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HKICPA

Dear Mr Ong

Exposure Draft of International Accounting Standards Board (IASB) Covering Fair Value Measurement

We refer to your letter dated 18 June 2009 and would like to set out below our members' comments on the above Exposure Draft.

Our members appreciate the objectives of IASB to clarify the definition of fair value and related guidance and to establish a single source of guidance for all fair value measurements required or permitted by International Financial Reporting Standards (IFRSs) so as to reduce complexity and improve consistency in their application.

With reference to various questions raised in the Exposure Draft, our members have the following comments:

Question 1

The Exposure Draft proposes defining fair value 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" (an exit price).

Theoretically, we consider that this definition is appropriate since the fair value should be a reasonable and achievable market price that the seller will receive and the buyer will pay. However, in practice, an "orderly" transaction may not exist in all cases and may involve many assumptions, which will make the fair value rather subjective in many cases. This may defeat the use of fair value.

Question 3

The Exposure Draft proposes that a fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place in the most advantageous market to which the entity has access.

We consider that this approach is appropriate since the entity will normally choose the market from which the best economic benefits could be derived in selling its asset or transferring its liability, matching usual business objectives.

Question 4

The Exposure Draft proposes that an entity should determine fair value using the assumptions that market participants would use in pricing the asset or liability.

We are of the view that although a reporting entity need not identify specific market participants, the criteria of "market participants" may pose difficulties to the reporting entity and auditors, as they may not be able to ascertain that the market participants satisfy those criteria.

In addition, while one of the criteria of "market participants" is that the buyers and sellers are "knowledgeable", i.e. they are sufficiently informed to make an investment decision and are presumed to be as knowledgeable as the reporting entity about the asset or liability, the "knowledgeable market participants" may not exist in the case of a very special asset.

Another "market participants" criterion is that market participants are independent of each other, i.e. they are not related parties. However, there may be cases where only the companies of a group are interested in the relevant asset, yet transactions are conducted on an arm's length basis, and this definition will exclude these group companies as market participants for the purpose of assessing the fair value.

Question 5

The Exposure Draft proposes that the fair value of an asset should consider a market participant's ability to generate economic benefit by using the asset or by selling it to another market participant who will make "its highest and best use" of the asset.

We opine that the notion of "highest and best use of an asset" for the purpose of determining fair value would reflect the motive of businesses to maximize shareholders' wealth. However, this is subjective and fair values may not be verifiable, as the highest and best use of an asset may be dependent upon specific reporting entities. Hence, the fair value of the same asset will be reported as different amounts by different reporting entities.

It is extremely difficult, if not impossible, for each reporting entity to identify the highest and best use of an asset. With no standard measurement basis, the incremental value will vary between each reporting entity making financial statements not comparable with reduced value for the users / readers.

The highest and best use is determined from the perspective of market participants, instead of the reporting entity. The Exposure Draft also states that there is no need to perform an exhaustive search for other potential uses if there is no evidence to suggest that the current use of an asset is not its highest and best use. We note that there is no guidance in the Exposure Draft on the definition of "evidence". According to the Illustration-Example 2, the evidence is that sites near the factory have recently been developed for residential use. How many sites have to be developed for residential use before it will be considered as "evidence"? This illustrates the issue of subjectivity and thus it is suggested that the Exposure Draft should provide further guidance on "evidence".

<u>Questions 7 and 8</u>

The Exposure Draft proposes that a fair value measurement assumes that the liability is transferred to a market participant at the measurement date and the fair value of a liability reflects non-performance risk, i.e. the risk that an entity will not fulfill the obligation.

We are of the view that this approach cannot remove the fallacy of IAS 39, i.e. in the case of an entity's "own debts", a revaluation gain would arise if the liability falls in value due to, e.g. worsening of the entity's credit rating.

<u>Question 10</u>

The Exposure Draft proposes guidance on valuation techniques, including specific guidance on markets that are no longer active.

We consider that the guidance is acceptable in general. However, in certain cases, there is a requirement for an "active market", which is defined as "A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis." However, this is subject to debate in terms of sufficient frequency and volume. The guidance on "not active market and transactions that are not orderly" is provided in B5 of the Application Guidance with no quantitative measurement basis. The significance and relevance of the factors, which the entity should consider and evaluate, are subjective and controversial.

Yours sincerely

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Secretary

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