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

Meeting summary – Valuations Advisory Panel meeting

Date/time: Monday, 26 June 2017, 9:30 a.m. – 11:45 a.m.

Venue: Conference Room, 37/F, Hong Kong Institute of Certified Public Accountants

Panel members present:
Mr. Eric Tang, Deloitte Touche Tohmatsu
Ms. Mimosa Chan, Ernst & Young
Mr. Yin Toa Lee, Ernst & Young
Mr. Robert Kwok, Ernst & Young
Mr. Martin Friedhoff, KPMG
Ms. Shelley Ip, PricewaterhouseCoopers
Mr. Spencer Tse, PricewaterhouseCoopers
Mr. Vincent Pang, Avista Group
Mr. Brett Shadbolt, Censere Group
Mr. KangKeng Wee, GW Appraisal
Mr. Kevin Chan, Jones Lang LaSalle

Staff in attendance:
Ms. Christina Ng, Director, Standard Setting
Mr. Anthony Wong, Associate Director, Standard Setting

Apologies:
Mr. Gordon Lee, Deloitte Touche Tohmatsu
Mr. Fran Hung, Deloitte Touche Tohmatsu
Ms. Janet Cheung, KPMG
Ms. Candy Fong, Foremost Advisers Ltd
Mr. Michael Wong, Goldman Sachs
Mr. Guochang Zhang, HKUST
Mr. Ricky Lee, Duff & Phelps
Mr. Simon Chan, Jones Lang LaSalle

Fair value measurement disclosures

Questions for the Panel (#1):
(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.

1. The Panel agreed that the Level 3 fair value measurements could provide useful information but may not be adequate for in-depth analysis.

2. One Panel member quoted a case where the aggregated information covered over 50 underlying investments but only a range of assumptions were disclosed. This doesn't provide meaningful information about the valuation of individual investments.

3. The Panel provided the following suggestion to improve the usefulness of Level 3 information:
   - Disclose the source of assumptions e.g. management or independent 3rd parties.
   - Disclose a sensitivity analysis for significant investments only.

4. The Panel also 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.

5. Some Panel members commented on the time and cost they spent in determining what are the key assumptions for disclosure. Some members also commented that they spent significant time with preparers/management discussing the classification of an input as Level 2 or Level 3. Preparers tend to avoid classifying an input as Level 3.

6. In addition, the Panel commented that it is generally difficult to determine/judge how much additional information is needed to disclose but they consider the following information would be useful to users:
   - Risk factors e.g. possibility of renewing an operating license

- Default rate for financial instruments
- Volatility of financial instruments

<u>Prioritising Level 1 inputs or the unit of account</u>

Questions for the Panel (#2):
(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?

7. Valuers usually assess an investment as a whole instead of using PxQ method as the PxQ method may not fully reflect the value of a long-term investment.

8. The Panel made the following observations:
   - The share price of certain Tier 3 listed entities 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).
   - 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.

<u>Application of the concept of highest and best use for non-financial assets</u>

Questions for the Panel (#3):

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.

9. The Panel generally thinks that, in China, it is more so challenging to assess the highest and best use for a land-use-right through the physically possible, legally permissible and financially feasible lens.

10. The Panel experienced cases where using the residual value method produced counter-intuitive results. A typical example: 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.

Applying judgements required for fair value measurements

Questions for the Panel (#4):
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 an 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.

11. The Panel generally considers it subjective in determining whether a market for an asset or liability is inactive. For example:
    - How would you determine whether thin-trading or infrequent transactions is

considered an inactive market; and

- The bond market in Hong Kong may be considered inactive as compared to Europe. Only top tier listed entities typically issue bonds in Hong Kong. Hence, limited comparable transactions can be obtained for valuation of bonds issued by private entities.

12. In addition, the Panel agrees that the following judgemental areas need further clarification as raised by SSD.
    - 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. The Panel observes that there is diversity in practice.
    - 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)?

<u>Education on measuring biological assets at fair value</u>

Questions for the Panel (#5a):
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?

13. One Panel member commented that valuers found it difficult to assess the quantity and stage of growth of biological assets. Agriculture experts may be required to help

them verify the inputs for valuation.

14. Biological assets are unique and usually require many different agriculture experts to assess the value of the assets. The Panel considers it may be difficult for IASB to provide additional help in this area.

Education on measuring unquoted equity instruments at fair value

Questions for the Panel (#5b):
Please describe your experience of measuring the fair value of unquoted equity instruments: (a) Have you used the IASB 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.

15. Some Panel members were not aware of the IASB's education material.

16. Under IAS 39, unquoted equity investments are exempted from fair value measurements. More practical guides to assist preparers may be necessary.

Effects and convergence

Questions for the Panel (#6):
(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.

17. The Panel does not consider that IFRS disclosure can help assess an entity's future cash flows as financial reports reflect the financial position as at balance sheet date only.