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

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.ifrs.org)

29 September 2017

Mr Hans Hoogervorst
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Hans,

IASB Request for Information of *Post-Implementation Review: IFRS 13 Fair Value Measurement*

The Hong Kong Institute of Certified Public Accountants ("HKICPA") is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Request for Information (RFI).

Overall, the HKICPA considers IFRS 13 generally worked well. However, the following difficulties were noted:

- Analysing the disclosure of aggregated Level 3 fair value information;
- Applying the highest and best use concept; and
- Determining whether a market is active.

The HKICPA noted other factors outside of IFRS 13 that affected the usefulness of fair value information and the application of fair values:

- Education on the concept of and need for fair values;
- Shortage of specialised professionals in agriculture business and high quality valuation experts for financial reporting in general; and
- The lack of regulation of the valuation industry for financial reporting and auditor education in auditing valuation estimates.

The HKICPA's and our stakeholders' responses to the questions raised in this RFI are explained in more detail in the Appendix.

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,

Christina Ng
Director, Standard Setting Department

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓
Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603
Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

APPENDIX

Question 1A - Your background
Please tell us:
(a) your principal role in relation to fair value measurement. For example, are you a preparer of financial statements, an auditor, a valuation specialist, a user of financial statements, a regulator, a standard-setter, an academic, or a professional accounting body? If you are a user of financial statements, what kind of user are you (for example, buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, asset or portfolio manager)?
(b) your principal jurisdiction and industry. If you are a user of financial statements, which geographical regions and industries do you follow or invest in?

The HKICPA is the only body authorised by law to set and promulgate standards relating to financial reporting for professional accountants in Hong Kong.

In collecting feedback on IFRS 13, the HKICPA:
(i) issued a public Invitation to Comment on RFI on 1 June 2017 and received responses from a preparer from the insurance industry and a preparer from the banking industry;
(ii) met and discussed with:

- HKICPA's Valuations Advisory Panel, which comprise valuation experts from large valuation and accounting firms, as well as an acadamic;
- HKICPA's Small and Medium Practitioners Committee Technical Working Group, which comprise auditors from small and medium-sized accounting firms;
- HKICPA's audit regulatory department; and
- members of The Hong Kong Society of Financial Analysts.

The HKICPA also discussed the RFI and our stakeholders' feedback with its Financial Reporting Standards Committee. The Committee comprises academics, preparer representatives from various industry sectors, regulators, as well as technical experts from small, medium and large accounting firms.

This submission outlines HKICPA's feedback as well as our stakeholders' comments.

Question 1B - Your experience

How extensive is your experience in relation to the measurement of the following items at fair value (including the measurement of their recoverable amount on the basis of fair value less costs of disposal)?

The table below reflects our stakeholders' experience with fair value measurements.

Type of item	The extent of your experience with fair value measurements		
	Little	Some	Much
Property, plant and equipment			V
Intangible assets including goodwill			V
Investment properties			V
Biological assets	V		
Investments in subsidiaries, joint ventures or associates		V	
Financial instruments			V
Other (please specify which)			N/A

Question 2 - Fair value measurement disclosures

(a) How useful do you find the information provided about Level 3 fair value measurements? Please comment on what specific information is useful, and why.

(b) In your experience of Level 3 fair value measurements:

(i) how do aggregation and generic disclosure affect the usefulness of the resulting information? Please provide examples to illustrate your response.

(ii) are you aware of any other factors (either within or outside IFRS requirements) affecting the usefulness of the information? Please provide examples to illustrate your response.

(iii) do you have suggestions on how to prevent such factors from reducing the usefulness of the information provided?

(c) Which Level 3 fair value measurement disclosures are the most costly to prepare? Please explain.

(d) Is there information about fair value measurements that you think would be useful and that IFRS 13 does not require entities to disclose? If yes, please explain what that information is and why you think it would be useful. Please provide any examples of disclosure of such information.

Usefulness of Level 3 fair value information and aggregation disclosure:

(A) Stakeholders' views

All stakeholders who responded consider that information provided about Level 3 fair value measurement is useful. However, most stakeholders agree that aggregation has affected the usefulness of Level 3 fair value information. They recommend to require disclosures on "material" assets/liabilities only.

Some investors found the reconciliation of Level 3 assets/liabilities useful as it explains the movements between two financial periods. Some preparers questioned the benefits of providing such a reconciliation.

Investors and a preparer from the insurance industry recommended that entities be required to disclose valuation assumptions of "material" investments only, for example, investments that constitute more than 10%-15% of that class of investment. This would enhance the usefulness and understanding of the fair value information.

(B) HKICPA's analysis and recommendation

The HKICPA considers that the Level 3 fair value information is useful as it provides an understanding of the valuation approach, significant unobservable inputs and the 'sensitivity to change'. The HKICPA also considers that there needs to be a good balance of aggregation and disaggregation – it may be unreasonable to expect excessive disaggregation for businesses that have high volumes of transactions that involve Level 3 fair value measurements.

The HKICPA is aware that, in practice, preparers are providing the required information for all Level 3 assets/liabilities. However, the HKICPA thinks that the usefulness of the fair value information could be influenced by the format of presentation. The HKICPA also thinks that IFRS[1] already permits an entity not to disclose all 'required' information if the information is not material.

The HKICPA therefore thinks that a possible issue here is preparers need further education or guidance from the IASB on how to apply the aggregation disclosure requirements appropriately.

---

1 Paragraph 31 of IAS 1 *Presentation of Financial Statements*: An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case even if the IFRS contains a list of specific requirements or describes them as minimum requirements.

Following the concept of principle-based standards, the HKICPA supports our stakeholders' feedback about disclosing material assumptions or Level 3 fair value measurement so that such information is more meaningful. However, we do not support adding bright-line materiality threshold to IFRS.

Suggestions to increase the usefulness of fair value information and suggested disclosure:

(A) Stakeholders' views

Investors commented that disclosing an aggregated range of unobservable inputs (e.g. discount rate from 10%-30%) is not useful. An average or mean of inputs would provide more meaningful information to analysts.

Valuation experts and auditors recommended that the IASB provides:

- guidance/examples, in addition to those in paragraph 92 of IFRS 13, on determining which types of investments can be aggregated for disclosure;
- examples of key assumptions/inputs that should be disclosed for common types of investments. Currently, limited examples are provided in paragraph B36 of IFRS 13.

The following are information that our stakeholders think would be useful and that IFRS 13 does not currently require.

- Name, company and accreditation details of a company's valuation expert.
- Reason(s) for specific valuation technique chosen and rationale for the inputs where judgement may be required.
- Basis of assumption (e.g. why a specific discount rate, and not another discount rate, is used).
- Reason(s) for change in assumptions between financial years.
- Significant assumption(s) such as risk factors (e.g. possibility of renewing an operating license), default rate for financial instruments, volatility of financial instruments and growth rate for unlisted investments.
- Similar information required under paragraph 93 of IFRS 13 when non-monetary assets are initially recognised at fair value. This would include the information on initial recognition of assets and liabilities as part of acquisition accounting and non-monetary exchange of assets (e.g. disposal of assets/business in exchanges of shares and/or other items).
- Separate line items of unrealised gains/losses arising from Level 3 valuations, when they are material.

(B) HKICPA's analysis and recommendation

The HKICPA supports the above suggestions made by our stakeholders. We strongly recommend that the IASB considers them.

Most costly Level 3 disclosure:

(A) Stakeholders' views

Other than providing Level 3 information for all assets/liabilities, valuation experts and auditors also find the following to be most costly.

- The quantitative sensitivity analysis on significant unobservable inputs if it involves very complicated financial modelling. In Hong Kong, it is observed that valuers impose additional charge for such a sensitivity analysis.
- Time and cost in determining what are the key assumptions for disclosure and in discussing the classification of an input as Level 2 or Level 3. Preparers tend to avoid classifying an input as Level 3.

(B) HKICPA's analysis and recommendation

The HKICPA does not have any comments.

Question 3 - Prioritising Level 1 inputs or the unit of account **(a) Please share your experience to help us assess:** **(i) how common it is for quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units to be measured at fair value (please support your comments with examples).** **(ii) whether there are material differences between fair value amounts measured on the basis of P×Q alone (when P is the quoted price for an individual instrument and Q is the quantity of financial instruments held) and fair value amounts measured using other valuation techniques. Please provide any examples, including quantitative information about the differences and reasons for the differences.** **(iii) if there are material differences between different measurements, which techniques are used in practice and why.** **Please note whether your experience is specific to a jurisdiction, a region or a type of investment.**

(b) The Board has undertaken work in this area in the past. Is there anything else relating to this area that you think the Board should consider?

(A) Stakeholders' views

Most preparers and auditors who responded consider it is uncommon to measure at fair value, quoted investments in subsidiaries, joint ventures and associates, and quoted cash-generating units. Joint ventures and associates are usually measured at cost in company-level financial statements and equity accounted in consolidated financial statements.

Some auditors consider fair value measurement is relevant when considering purchase price allocation and impairment using the value-in-use model.

Most stakeholders consider that valuing investments in subsidiaries, joint ventures and associates as a whole reflects a better picture of an entity's investment as it incorporates the prospects of holding such investments. Valuation experts and auditors shared the following observations:

- The share price of listed entities with low market capitalization can be high while the entities are loss-making in practice.
- The share price of a listed entity may be affected by a significant transaction (e.g. merger, acquisition or disposal and that impact could be temporary).
- The share price of a listed entity may reflect the value of the listed shell company and not the underlying operations.
- The share price may not reflect the liquidity of a listed entity.

(B) HKICPA's analysis and recommendation

Theoretically, the nature of and intention of holding an investment (akin to a business model approach) would dictate the unit of account and therefore how the investment is measured. For example, an entity that holds shares in a company for short-term trading would find it more appropriate to measure those shares using the PxQ method. For entities that hold shares in a company for long-term strategic reasons and have control or influence over the company's business, the unit of account of the investment as a whole would be more appropriate and relevant.

Following this line of thinking, HKICPA maintains its view provided in response to the IASB ED/2014/4 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value.* That is, investments in subsidiaries, joint ventures and associates, should be measured at investment as a whole.

IFRS 13, however, considers the measurement of fair values from the perspective of market participants, not the entity. This therefore creates a tension in applying the standard.

Question 4 - Application of the concept of highest and best use for non-financial assets **Please share your experience to help us assess:** **(a) whether the assessment of an asset's highest and best use is challenging, and why. Please provide examples to illustrate your response.** **(b) whether the current uses of many assets are different from their highest and best use, and in which specific circumstances the two uses vary.** **(c) whether, when applying highest and best use to a group of assets and using the residual valuation method, the resulting measurement of individual assets in the group may be counter-intuitive. If so, please explain how this happens, and in which circumstances.** **(d) whether there is diversity in practice relating to the application of the concept of highest and best use, and when and why this arises.** **Please note whether your experience is specific to a jurisdiction, a region or a type of asset.**

(A) Stakeholders' views

Valuation experts and auditors who responded generally think that it is challenging to apply the highest and best use concept more so in jurisdictions that apply land-use-rights as there may be legal restrictions imposed by a government.

A preparer from the banking industry does not have significant issues in dealing with the concept of "the highest and best use for non-financial assets", and believes that the existing guidance in IFRS 13 is sufficient.

Valuation experts and auditors also think that the residual value method could produce counter-intuitive results. A typical example they observed in practice: a factory on a land is currently valued at $5 million but the highest and best use of the land only is $6 million. The counter-intuitive result is the value of the factory is nil and therefore, the highest and best use is to knock down the factory.

Some auditors noted a diversity in how preparers apply the highest and best use assessment. In particular, they question how much work is required to determine the highest and best use.

(B) HKICPA's analysis and recommendation

The HKICPA thinks that the challenge with the highest and best use concept is whether it should apply to a single asset or a group of assets. Having said that, the HKICPA believes there is merit in providing such information to investors in order for them to assess management's stewardship and opportunity cost. The HKICPA therefore recommends that the IASB considers the overall cost-benefits of making this assessment. If the concept were to be retained, the concept and the objective of the concept needs to be better explained in IFRS 13.

Question 5 - Applying judgements required for fair value measurements

Please share your experience to help us assess the challenges in applying judgements when measuring fair value:
(a) is it challenging to assess whether a market for a asset or a liability is active? Why, or why not?
(b) is it challenging to assess whether an input is unobservable and significant to the entire measurement? Why, or why not?
Please provide specific examples to illustrate your response and note whether your experience is specific to a jurisdiction or a region or a type of asset or liability.

(A) Stakeholders' views

Most stakeholders found that IFRS 13 has sufficient guidance on whether an input is unobservable and thus have not found this to be a challenge. However, they found it challenging to assess whether some markets are active and whether an input is significant to the entire measurement.

Valuation experts and auditors generally consider it subjective in determining whether a market for an asset or liability is inactive. For example:

- How to determine whether thinly-traded or infrequently transacted instruments are inactive?
- Whether the listed bond market in Hong Kong is active? There are only limited listed bond transactions in Hong Kong as compared to Europe.

One regulator and one preparer found that it is difficult to judge whether over-the-counter (OTC) markets are active and whether OTC instruments should be classified as Level 1 or

Level 2 investment.

One regulator observed that auditors have used 'audit materiality' to determine whether an input is significant in a valuation. However, the materiality threshold may be different in valuation practices. They would like clarification on what the standard means by a "significant" input.

(B) HKICPA's analysis and recommendation

The HKICPA also thinks that the concept of an active market can be judgemental and recommends IASB to provide further education/guidance (e.g. a list of criteria that preparers can use to assess whether the market is active or better explain the concept and the application).

In addition, we consider that the following areas need further clarification.

- Paragraph 73 of IFRS 13 requires the hierarchy of inputs (Level 1 – Level 3) to be determined based on the lowest level input that is significant to the entire measurement. However, paragraphs 76-77 of IFRS 13 require a Level 1 fair value only if 'the only input' is an unadjusted quoted price for identical items in an active market. This creates a conflict in assessing the valuation of a unit fund. For example, in Hong Kong, there are unit funds that invest in quoted shares only (measured as Level 1 investment) and have few (if any) other assets/liabilities. Investors of unit funds typically determine the value of the funds using 'net asset value'. The issue here is whether net asset value can be considered Level 1 input following paragraphs 73 and 76-77 of IFRS 13.
- Paragraph 70 states that the use of bid price and ask price is permitted but not required when measuring an asset and a liability, respectively. However, paragraph BC163 of IFRS 13 suggests that judgement is used in determining which price in the bid/ask range is most representative of fair value.
- In the context of comparable transactions (e.g. refer to paragraph B37), what is meant by 'recent' or 'relevant'. For example, how recent is 'recent' (e.g. 1 to 24 months) and how relevant is 'relevant' (e.g. similar credit characteristics)?

Question 6A - Education on measuring biological assets at fair value

Please describe your experience of measuring the fair value of biological assets:
(a) are any aspects of the measurement challenging? Why, or why not? Please provide examples to illustrate your response.
(b) what, if any, additional help would be useful in applying IFRS 13? In which areas?

Question 6B - Education on measuring unquoted equity instruments at fair value

Please describe your experience of measuring the fair value of unquoted equity instruments:
(a) in 2012, the IFRS Foundation Education Initiative published *Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*. Have you used this education material? If so, how did this material help you to measure the fair value of unquoted equity instruments?
(b) do you have questions not covered in *Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*? Do you think that additional help would be useful in applying the requirements? Why, or why not? Please provide examples to illustrate your response.

(A) Stakeholders' views

Valuation experts and auditors who responded consider that accounting for biological assets is a highly specialised area and requires agriculture experts to be involved when valuing such assets. It may not be possible for the IASB or IFRS 13 to assist further. The challenge faced when valuing biological assets is the availability of high quality agriculture experts.

One valuation expert commented that valuers found it difficult to assess the quality, quantity, yield and stage of growth of biological assets. Agriculture experts may be required to help them verify the inputs for valuation.

Some stakeholders are not aware of the IASB's educational material *Unquoted equity instruments within the scope of IFRS 9 Financial Instruments*.

Some preparers already experience difficulty in fair valuing unquoted equity instruments due to the lack of available information about privately-held entities. Immediate guidance is needed to help preparers measure such investments as the cost exemption is no longer available under IFRS 9.

(B) HKICPA's analysis and recommendation

The HKICPA does not have any comments.

Question 7 - Effects and convergence

(a) Please share your experience of the overall effect of IFRS 13:

(i) what effect did IFRS 13 have on users' ability to assess future cash flows? If you are a user of financial statements, please provide us with examples of how you use information provided by entities about their fair value measurements and any adjustments you make to the measurements.

(ii) what effect did IFRS 13 have on comparability of fair value measurements between different reporting periods for an individual entity and between different entities in the same reporting period?

(iii) what effect did IFRS 13 have on compliance costs; specifically, has the application of any area of IFRS 13 caused considerable costs to stakeholders and why?

(b) Please comment on how you are affected by the fact that the requirements for fair value measurement in IFRS 13 are converged with US GAAP; and please comment on how important it is to maintain that convergence.

(A) Stakeholders' views

Valuation experts and auditors do not consider that IFRS disclosure can help assess an entity's future cash flows as financial reports are meant to reflect the financial position as at a balance sheet date only.

A preparer from the insurance industry think that IFRS 13 enhances the comparability of fair value measurements between different reporting periods for an individual entity. However, the measurements may not be comparable between different entities, especially if entities use different valuation techniques.

(B) HKICPA's views

The HKICPA considers it is desirable to have converged standards. However, the HKICPA urges the IASB to prioritise a standard that is high quality, understandable and principle-based, rather than compromise on the principles for the sake of convergence.

If IFRS 13 is no longer converged with the US equivalent standard, HKICPA strongly suggests that the IASB adds a table of comparison to IFRS 13 that explains the text that are no longer the same and whether and why the Boards think they would or would not lead to the same accounting outcome.

Question 8 - Other matters

Should the Board be aware of any other matters as it performs the PIR of IFRS 13? If so, please explain why and provide examples to illustrate your response.

The HKICPA supports the use of fair values in financial reporting as it provides useful information to primary users of financial reports. However, such information is useful only when there is proper support (and this could require jurisdictional effort) to facilitate the provision of high quality valuations.

The HKICPA considers that an accounting standard on its own is not sufficient to ensure that fair value measurements are applied/reported correctly.

The HKICPA considers that a centralised body that regulates the valuation industry as well as more informed auditors (on auditing estimations) are also necessary for the use of fair values to be successful. To the extent possible, the IFRS Foundation could consider leveraging its relationships with global regulators and the IAASB, and consider how to work together to improve valuations globally.

The IASB could also consider initiating more education programs on the concept of and need for fair values in financial reporting – the HKICPA would be happy to assist/support this in any way we can.

~ End ~