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

Our Ref.: C/FRSC

Sent electronically through the email at CommentLetters@ivsc.org

7 September 2010

International Valuation Standards Board
41 Moorgate
London EC2R 6PP
United Kingdom

Dear Sirs,

IVSC Exposure Draft of *Proposed New International Valuation Standards*

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned Exposure Draft.

We commend the International Valuation Standards Council (IVSC) for the comprehensive body of work that it has prepared on this important project. We support the work that the IVSC is undertaking in its effort to develop clear internationally recognized and accepted valuation standards.

Our comments at this time have been restricted to certain conceptual issues concerning the approach that appears to being taken by the IVSC in the development of valuation standards related to financial reporting. We have responded to questions that may have implications for financial reporting in the appendix for your consideration.

We generally agree with the principles-based approach adopt in the proposed standards. We consider that valuation standards need to be principle-based in order that they can be applied by the practitioner with a proper consideration of all the relevant factors. We believe that additional deliberation and details in applying the valuation principles for financial reporting may more appropriately be included in the implementation guidance rather than be incorporated in the body of a standard. In our view the International Accounting Standards Board (IASB) is responsible for setting the principles on which valuations used for financial reporting should be based. More detailed guidance produced by the IVSC should be consistent with the principles in International Financial Reporting Standards (IFRS). For this reason, we encourage the IVSC to work with the IASB to bring together the accounting standard-setting and valuation professions to address valuation issues in an IFRS context.

In preparing valuations in the context of financial reporting, we understand that valuators necessarily need to follow the applicable accounting standards. While we welcome references to IFRS in the valuation standards as a way to increase the familiarity of valuers with accounting guidance that applies when performing valuations for financial reporting purposes, we do not agree with the current approach by paraphrasing the IFRS requirements in the standards. We consider that where the standards that require to relate to IFRS should be cross referred to the appropriate IFRS requirements so as to prevent an unnecessarily risk of diversity in application.

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Moreover, accounting standards are in state of change and will likely continue to evolve. To the extent that matters in the exposure draft, and hence the valuation standards to which they would eventually relate, are based on the requirements of accounting standards, they would need to continue to change as well. The IVSC will need to ensure that it has a mechanism in place that will achieve this.

Finally, we are concerned that the different meaning and application scope of "fair value" in accounting and asset valuation would create misunderstanding and confusion. It was noted that the proposed IVS definition of fair value reflects a price that is fair to two identified parties, while fair value under IFRSs, reflects the value to market participant generally. Given the significant role of the accounting profession in fair value measurement, we recommend that the International Valuation Standards (IVS) uses identical definition of fair value under IFRS and adopt an alternative name for fair value used for purposes other than financial reporting.

If you have any questions on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong, FCPA, FCA
Director, Standard Setting Department

SO/WC/jn

APPENDIX

Hong Kong Institute of CPAs

Comments on the IVSC Exposure Draft *Proposed New International Valuation Standards*

General Questions

<u>Question 2</u>

The Application Standards contain some information on the background to the valuation requirement and the Asset Standards information on the asset type in question and the characteristics affecting value. They also identify particular actions that should be taken in order to apply the principles in the General standards to the particular valuation purpose or when valuing the particular type of asset.

Do you consider that the combination of background information and specific directions to be helpful? Would you prefer all background information and explanatory information on asset classes to be removed from the standards so that only the specific directions applicable to each application or asset type remained?

We appreciate the IVSC's effort to provide an overview of valuation-related points from various IFRSs in the standards. However, we are concerned that the current approach of paraphrasing the underlying IASB material in the standard may create potential confusion in practice and difficulties in keeping the standard up to date with the ever changing IFRS. In our view, standards should be confined to high level principles and cross reference to IFRS is sufficient to enable those performing valuations for financial reporting purposes be aware of the underlying accounting requirements and guidance. We believe that additional deliberation and details in applying the valuation principles for financial reporting may more appropriately be included in the implementation guidance rather than be incorporated in the body of a standard.

In our view the IASB is responsible for setting the principles on which valuations used for financial reporting should be based. More detailed guidance produced by the IVSC should be consistent with the principles in IFRS. For this reason, we encourage the IVSC to work with the IASB to bring together the accounting standard-setting and valuation professions to address valuation issues in an IFRS context.

IVS 101- General Concepts And Principles

<u>Question 4</u>

This Standard is intended to explain fundamental concepts and principles that are referred to throughout the remainder of the standards to assist in their application. Some of the material has been carried forward from previous editions of IVS and some new concepts have been introduced, for example the discussions on market activity and market participants.

Do you consider that this objective has been met? Do you consider that there are any additional valuation concepts and principles that should be considered and discussed in this standard?

In general, we consider that the goal of a single set of high quality, understandable and enforceable global valuation standards can only be achieved by using consistent definitions. We suggest that the IVSC uses identical definitions to those included in IFRS to avoid confusion in practice.

It was noted that the term "fair value" under valuation standards is a broader concept than it under IFRS. The definition of market value included in the IVS is broadly equivalent to the definition of fair value included in IFRSs. The proposed IVS definition of fair value reflects a price that is fair to two identified parties, while market value, or fair value under IFRSs, reflects the value to market participant generally. We consider that using a same terminology but different explanations for fair value in valuation and accounting standards would likely to increase the difficulties in understanding and using this concept. Given the significant role of the accounting profession in fair value measurement, we recommend that the IVS uses identical definition of fair value under IFRS and adopt an alternative name for fair value used for purposes other than financial reporting.

IVS 102- Valuation Approaches

Question 6

Previous editions of IVS have identified the principal valuation approaches listed in this proposed standard.

Do you agree that these three approaches encompass all methods used in the assets or liabilities that you value? If not, please describe what approaches you feel have been omitted.

We agree that the three approaches discussed in the proposed IVS, namely the direct market comparison approach, the income approach and the cost approach are broadly consistent with the IFRS concepts. We consider that more guidance can be provided by the IVSC in the form of implementation guidance in helping the practitioners to select the appropriate valuation method and whether use of an additional method would be likely to provide additional relevant information to influence and support the valuer's opinion of value.

Question 7

Paragraph 6 of the draft sets out a proposed hierarchy of approaches which indicates that the direct market comparison approach is generally to be preferred where there are observable prices for similar assets available at the valuation date.

Do you agree with this hierarchy and do you consider it helpful? If not explain if you would prefer to see no reference to a hierarchy or would prefer an alternative hierarchy.

We agree that the hierarchy of approaches is helpful especially when sufficient and reliable market information is not available. Although the IASB proposed a hierarchy of valuation inputs, rather than valuation techniques, we consider the general hierarchy proposed by IVSC is generally consistent with that in the IFRS. We suggest that details of the difference between the approach adopted by the IVSC and the IFRS can be included in the implementation guidance.

IVS103 - Bases Of Value

Question 12

In IVS highest and best use (HABU) is treated as an inherent feature of market value. This follows the economic theory that the price of an asset which is fully exposed to all potential buyers will sell for a price reflecting the most efficient or productive use of that asset. Other literature that has been published recently presents highest and best use as a separate concept from the price that would be paid in a hypothetical exchange between market participants.

Do you agree with the approach taken in IVS? If not, explain why not and give examples where you believe the highest and best use may be different from the market value.

We generally consider that the highest and best use concept inherent in the market value as proposed by the IVS is consistent with that in the IFRS. In our view, more examples and guidance on the application of the notion of highest and best use in the valuation would be useful for valuers since it will most likely require the use of judgement, especially in applying in non-financial assets. For example, land used for agricultural, residential or commercial purposes would have differing best use values. We are concerned that without the guidance, potential variability in valuation outcome will be resulted.

In addition, it would also be helpful for the IVS provides clarification that the highest and best use concept applies to financial reporting should be determined from the perspective of market participants. Any specific synergy arises from an asset and the respective advantages or disadvantages of the specific parties should not be considered as the fair value under IFRSs that only reflects the value to market participant generally.

Question 13

In the existing IVS a clear distinction is made between fair value in general use and fair value as defined in IFRS. Some found this confusing since the definition of fair value in IVS was identical to that currently appearing in IAS16. Although the IASB is likely to change the definition of fair value in IFRS in its proposed new Fair Value Measurement Standard, in this draft the definition of fair value in general use has been changed to emphasize the distinction from the usage of the term in IFRS.

Do you consider this proposed change in the definition to be helpful? If not, please indicate how you believe it could be improved.

We consider the proposed change in the definition of fair value in IVS is not very helpful. As discussed in Question 4, we consider that using a same terminology but different explanations for fair value in valuation and accounting standards would likely increase the difficulties in understanding and using this concept. We recommend that the IVS uses identical definition of fair value under IFRS and adopt an alternative name for fair value used for purposes other than financial reporting. We would also recommend continued cross-referencing of terms used in IVS and their IFRS equivalent terms; and clear explanations of any differences between terms used in IVS and the IFRS meaning of the same terms.

IVS 105 - Valuation Reporting

Question 15

This proposed standard is significantly less prescriptive than the equivalent standard IVS 3 in the current IVS. The proposed changes reflect the general recommendation of the Critical Review Group that the standards should contain less prescription and focus on principles. It also reflects the need to ensure that these standards can be applied to a wider sector of asset classes than previously.

Do you agree with the changes that have been made? If not, please explain what provisions of the current IVS3 you believe should be carried forward into the new standard.

We agree with the proposed changes. We believe valuation standards need to be principles-based in order that they can be applied by the practitioner with a proper consideration of all the relevant factors. However, we aware that more practical implementation guidance related to financial reporting would be welcomed by emerging economies such as China as those entities might find it difficult to apply the principles in practice due to the immaturity of the market. Information that can be obtained from emerging economies is not as readily-available or as transparent as developed markets and they also lack of relevant experience in performing valuation for a hypothetical transaction with a hypothetical market participant.

We encourage the IVSC to work closely with local valuation standard setters such as The Royal Institution of Certified Surveyors (RICS) in UK and Hong Kong Institute of Surveyors (HKIS) in Hong Kong in developing principles-based standards and practical guidance so as to avoid any unnecessary duplication and inconsistencies.

We would also encourage additional requirements to disclose detailed information regarding the valuation methodology and assumptions applied within the valuation report.

Application Standards

Question 16

The standards in the 200 series relate to valuations for specific purposes. They provide guidance on the background for the valuation requirement before setting out specific matters that should be reflected or considered when applying the principles in the General Standards. Some consider that the fundamental principles of valuation should remain unchanged regardless of the purpose for which it is being prepared and therefore these application standards are superfluous. Others consider that it is important that valuation standards highlight factors that could be relevant to determining the appropriate valuation hypothesis for different purposes, and to set down criteria to ensure that reports contain the appropriate information.

Which view do you support? If you consider that future IVS should contain application standards, do you consider that the degree of detail of those in the draft is appropriate and help the better understanding of the valuation requirements?

We believe that additional deliberation and detail on applying the IFRS in valuation is required to provide more useful application guidance for valuers. Since we prefer principles-based rather than specific techniques oriented standards, guidance for specific requirements under IFRS may more appropriately be included in the implementation guidance rather than be incorporated in the body of a standard. As discussed in Q2, we encourage the IVSC to work with the IASB to bring together the accounting standard-setting and valuation professions to address valuation issues in an IFRS context.

Question 17

The series 201.01 - 201.04 inclusive are all concerned with valuations under IFRS. With the exception of 201.01, which addresses the current IASB Fair Value project, the topics covered all appear in IVA 1 in the current edition of IVS, although in this draft the text has been updated and some additional detail included to address issues of particular relevance to the valuation task. There are opposing views as to the extent and how IVS should address valuation issues under IFRS.

View (a) is that IVS should not refer to valuations under IFRS at all because the IASB is in the process of producing its own fair value standard that will clearly set out the valuation criteria for all valuation measurements required under IFRS and if parallel valuation standards are produced in IVS these will have no relevance. Supporters of this view also argue that limited references to the accounting requirements under IFRS can be misleading and lead to misinterpretation.

View (b) is that valuation measurements under IFRS are intended to reflect market reality and are not a special type of valuation reserved for financial statements. It is therefore important that the requirements under IFRS are properly related to wider valuation principles and practice through cross

references in IVS. Supporters of this view also believe that limited references to IFRS are necessary to help those who are valuers rather than accounting experts understand the required criteria and assumptions so that appropriate valuations can be provided.

Which of these views do you support?

We support View (b). We welcome the references to IFRS in the valuation standards as a way to increase the familiarity of valuers with accounting guidance that applies when performing valuations for financial reporting purposes. However, we consider that where the standards that require to relate to IFRS should be cross referred to the appropriate IFRS requirements rather than to paraphrase the IFRS requirements in the standard so as to prevent an unnecessarily risk of diversity in application.

As discuss previously, we recommend the IVSC to allocate sufficient resources to work with the IASB and local standard setters in developing implementation guidance.

Asset Standards

<u>Question 18</u>

The proposed standards in the 300 series are all concerned with the application of the General Standards to specific asset types. Each standard contains some high level guidance as to the characteristics of each asset type that are relevant to value, a discussion on the principal valuation approaches and methods used and sets down specific matters that should be addressed in settling the scope of work or when reporting. Many of the asset classes included in this Exposure Draft are the subject of "Guidance Notes" in previous editions of IVS and much of the material has been drawn from these. Question 2 asked for your views on whether this combination of background information and specific directions was appropriate or whether you would prefer a clear separation.

Do you have any other comments on the general structure of the Asset Standards?

It is noted that in the proposed IVS, the standards are divided into three classes: general standards, application standards and asset standards. As discussed in Q2, we support that standards should be confined to high level principles and leaving the application guidance and examples in the implementation guidance. However, we would like the IVSC to clarify whether there is a hierarchy between the three classes of standards if potential conflicts existed.

Question 19

The Board is proposing a project to produce a new standard on valuing non financial liabilities, i.e. liabilities that are not attached to a financial instrument.

Do you agree that a standard on valuing non financial liabilities is required and what topics should it cover?

We believe that the IVS should be broad enough to deal with any type of valuation of asset types including non-financial liabilities. To bridge the valuation principles with financial reporting valuation application, joint effort between the IVSC and the IASB is required in developing implementation guidance for financial reporting.

Question 20

The Board would welcome suggestions for additional asset (and liability) types that are not already the subject of a proposed new standard or project.

Please identify any additional types of asset or liability that you believe should be considered for future inclusion in IVS, together with an indication of the benefits that you consider a new standard would bring.

We suggest that separate implementation guidance shall be developed for the valuation of investment property, defined benefit plan, share-based payment and extractive industries for IFRS reporting purpose due to their complex in nature and lack of common practice currently.

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