

International Valuation Standards Council  
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London EC2V 8AU  
United Kingdom

Our ref: hkpolyu/kwok/ivs200

29 August 2016

Dear Sirs,

**Exposure Draft of IVS 200: Business and Business Interests (“ED-BBI”)**

I welcome the opportunity to review and provide feedback on the ED-BBI published by International Valuation Standards Council (“IVSC”) on 2 June 2016.

By way of background, I am a director of two companies, an author of four professional titles published worldwide and a visiting fellow in academia. I have been involved in business valuation as a forensic accountant and as an expert witness in Hong Kong for many years, and my comments in this letter are provided from the perspective of business valuers. Without a statutory regulator for business valuation in Hong Kong, some business valuers voluntarily follow International Valuation Standards (“IVS”) as a guide in their work.

I very much appreciate the efforts by IVSC in expanding the quality and depth of IVS and ensuring they are fit for purpose and provide clarity and market efficiency. My specific comments on the ED-BBI are set out as follows.

**Question (a) in the ED-BBI**

1.1 Question (a) asks that: *“In IVS 2013, all substantive portions of IVS 200 Business and Business Interests were labelled as “commentary” (except for scope and effective date). This label seems to have created some confusion amongst stakeholders as to whether the standard was mandatory. The Board’s position is that all aspects of IVS 2017 should be mandatory and this Exposure Draft has removed the “commentary” label for clarity. Do you agree with the removal of the commentary label?”.*

- 1.2 In my view, any materials which are intended to be mandatory should not be labelled as “commentary” to avoid confusion, i.e. I agree with the removal of the label of “commentary”. However, business valuers should find helpful if certain prescriptive and non-mandatory materials (possibly in the forms of illustrative examples or application guidance) are added to the ED-BBI upon finalization.

**Question (b) in the ED-BBI**

- 2.1 Question (b) asks that: *“The Board believes that the standard presented in this Exposure Draft can be applied in the valuation of business and business interests regardless of the purpose of the valuation (acquisitions, mergers and sales of businesses, taxation, litigation, insolvency proceedings and financial reporting). Do you agree? If not, for what purpose(s) do you believe this standard cannot be applied? Why?”*.
- 2.2 Subject to the two exclusion clauses of “Exceptions” and “Departures” as set out in paragraphs 60.1 to 60.4 of the Exposure Draft of IVS 2017: Introduction & Framework, I generally agree that the ED-BBI can be applied in business valuation regardless of the purpose.
- 2.3 Notwithstanding the foregoing, I suggest adding “compensation” as another example of the purpose of business valuation because compensations in some cases are determined without contention or any need to proceed to litigation. In Hong Kong, compensations, as in a land resumption, may be determined for the amount of loss or damage to a business conducted by a claimant at the date of resumption on the land resumed or in any building erected thereon, due to the removal of the business from that land or building as a result of the resumption under section 10(2)(d) of the Lands Resumption Ordinance (Chapter 124).

**Question (c) in the ED-BII**

- 3.1 Question (c) asks that: *“Are there any further topics or special considerations that you feel the Board should add or remove from IVS 200 Business and Business Interests? If so, what are they and what is your rationale?”*.
- 3.2 As the ED-BBI has been set at a high level, many important issues in business valuation do not appear adequately addressed. In my view, topics for further consideration in the ED-BBI should include but not be limited to:

- 3.2.1 Control premiums or discounts for lack of control – The issue of control premiums has been raised in paragraph 90.4(b) of the ED-BBI which makes further reference to paragraph 30.18(b) of the Exposure Draft of IVS 105: Valuation Approaches and Methods (“ED-IVS105”). The ED-IVS105 states that: *“Control premiums ... may be quantified using any reasonable method, but are typically calculated based on observed prices paid for controlling interests in publicly-traded securities compared to the publicly-traded price before such a transaction is announced (often referred to as market participant acquisition premiums, or MPAPs).”*. Various studies indicate a wide range of control premiums, while some extreme findings even point to a negative value of control premiums. Due to the possible impact of control premiums on the value of a business, the ED-BBI should give a more meaningful discussion of the relevant factors affecting the degree (and direction) of control premiums.
- 3.2.2 Discounts for Lack of Marketability (“DLOMs”) – DLOMs have not been explicitly addressed in the ED-BBI other than being cited as an example of adjustments for the marketability of the interest being value under income approach in paragraph 60.10 of the ED-BBI. Further reference about DLOM can be sought in paragraph 30.18(a) of the ED-IVS105 which states that *“DLOMs may be quantified using any reasonable method, but are typically calculated using option pricing models, studies that compare the value of publicly traded shares and restricted shares in the same company, or studies that compare the value of shares in a company before and after an initial public offering.”*. Various studies indicate a wide range of DLOMs. Due to the possible impact of DLOMs on the value of a business, the ED-BBI should give a more meaningful discussion of the relevant factors affecting the degree of DLOMs.

### **Matters for clarification**

- 4.1 Paragraph 100.2 of the ED-BBI states that *“Although the value on a given date reflects the anticipated benefits of future ownership, the history of a business is useful in that it may give guidance as to the expectations for the future. Valuers should therefore consider the business’ historical financial statements as part of a valuation engagement ...”*. The ED-BBI should acknowledge that an independent audit can add credibility on historical financial statements enhancing the integrity of factual or observable inputs in business valuation.
- 4.2 Certain terminologies in the ED-BBI should be aligned with the International Financial Reporting Standards to improve consistency. “Minority interest” in paragraph 90.2 should be replaced by “non-controlling interest”, while “balance sheet” in paragraphs 60.9 and 120.3 should be replaced by “statement of financial position”.

## **Typos for correction**

- 5.1 Paragraph 50.4 of the ED-BBI states that “*When applying a market multiple, adjustments such as those in para 50.8 may be appropriate.*”. However, paragraph 50.8 is not a valid reference in the ED-BBI, and the correct reference may include paragraph 60.8 of the ED-BBI.
- 5.2 In applying the income approach, paragraph 60.2 of the ED-BBI makes reference to section 50 of the ED-IVS105. There are two typos in that particular section which are:
- 5.2.1 “principle on debt” in paragraph 50.5(a) of the ED-IVS105 (to be replaced by “principal on debt”); and
- 5.2.2 “difference discount rate” in paragraph 50.17 of the ED-IVS105 (to be replaced by “different discount rate”).

If you have any questions or require any clarifications regarding the matters raised in this letter, please do not hesitate to contact me.

Yours truly,

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