 105 *Valuation Approaches and Methods* and IVS 210 *Intangible Assets*

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to set and promulgate standards in Hong Kong relating to financial reporting, auditing, and ethics for professional accountants. We welcome the International Valuation Standards Council's (IVSC) efforts in expanding the depth of its standards, and ensuring that the International Valuation Standards (IVS) provide clarity and market efficiency and are fit for purpose.

The role of valuation is getting more prominent in financial reporting as more items are required or can be measured at fair value under IFRS/HKFRS. In Hong Kong, no regulatory body sets valuation standards and, while there are no requirements for valuation experts in Hong Kong to comply with the IVS set by the IVSC, we are aware that some valuers use IVS as a guide. We are therefore commenting on these exposure drafts in light of the impact they may have on financial reporting.

Our comments have been developed through deliberation with our advisory members from valuation practices and academia, and our Financial Reporting Standards Committee.

Given the prevalence of performing valuation for financial reporting under IFRS, our main concerns are from the perspective of ensuring the guidance between IFRS and IVS, where relevant, are consistent. One inconsistency we note relates to Exposure Draft on IVS 105 *Valuation Approaches and Methods*, in particular paragraphs 10.3 and 10.4. These paragraphs may not be consistent with paragraph 63 of IFRS 13 *Fair Value Measurement*, which states the following:

> In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.

If the IVSC keeps paragraphs 10.3 and 10.4 of the proposed IVS 105, we urge that the IVSC explains under what circumstance would valuers only use one valuation method in its assignments.

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We also consider that it would be useful to add to IVS 105 and/or other related standards a reminder that IFRS and other reporting standards, e.g. USGAAP, have specific requirements or guidance relating to valuation. Valuers should therefore be mindful and apply the relevant literature as appropriate.

In terms of disclosures, as a principle, we consider that valuation experts should be required to provide in their reports to clients the rationale for using a particular methodology, inputs, assumptions and details of comparable transactions used in the valuation model. We therefore urge the IVSC to require such a disclosure as an over-arching principle.

We also have other comments that seek to clarify certain requirements and request for more guidance in IVS 104 *Bases of Value*, IVS 105 *Valuation Approaches and Methods* and IVS 210 *Intangible Assets.* These comments are explained in detail in the Appendix.

The HKICPA is aware of the memorandum of understanding between the IVSC and the International Accounting Standards Board (IASB). We therefore support members and staff of both IVSC and IASB to actively monitor and provide input on the development or improvement of standards that are set by respective boards, where they relate to valuation.

If you have any questions regarding the matters raised in this letter, please contact me or Anthony Wong, Associate Director of the Standard Setting Department (anthonylwwong@hkicpa.org.hk).

Yours sincerely,

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Christina Ng
Director, Standard Setting Department

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cc IASB

Detailed comments on IVSC EDs

The comments in this Appendix seek to clarify certain requirements and request for more guidance in IVS 104 *Bases of Value*, IVS 105 *Valuation Approaches and Methods* and IVS 210 *Intangible Assets.* Other pertinent comments are explained in the cover letter of this Appendix.

Exposure Draft on IVS 104 Bases of Value

Bases of value
The proposed IVS 104 provides the definition of 'basis of value' without discussing when those bases of value could be used. It would be helpful if the IVSC provides more guidance such as factors or examples for valuers to decide which basis of value to use for different types of valuation assignments.

Highest and best use
Paragraph 150.1 of the proposed IVS 104 states that, "Highest and best use is the use that would produce the highest value for an asset, liability or a group of assets and/or liabilities, regardless of the actual current use.". The paragraph defines the concept of 'highest and best use' but the exposure draft does not distinguish the use of this concept between financial and non-financial assets. Paragraph BC63 of IFRS 13 makes such a distinction.

We therefore suggest that the IVSC specifies when and how 'highest and best use' should be applied. For example, it is often used in the valuation of land and buildings. It would also be useful if the IVSC acknowledges in IVS 104 that IFRS 13 applies 'highest and best use' to non-financial assets that are fair valued only.

Transaction costs
We consider that there is a lack of guidance on the use of transaction costs in valuation and therefore suggest that IVS 104 includes the following discussion:

(a) Under what circumstance should fair value be adjusted for transaction costs. For example, should fair value incorporate transaction costs if it is a characteristic of the asset, like in the case of real estate valuation from a buyer's perspective.
(b) How transaction costs should be considered when determining highest and best use, the market for a transaction, and the likely market participants.

Exposure Draft on IVS 105 Valuation Approaches and Methods

Market approach
We request that the IVSC provides more guidance or examples that explain when/how the circumstances identified in paragraph 20.2 of IVS 105 would lead to the use of market approach in practice. In particular, the IVSC should discuss the thought process for making the decision to use the market approach under the circumstances outlined in paragraphs 20.2(a) - (c) of IVS 105.

Paragraph 30.13(c) mentions 'thinly-traded' but we consider that this text is not well defined in accounting and valuation literature nor in practice. We therefore suggest that paragraph 30.13(c) says 'Securities that trade in an active market provide more meaningful evidence'.

Discounts/Premiums
Paragraph 30.18(c) of IVS 105 explicitly states that blockage discounts are prohibited in IFRS 13. We suggest that this statement be moved to paragraph 30.18 (main paragraph) to make it more prominent that certain adjustments are not allowed for particular bases of value. This can also avoid the impression that paragraphs 30.18(a) and 30.18(b) of IVS 105 have no differences from the fair value measurement guidance in IFRS 13. Pointing such

differences out selectively in paragraph 30.18(c) creates the appearance that all other instances do not conflict with IFRS 13.

We consider that the current grouping of the guidance about discounts/premiums under 'Other Market Approach Considerations' is misleading as discounts/premiums should also be considered in the income approach. These guidance should not be grouped under a particular approach and should be relocated under a more general heading.

Income approach
We consider that paragraph 40.5 of IVS 105 is mainly a theoretical statement and is not as relevant in practice. In reality, investors may end up with concentrated or undiversified risks for commercial reasons. We therefore suggest that IVSC deletes this paragraph or provide more context on the objective for including this paragraph.

We also consider that a practical example would be useful to illustrate the application of paragraph 50.5(c) of IVS 105.

We note that paragraph 50.7 of IVS 105 defines 'functional currency' while paragraph 9 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* also defines this term. We suggest that the IVSC considers how best to prevent any confusion on the use of this term for valuation and accounting purposes.

Cost approach
We consider that some high level factors on when to include the direct/indirect costs mentioned in paragraph 80.11 of IVS 105 is necessary as some of the costs quoted are not relevant for certain types of valuations.

Discount rate
We note that there is little discussion in IVS 105 on the application and determination of discount rates and therefore request that the IVSC provides further guidance:

(a) in paragraph 60.10 by including:
  (i) a comparison of common methods for developing a discount rate and consideration for selecting the appropriate method;
  (ii) illustrations of how a discount rate could be developed from the list of common methods;
  (iii) examples to explain the consideration factors; and
(b) in paragraph 50.6 by including the methods of adjusting pre-tax and post-tax rates, and consideration factors for choosing the appropriate method.

We consider that it is necessary to clarify that CAPM, WACC and build-up method are methods for developing a discount rate while IRR and WARA are methods for determining the reasonableness of a discount rate in paragraph 60.10 of IVS 105.

Exposure Draft on IVS 210 Intangible Assets

We suggest that the IVSC reorders the sequence of discussion on the valuation approaches by order of hierarchy, that is, discuss the market approach before the income approach to prevent any confusion that the income approach is the preferred approach in valuing the intangible asset.

In addition, we suggest that the IVSC discusses 'opportunity cost' (paragraph 140.3(d) of IVS 210) as part of the 'profit margin' discussion (paragraph 140.3(c) of IVS 210), as, in practice, opportunity cost is a factor of profit margin, not an alternative to profit margin.

~ End ~