THE HKIS VALUATION STANDARDS
ON
TRADE-RELATED BUSINESS ASSETS
AND
BUSINESS ENTERPRISES

First Edition 2004

FOREWORD

The mounting demand for valuation of trade-related business assets and business enterprises in recent years has given rise to the need for a closer look into standardisation of valuation practices. In line with the long-standing mission of the Hong Kong Institute of Surveyors (HKIS) to make continuous contributions to the industry and the community, the General Practice Division (GPD) of the HKIS proactively initiated discussion last year regarding the establishment of a set of business valuation standards. With close to a year of diligent efforts, the First Edition of the HKIS Valuation Standards on Trade-related Business Assets and Business Enterprises (the "HKIS Business Valuation Standards" or the "Standards") endorsed by the General Council of the HKIS was successfully promulgated in August this year.

The objective of the Standards is to provide guidance to Members to follow in preparing business valuation reports. We strongly encourage Members to observe and comply with the Standards which has been developed to ensure the highest professionalism, integrity, clarity, reliability and impartiality of business valuation practices. More importantly, the promulgation of the Standards shall further enhance the professional standards and international status of Hong Kong's valuation profession.

The HKIS will regularly review and closely monitor the Standards. Amendments and additions will be issued as and whenever the HKIS considers appropriate. We welcome any comment on the Standards.

I would like to take this opportunity to express my gratitude to the members of the Business Valuation Panel particularly Yu Kam-hung, KK Chiu, Lawrence Pang, Joseph Ho and external legal advisor Hui Yung Yung Janet who have made significant contributions in the preparation of the Standards.

Tony Tse
President
The Hong Kong Institute of Surveyors

August 2004

ACKNOWLEDGEMENT

The accomplishment of standardising valuation practices for trade-related business assets and business enterprises (also known as "business valuation") is the great honour of the Hong Kong Institute of Surveyors (HKIS). We are delighted to see the successful promulgation of the HKIS Business Valuation Standards (the Standards) in August 2004.

In the past, business valuation was performed by experienced members of the General Practice Division (GPD) of the HKIS. Due to the rising demand for business valuation, partly resulting from the increasing popularity of mergers and acquisitions activity in Hong Kong and mainland China, the HKIS considers it necessary to establish standards that would govern practices of related valuation activities. The standardisation aims to address the general public's concerns as well as to further enhance the professionalism of the HKIS.

Following discussion with the Securities and Futures Commission of Hong Kong (SFC) and Hong Kong Exchanges and Clearing Limited (HKEx), the HKIS believes that it shall take up the role of establishing, monitoring and enforcing professional standards related to the ethics, competency, conduct of work of business valuation and the form and content of business valuation reports for the public. With close to a year of diligent efforts and close collaboration among the related parties, the Standards was successfully promulgated.

We would like to take this opportunity to express our sincere gratitude to those who have put unlimited efforts in the preparation of the Standards. We would like to thank Mr. Joseph Ho of the HKIS for preparing the Standards at the preliminary stage; solicitor Ms. Hui Yung Yung Janet for her valuable legal advice on the Standards; and Mr. Lawrence Pang and other members of the Business Valuation Panel for their invaluable time in finalising the Standards. We are also very grateful to Hon PC Lau of our past President and Member of Legislative Council, the SFC and the HKEx, whose efforts made possible the standardisation of business valuation practices in such a tight time frame.

We look forward to an industry-wide observation of the Standards in the near future, which shall further enhance the professional standards and international status of Hong Kong's valuation profession.

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The Hong Kong Institute of Surveyors

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The Hong Kong Institute of Surveyors

August 2004

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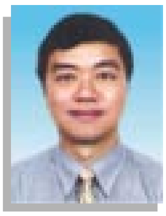

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Introduction

The HKIS Valuation Standards on Trade-related Business Assets and Business Enterprises (the "HKIS Business Valuation Standards" or the "Standards") was first published in August 2004.

The definition of 'Market Value' and the 'Business Valuation Approaches' adopted in the Standards are reproduced from the International Valuation Standards (Sixth Edition 2003) with the permission of the International Valuation Standards Committee (IVSC) who owns the copyright. No responsibility is accepted by the IVSC for the accuracy of information contained in the text and the English version as published by the IVSC shall be regarded as the official version of the Standards. The full text of the original version may be obtained from the IVSC International Headquarters, 12 Great George Street, London SW1P 3AD, UK. http://www.ivsc.org

In the Standards: (a) references to the masculine include, where appropriate, the feminine; and (b) words in the singular number include the plural and vice versa; and (c) headings are inserted for convenient reference only and have no effect in limiting or extending the language of the provisions to which they refer.

The Hong Kong Institute of Surveyors (HKIS) would make its best efforts to ensure that all information contained in the Standards is accurate and update. The HKIS reserves the right to make any changes to the Standards from time to time as a result of any changes in laws, rules and regulations, market practices, government policies, requirements of Hong Kong Exchanges and Clearing Limited (HKEx) or Securities and Futures Commission of Hong Kong (SFC) and any other reasons as the HKIS deems appropriate without further notice. The HKIS will publish updated version of the Standards from time to time and Members of the HKIS (as defined in the Standards) shall obtain updated version of the Standards from the website www.hkis.org.hk. The status and application of the Standards are set out in Part I of the Standards. The HKIS accepts no responsibility and shall not be held responsible or liable for any losses or damages that may be suffered or incurred by any person or entity as a result of his or its relying on any information provided in the Standards. The Standards shall be governed by and construed in accordance with the laws of Hong Kong. In the event that there is any inconsistency between the Standards and the laws of Hong Kong, the laws of Hong Kong shall prevail to the extent of such inconsistency.

Special thanks are given to Miss Hui Yung Yung Janet for reviewing and giving legal advice on the Standards.

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Part I

Status and Application of the Standards

1. Background

1.1 With the growing trend of mergers and acquisitions of business enterprises based on their earning capacities in Hong Kong and mainland China, there is an increasing need for valuing these earning capacities as an on going concern, in addition to valuing the tangible assets and financial assets of the appraised business enterprises.

1.2 Under such circumstances, the General Practice Division (GPD) of the HKIS, for the interest of the general public, started a dialogue with SFC and HKEx in order to explore and understand the issues and concerns of the general public, HKEx and SFC have.

1.3 In December 2003, after several rounds of discussions, the GPD of the HKIS set up a Business Valuation Panel with the following objectives:

(a) To develop a set of publicly recognised business valuation standards;

(b) To communicate and work in consultation with SFC and HKEx with an aim to provide the general public with professional and trustworthy business valuation services;

(c) To develop a continuous education development program for the benefit of the Members (as defined in the Standards);

(d) To maintain a list of Members qualified (i.e. Valuers as defined in the Standards) to provide business valuation services;

(e) To liaise with the other professions to promote and maintain the highest quality business valuation practice in Hong Kong; and

(f) To communicate and work in cooperation with the Royal Institution of Chartered Surveyors (RICS) on the development of the business valuation practices for dual members.

1.4 In June 2004, a draft copy of the Standards was issued by the Business Valuation Panel and circulated to the Members for their comments.

1.5 Based on the comments received, in particular from SFC, by the Business Valuation Panel during the consultation period, subsequent amendments were made to the drafted version of the Standards and the final version of the Standards was released with the approval from the General Council of the HKIS.

2. Objectives and arrangement of the Standards

2.1 The Standards is prepared with an intent to:

(a) Identify the general public's concerns in business valuation reporting and rules of conducts to be adhered to by the Members;

(b) Solve the general public's concerns by introducing a uniform business valuation report development process and, in particular, a code of ethics to supplement the existing HKIS disciplinary procedures;

(c) Match with the requirements for preparing general valuation reports under the rules and regulations prevailing in mainland China with an aim that Reports (as defined in the Standards) prepared under the Standards can be used by companies operating business in mainland China; and

(d) Pave the way for the HKIS to work with the Valuation Faculty of the RICS and other local professional bodies in promoting business valuation services in Hong Kong.

2.2 The objective of the Standards is to provide appropriate guidance to the Members so that Reports prepared by them can achieve the highest standards of professionalism, integrity, clarity, reliability and impartiality, and are prepared in accordance with recognised bases that are appropriate for the purposes of its preparation. The Standards will define:

(a) Criteria used to establish whether Members are appropriately qualified to act as Valuers and the steps suggested to assist them to deal with any actual or perceived threat against their acting independently and impartially in preparing a Report;

(b) Matters to be considered by the Members when agreeing to the terms and conditions of their engagements in preparing the Reports;

(c) Bases of valuation, assumptions and material considerations that must be taken into account when preparing a Report;

(d) Minimum contents and standards of a Report; and

(e) Matters that shall be disclosed if the Reports might be relied upon by third parties.

2.3 The Standards contains the following four parts:

Part I	Status and application of the Standards.
Part II	Glossary of terms used in the Standards and Reports.
Part III	Practice Statements that apply to Valuers undertaking trade-related business assets and business enterprise valuations in Hong Kong and mainland China, and where the International Valuation Standards are applicable.
	Practice Statement 1. Engagement.
	Practice Statement 2. Valuation Bases and Applications to Business Enterprise Valuations.
	Practice Statement 3. Valuation Bases and Applications to Trade-related Business Assets Valuations.
	Practice Statement 4. Business Valuation Reporting.
	Practice Statement 5. Professional Ethics and Disciplinary Procedures.
Part IV	Guidance Notes on the application of the Practice Statements.

2.4 Apart from the Standards, commentaries are provided to supplement the interpretation, application and implementation of the Standards. They are an essential part of the Standards and shall have the same force and effect. The commentaries may be amended more frequently than the Standards in order to deal with issues that might come up from time to time but such amendments would not be made lightly.

2.5 The Standards also contains certain Guidance Notes to provide guidance and examples to assist the Members in their applying and implementing the Standards. The Guidance Notes are not binding on the Members.

2.6 There are also Appendices intended to supplement the information contained in the Practice Statements or Commentaries, or provide background materials that will assist in understanding the context of the Practice Statements that it supports. The materials in the Appendices are advisory.

3. Works exempted from the Standards

3.1 Sometimes clients may require valuations be done for purpose as required by law or for any other purpose where strict application of the Standards is not appropriate. Circumstances where strict applications of the Standards may not be appropriate include but not limited to the following:

3.1.1 Advice required for use in legal proceedings

This refers to Reports required to be prepared to serve as evidence in legal proceedings when the value of the business is in dispute or is part of the dispute. However, a Member who adopts the Standards in preparing Reports for use in legal proceedings may have a better chance to withstand cross-examination in court as such Reports comply with the minimum professional requirements set out in the Standards.

3.1.2 Acting as arbitrator, independent experts and mediators

When Members act in the capacity as arbitrators, independent experts and mediators for resolution of certain disputes, their Reports would be exempted since they might have to comply with certain statutory and/or other mandatory requirements imposed on them as a result of their appointment. However, when a Member acts as an independent expert, the Member shall, whenever it is practicable and as long as there is no conflict with their terms of appointment, follow the requirements set out in the Standards. The exemption set out in this paragraph does not apply in circumstances where the value is not yet in dispute, for example, when a Report is required as part of the process of settling a different matter, such as a matrimonial separation dispute.

3.1.3 In the course of negotiations

This refers to situations when advice is required on the possible outcome of current or impending negotiations, or in connection therewith. If the negotiations relate to a matter that may be subject to determination by a third party or court, the comments in the two preceding paragraphs 3.1.1 and 3.1.2 may be applicable.

3.1.4 Internal valuations

This refers to Reports prepared by Internal Valuers solely for internal use by their own company and no part of the Reports, including the valuation figure, will be disclosed and relied upon by any third party. However, the Valuers shall still follow the Codes of Ethics of the Standards in preparing the Reports and the Valuers shall adopt the spirit of the Practice Statements wherever practicable.

3.1.5 Agency or investment related work

This refers to circumstances when advice is prepared in the expectation of, or in the course of an instruction in order to dispose of, or acquire, an interest in an asset on the anticipated price achievable or payable, including advice on whether a particular offer shall be made or accepted.

3.2 The exemptions set out in the above paragraph 3.1 shall not apply if the client specifically requires a Report to be prepared in accordance with the requirements set out in the Standards. Further, even if a Report is prepared under the condition that it shall comply with certain statutory or other mandatory requirements, the Standards will also apply, subject to such amendments as may be necessary to meet those statutory or other mandatory requirements.

4. Compliance with the Standards

4.1 The standards contain each and every part set out in the Standards, including, but not limited to, Practice Statements, Appendices and Guidance Notes.

4.2 The HKIS Bye-Law Part VI 6.1 requires its members to observe all relevant standards approved and published by, or on behalf of, the General Council. The Standards is issued under the HKIS Bye-Law Part VI 6.1 and the Members shall observe and strictly comply with the following mandatory parts of the Standards (Mandatory Parts):

- Part I : 5. Departure notes;
- Part III : Practice Statement 1 - 1. Qualifications of Valuer;
- Part III : Practice Statement 2 - 1. Use of appropriate basis, 2. Market Value, 3. Use of appropriate valuation approaches and methods;
- Part III : Practice Statement 4 - 6. Departure notes; and
- Part III : Practice Statement 5 - 1. Codes of Ethics and 2. Disciplinary procedures.

The HKIS reserves the right to increase or reduce the Mandatory Parts of the Standards from time to time, as it deems appropriate.

4.3 The Members shall observe and comply with the Mandatory Parts of the Standards and, to the extent as far as possible, follow other parts of the Standards when preparing a Report in Hong Kong, mainland China and overseas. However, in the event of any conflict between the Standards and those of local practice overseas, the Standards shall not be interpreted as imposing a lesser standard than the standards prevailing overseas.

4.4 Subject to the above paragraph 4.3, where a valuation involves assets in two or more places with different sets of valuation standards, the Member must agree with the client the standards that shall apply in preparing a Report.

4.5 It is recognised that there are situations and circumstances where Members, after exercising their proper professional skill and judgement, believe that it may not be appropriate or advisable to follow the Standards in preparing Reports. However, if the Standards is not followed, and the Members' actions are called into question, they will be asked to justify the steps they took, and this may be taken into account in any disciplinary action.

4.6 When an allegation of professional negligence is made against a Member, the court is likely to take into account, in deciding whether or not the Member has acted with reasonable skill and care, the extent to which the Member has complied with the Standards.

4.7 Unless otherwise specified in the Standards (including but not limited to paragraphs 4.2 and 5.1) or by HKIS in writing, the Standards is designed to provide guidance to the Members of the HKIS who need to perform business valuation and provide a structure for regulating the development and reporting of business valuation through uniform practices and procedures. Departures from the Standards neither mean that the Members will attract or incur any civil liability nor create any presumption or evidence that a duty of care has been breached. Moreover, compliance with the Standards does not create any special relationship between the Valuer and any other person.

5. Departure notes

5.1 No departure is permissible from the requirements that each Report shall clearly and accurately set forth the conclusions of the valuation and clearly discloses any assumptions, limitations and constraints which affect the valuation and value conclusion.

5.2 If a Member is asked to perform an assignment that departs from these requirements or calls for something less than, or different from, the work normally performed in compliance with the Standards, the Member shall accept and perform such services only when the following conditions can be met:

5.2.1 The Member determines that the instructions will not tend to mislead the intended users;

5.2.2 The Member determines that the valuation is not limited to the extent that the results are no longer reliable and credible for the intended purpose and use of the valuation; and

5.2.3 The Member must advise the client that the instructions for the assignment involve a departure from the Standards and such departures must be disclosed in full in the Report.

5.3 Where the Member considers that there are special circumstances which make it inappropriate or impractical for the Report to be made wholly in accordance with the Standards (provided that there is no departure from the Mandatory Parts of the Standards), those circumstances must be confirmed and agreed with the client in writing and as a specific departure before a Report is prepared. The adoption of a Special Assumption (as defined in the Standards) will not be regarded as a departure provided that the Special Assumption does not depart from or inconsistent with the Mandatory Parts of the Standards.

5.4 A clear statement in writing of any departures and Special Assumptions, if any, together with details of, and reasons for them, and the client's agreement, must be given in the Report.

5.5 A Member who makes a departure from the Mandatory Parts of the Standards will be required to justify the reasons for this departure to the HKIS. If the HKIS is not satisfied with the reason(s) provided and/or the manner in which the departure is declared or made, they are entitled to take appropriate disciplinary actions.

5.6 The HKIS strongly recommends its Members to observe and comply with the non-Mandatory Parts of the Standards. However, in each and every case of preparing a Report, it is the ultimate responsibility of the Member to apply the Reasonable Valuer (as defined in the Standards) test, and not the client or other intended users, to determine whether any departures from the Standards are reasonable and justifiable.

6 Effective date, amendments and additions of the Standards

6.1 The Standards contains all standards approved by the HKIS as of the date of its publication, and shall be used in conjunction with the Guidance Notes in Connection with Part VI of the Bye-Laws: Professional Conduct of the Institute (the HKIS Guidance Notes) and where applicable, the HKIS Valuation Standards on Properties.

6.2 The Members shall follow and comply with the Mandatory Parts of the Standards and use the non-Mandatory Parts of the Standards as guidance in preparing Reports with effect from 31 August 2004 and the Standards applies to all Reports issued by the Members on or after that date. Where the Standards has been amended, the effective date of the amendments will be shown at the bottom of the page.

6.3 The contents of the Standards are under regular review; any amendments and additions will be issued by the HKIS from time to time as required. Updates to the Standards will be posted to the GPD webpage at www.hkis.org.hk.

With Effect from 31 August 2004
First Published in August 2004

Part II

Glossary of terms used in the Standards and Reports

1. Introduction

1.1 The HKIS believes that the Members who prepare a Report shall possess specialised skills, experience, expertise and knowledge. Also, the Members shall communicate the procedures to value and conclusion, in a manner that is clear and not misleading, to the clients. For sake of consistency and better communication, it is advisable for the global business valuation profession to use commonly used definitions, which meanings have been established clearly and consistently, to be applied throughout the profession.

1.2 In order to enhance and maintain the professional standard of the Members in preparing the Reports in accordance with the requirements set out in the Standards, the HKIS has adopted certain definitions published by various institutions, including, but not limited to, the IVSC and the RICS, in this glossary and highly recommends the Members to adopt such definitions in the Reports.

1.3 If any of the Members wishes to adopt any definitions that materially depart from the definitions set out in this glossary, it is recommended that the Member sets out his own definitions clearly in the Engagement Letter (as defined in the Standards) to avoid confusion and potential disputes. And, such departure from the definitions set out in this glossary should be disclosed in the Report.

1.4 The definitions set out in this glossary are not exhaustive. If there are any definitions that are not referred to in this glossary, it is recommended that the definitions be defined and elaborated precisely and clearly in the Engagement Letter.

1.5 The definitions referred to in this glossary are, by no means, intended to replace or to simplify the narrative sections related to *approach to value* and *valuation method* in a Report; rather, a Valuer shall exercise his own professional judgement to determine how can his Report be presented to his client in a precise and unambiguous way with or without reference to the definitions set out in this glossary.

1.6 Departure from this glossary does not mean that it attracts or incurs any civil liability and shall not be presumed to create evidence that a duty of care has been breached.

2. Definition

Adjusted Book Value. The book value that results when one or more asset or liability amounts are added, deleted, or changed from the reported book amounts.

Assumption. A supposition taken to be true. It involves facts, conditions or situations affecting the subject of, or approach to, a valuation that, by agreement, need not be verified by the Member as part of the valuation process. Typically, Assumptions are made where specific investigation by the valuer is not required in order to prove that something is true.

Appraisal. See Valuation.

Approach to Value. See Valuation Approach.

Asset-Based Approach. A means of estimating the value of a business interest using methods based on the Market Value of individual business assets less liabilities.

Basis of Valuation. A description, or definition, of the type of value being sought within a given set of parameters.

Book Value.

(a) With respect to assets, the capitalised cost of an asset less accumulated depreciation, depletion, or amortisation as it appears on the books of account of the business.

(b) With respect to a business enterprise/entity, the difference between total assets (net of depreciation, depletion, and amortisation) and total liabilities of a business as they appear on the balance sheet.

Business Enterprise/Entity. A commercial, industrial, service, or investment entity pursuing an economic activity.

Business Valuation. The act or process of arriving at an opinion or estimation of the value of a business or enterprise/entity or an interest therein.

(the) HKIS Bye-Laws. The Constitution and Bye-Laws as published and amended by the Hong Kong Institute of Surveyors from time to time.

Capitalisation.

(a) The conversion of income into value.

(b) The capital structure of a business.

(c) The recognition of an expenditure as a capital asset rather than a periodic expense.

Capitalisation Factor. Any multiple used to convert income to value.

Capitalisation Rate. Any divisor (usually expressed as a percentage) that is used to convert income to value.

Capital Structure. The composition of the invested capital.

Cash Flow. Net income plus depreciation and other non-cash charges (also called gross cash flow). Specific types of cash flow are defined under the entry for net cash flow in the Glossary.

Control. The power to direct the management and policies of a business.

Control Premium. The additional value inherent in the control interest as contrasted to a minority interest, which reflects its power of control.

Discount for Lack of Control. An amount or percentage deducted from a pro rata share of the value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount Rate. A rate of return used to convert a monetary sum, payable or receivable in the future, into present value.

Economic Life. The period over which property may be profitably used.

Effective Date. The date as of which the Valuer's opinion of value applies (also referred to as the Date of Valuation and/or Valuation Date and/or As of Date).

Engagement Letter. Written confirmation of the conditions that the Member either proposes, or that the Member and client have agreed, shall apply to the undertaking and reporting of Valuation or Appraisal.

Enterprise. See Business Enterprise.

Financial Statements. Written statements of the financial position of a person or a corporate entity, and formal financial records of prescribed content and form. These are published to provide information to a wide variety of unspecified third-party users. Financial Statements carry a measure of public accountability that is developed within a regulatory framework of accounting standards and the law.

Going Concern.

(a) An operating business.

(b) A premise of valuation, under which Valuers and accountants consider a business as an established enterprise/entity that will continue in operation indefinitely. The premise of a going concern serves as an alternative to the premise of liquidation. Adoption of a going concern premise allows the business to be valued above liquidation value and is essential to the development of Market Value for the business.

Going Concern Value. The value of a business, or of an interest therein, as a going concern. Intangible elements of value in an operating business resulting from factors such as: having a trained work force; an operational plant; and the necessary licenses, systems and procedures in place.

Goodwill. That intangible asset that arises as a result of name, reputation, customer patronage, location, products, or similar factors that generate economic benefits.

Holding Company. A business that receives returns on its assets.

Income Approach. Also known as Income Capitalisation Approach. A general way of estimating a value indication of a business, business ownership interest, or security, using one or more methods wherein a value is estimated by converting anticipated benefits into capital value.

(the) Institute/HKIS. The Hong Kong Institute of Surveyors incorporated under the Hong Kong Institute of Surveyors Ordinance (Chapter 1148 – Laws of Hong Kong).

Invested Capital. The sum of the debt and equity in a business on a long-term basis.

Liquidation Value. The net amount of assets of the business that can be realised net of all liabilities upon liquidation. The value of the assets upon liquidation is often less than market value or book value due to the time limit imposed to dispose of the assets.

Majority Interest. Ownership position greater than 50% of the voting interest in a business.

Majority Control. The degree of control provided by a majority position.

Market Approach. A general way of estimating a value indication of a business, business ownership interest, or security, using one or more methods that compare the subject to similar businesses, business ownership interests, or securities that have been sold.

Market Value. The estimated amount for which an asset should exchange on the date of valuation between a willing buyer and willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.

Marketability Discount. An amount or percentage deducted from an equity interest to reflect lack of marketability.

Method of Valuation. See Valuation Method.

Member. A member from the Professional Grade of the Hong Kong Institute of Surveyors and referred to in the Constitution of the Hong Kong Institute of Surveyors as Corporate Member.

Minority Interest. Ownership position less than 50% of the voting interest in a business.

Minority Discount. A discount for lack of control applicable to a minority interest.

Net Assets. Total assets less total liabilities.

Net Income. Revenue less expenses, including taxes.

Net Cash Flow. During an operating period, that amount of cash that remains after all cash needs of the business have been satisfied. Net cash flow is typically defined as being cash available to equity or invested capital.

(a) Equity Net Cash Flow is typically described by the following equation:

Net income after taxes, plus depreciation and other non-cash charges, minus capital expenditures, minus increases in working capital, plus increases in interest-paying debt net of repayments.

(b) Invested Capital Net Cash Flow is typically described by the following equation:

Earnings before interest and taxes, less income taxes, plus depreciation and other non-cash charges, minus capital expenditures, minus increases in working capital.

Operating Company. A business that performs an economic activity by making, selling, or trading a product or service.

Practice Statement (PS). A statement of the highest professional standards which Members are required to observe when providing written valuations of trade-related business assets and business enterprises in Hong Kong, the mainland China and overseas, for all purposes to which the Standards applies.

Rate of Return. An amount of income (loss) and/or change in value realised or anticipated on an investment, expressed as a percentage of that investment.

Reasonable Valuer. A Reasonable Valuer is one who maintains a level of performance that would be acceptable to the General Practice Division Council of the HKIS who if otherwise concludes that there is no rational foundation for an analysis or opinion, then such analysis or opinion would not be justified.

Replacement Cost New. The current cost of a similar new item having the nearest equivalent utility as the item being appraised.

Report. The written means, including material transmitted by electronic means of providing the client with the Valuation or Appraisal.

Report Date. The date of the Valuation Report. May be the same as or different from the Valuation Date.

Reproduction Cost New. The current cost of an identical new item.

(the) Rules/the HKIS Guidance Notes. The Rules of Conduct (i.e. Guidance Notes in connection with Part VI of the Bye-Laws: Professional Conduct) as published and amended by the Hong Kong Institute of Surveyors from time to time.

Significant Financial Interest. It refers to a situation where a person or his family members, associate entitling (individually or together) to exercise, or control the exercise of, by the ownership of equity interest or options, 5% or more of the voting power at any general meeting of a business enterprise.

Special Assumption. An Assumption that either:

(a) requires the valuation to be based on facts that differ materially from those that exist at the date of valuation; or

(b) is one that a prospective purchaser (excluding a purchaser with a special interest) could not reasonably be expected to make at the date of valuation, having regard to prevailing market circumstances.

(the) Standards. The Valuation Standards on Trade-related Business Assets and Business Enterprises as published and amended by the Hong Kong Institute of Surveyors from time to time.

Trade-related Business Assets. Asset used in the operation of a trade or business, including real estate, inventories, buildings, machinery or other equipment, and identified or unidentified intangible asset such as patents, franchise rights or copyrights.

Valuation. A valuer's opinion of the value of a specified interest or interests in an asset or a business, at the date of valuation, given in writing. Unless limitations are agreed in the Engagement Letter, this will be provided after any further investigations and enquiries that are appropriate, having regard to the nature of the subject interest(s) and the purpose of the valuation.

Valuation Approach. In general, a way of estimating value using one or more specific valuation methods. There are three conventional approaches to value a business enterprise. They are: the Asset-Based Approach, the Market Approach, and the Income Approach.

Valuation Method. Within approaches, a specific way or a series of steps to estimate value. Examples of such methods include guideline companies, discounted cash flow and the residual income method. It is the responsibility of the individual Member to choose the appropriate method of valuation to use in each case.

Valuation Procedure. The act, manner, and technique of performing the steps of a valuation method.

Valuation Ratio. A factor wherein a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Valuer. A Member from the General Practice Division of the Hong Kong Institute of Surveyors who complies with the requirements set out in Part III, PS 1 - 1. Qualifications of Valuer of the Standards.

Working Capital. The amount by which current assets exceed current liabilities.

Part III

Practice Statement 1 – Engagement

1. Qualifications of Valuer

1.1 Each Report to which the Standards applies must be and can only be prepared by an appropriately qualified Member (i.e. a Valuer as defined in the Standards) who, must possess sufficient knowledge of the appraised asset(s), and the necessary skills and experience in order to be able to undertake, prepare and complete the Report competently, independently, impartially and, shall accept full responsibility for it.

Commentary:

1. Members shall achieve and maintain high standards of professionalism and competence in preparing and completing the Reports, and their conducts shall be subject to the ethical safeguards in the Rules (as defined in the Standards).

2. Prior to accepting a valuation-related assignment or entering into an agreement to perform any valuation-related assignment, the Member must ensure that he possesses sufficient knowledge of the appraised asset(s), and the skills and experience necessary to undertake, prepare and complete the Report competently, independently, impartially and, shall accept full responsibility for it. On the other hand, if a Member lacks the requisite knowledge and experience in preparing a Report, he must disclose this limitation to his client and if he decides to undertake preparing the Report, he must take all steps as necessary and appropriate to complete the Report professionally, these including, but not limited to, obtaining assistance from a competent and knowledgeable person(s) within the valuation profession.

3. A Member who signs a certificate of value accepts full responsibility for the valuation and the contents of the Report. He will also be held liable for the decision to rely on the work done by others who do not sign the certificate of value to the Report.

4. The personal qualification requirements on level of expertise to undertake the Report may be met in aggregate by more than one Valuer within the same firm provided that each Valuer meets all the other requirements of this Practice Statement and each shall sign on the certificate of value as Joint Valuers.

5. Client's prior approval must be obtained if a Member proposes to employ an additional Valuer to provide some of the valuations that are part of the instructions given by the client.

6. When a Member is instructed to produce a Report for publicly traded companies in Hong Kong, he shall follow the requirements of SFC and HKEx, wherever applicable.

1.2 Members undertaking valuations must act with independence, integrity and impartiality.

Commentary:

1. It is crucial that a Member should at all times maintain high ethical standards in providing valuation services to clients. Members are bound by the Rules which set out a framework under which Members provide their valuation services to clients.

2. A Member is required to, in valuing any asset or performing any valuation-related assignment in the capacity of a Valuer, exercise independent judgments and shall not be subject to any direction or influence from any person. This means that a Member, together with his associates, must not have any material links or interests (either directly or indirectly) with the prospective client or the subject of the prospective valuation-related assignment from the time when the prospective engagement is proposed until the engagement is completed.

3. Rules 1.3.1 and 1.3.2 of the Rules requires that all Members shall discharge their duties owed to their clients with integrity and in accordance with the highest standard of business ethics.

1.3.1 Members shall at all times act with and maintain the highest standards of professionalism, including, but not limited to, complying with the following requirements:

(a) Act with dignity and integrity;

(b) Always be honest;

(c) Be open and transparent in their dealings;

(d) Be accountable for all their actions;

(e) Aware of and act within their limitations;

(f) Be impartial at all times;

(g) Treat others with respect;

(h) Set a good precedent; and

(i) Have the courage to make a stand.

1.3.2 In addition, in the course of performing any work, neither the Members nor any person acting on their behalf, or at their instruction or inducement, must act in a manner which compromises or impairs, or is likely to compromise or impair, any of the following:

(a) The integrity of the Member;

(b) The reputation of the HKIS, the related profession or other Members;

(c) The high standards of professional conduct expected of a Member;

(d) Compliance with any code, standard or Practice Statement issued by the HKIS or any laws, rules and regulations in force at that time;

(e) The Member's duty to act for the best interest of his client or employer subject to compliance of legal or other mandatory constraints; and

(f) A person's freedom to instruct a Member of his choice.

1.4 Rules 1.3.1 and 1.3.2 of the Rules deal with issues regarding conflicts of interest, impartiality and independence of Members. Members shall follow these Rules to identify, manage and resolve issues concerning possible conflicts of interest before accepting a valuation instruction from his client. If a client has no objection to the Member's accepting a valuation instruction and the Member agrees to accept a valuation instruction after he discloses a potential conflict of interest to his client, the client's no objection attitude and the disclosure made by the Member must be recorded in the Engagement Letter (as defined in the Standards).

1.5 A Member shall at all times maintain the duty of confidentiality that he owes to his client and shall be aware of confidentiality obligations undertaken by him when he makes any disclosure of his past or present involvement in any valuation works to third parties. If a Member finds that his disclosure of certain information to his client might result in a breach of the confidentiality obligations that he owes to other clients, the Member shall decline or refuse to accept the current client's instructions.

1.6 A Member may be instructed by two different parties in the same transaction to prepare Reports for them. The Member must consider seriously and thoroughly on any potential conflict of interest that may arise in the future before he accepts both parties' instructions. If, after due considerations, the Member believes that it is neither inappropriate nor unprofessional for him to act for both parties, the Member shall obtain the written consent of both parties before accepting the instructions and such consent must be recorded in the Report.

1.7 A Member's impartiality may be affected if he discusses the outcome of a valuation with either his client or any party who has an interest in the valuation prior to his completing the Report. Although such discussions may be of value to both the Member and the client, the Member shall be aware of the potential influence that such discussions may have on his providing an impartial opinion. When such kind of discussions takes place, the Member shall record in writing contents of the meetings or discussions and reasons why the Member decides to amend a provisional valuation made by him as a result of such discussions.

1.8 Independent valuations are those which require to be carried out by an Independent Valuer as defined in Appendix PS 1.1. A Member who has been asked to provide an independent valuation should ask his clients what are their purposes of doing the valuation and the identity of any other party who may have an interest in the valuation. The Member should also, with reasonable judgement, disclose any past or present relationship that he has with any of the interested parties or previous involvement with the subject asset(s) so that the parties can decide whether the Member is in an "independent" position under the particular circumstances and if they are still prepared to instruct him in light of the information disclosed by him.

2. Valuation engagement

2.1 The Members shall always confirm the instructions with the clients by having an Engagement Letter in place. The Engagement Letter should be issued to and signed by the client, whenever possible, prior to the commencement of the engagement, or at the latest, before any Report is issued.

Commentary:

1. To ensure client satisfaction and minimise the possibility of any misunderstanding and dispute between a Member and his client, the Member shall understand the client's needs and requirements, and whenever possible, put them in writing before issuing any Report.

2. Although this Practice Statement requires the terms of engagement to be agreed by the parties before the Member undertakes the valuation-related assignment, it is possible that information may not be available or, due to the urgency of the matter, detailed terms could not be finalised by the Member and the client in advance, and therefore an Engagement Letter is not signed before the commencement of the valuation-related assignment. Under such circumstances, the Member shall ensure that an Engagement Letter, including all necessary terms and conditions, subsequent changes and modification, shall be signed by the client before any Report is issued.

2.2 An Engagement Letter is a contract made between a Member and his client, setting out the terms and conditions of the client's appointment. Therefore an Engagement Letter shall contain, wherever possible, the following terms and conditions:

(a) The identity of the client (including but not limited to client's full name, address of registered office, etc);

(b) The purpose of the valuation;

(c) The subject of the valuation;

(d) The interest to be valued;

(e) The basis of valuation;

(f) The date of valuation;

(g) The status of the Valuer and disclosure of any conflicts of interest or previous involvement;

(h) The currency in which valuation is to be expressed;

(i) Any Assumptions, Special Assumptions, reservations, any special instructions or departures;

(j) The extent of the Valuer's investigations;

(k) The nature and source of information to be relied on by the Valuer;

(l) Any consent to, or restrictions on, publication;

(m) Any limits or exclusion of liability to parties other than the client;

(n) Confirmation that the valuation will be undertaken in accordance with the Standards;

(o) The basis on which the fee will be calculated; and

(p) Other standardised terms and conditions.

Commentary:

1. It would be helpful if, in connection with the basis of valuation, the client discloses the purpose for which the valuation is required. This is particularly important in cases where the valuation of the asset(s) is being undertaken by more than one Valuer, or where the client gives instructions to adopt unusual assumptions.

2. The purpose why a client wishes the Valuer to carry out a particular valuation is important information which would assist a Member in his identifying an appropriate basis of valuation. The Member is advised to discuss and agree with the client and the client's professional adviser(s) on the scope and basis of valuation before issuing any Report.

3. Unless otherwise specifically agreed, the value advised by the Valuer shall be Market Value as defined in Part II, 2. Definition of the Standards as of the date of valuation and this should be expressly stated in the Engagement Letter.

4. The Member shall expressly disclose in the Engagement Letter whether or not he would rely upon any information provided to him by his client or his client's professional adviser(s) in the Report to be prepared by him.

5. The Member shall consider establishing standing terms of engagement with his client if there is an ongoing relationship between the Member and his client. This will avoid the need to agree and confirm revised terms for each new instruction given by the client.

6. The Member shall discuss and agree with the client the extent of the investigations and Assumptions that are appropriate to the circumstances and purpose of the valuation. In particular, the Member shall ensure that any Assumptions or Special Assumptions that will be included in the Report are recorded in the Engagement Letter.

7. The Member shall obtain his client's prior approval if he wants to appoint another firm or company to provide some of the valuations on his behalf which are the subject of the instruction.

8. The Member shall confirm with his client in writing prior to his issuing any Report if he wants to include any Special Assumptions in the Reports.

9. If a Member or his client identifies that a valuation may need to reflect an actual or anticipated marketing constraint, details of that constraint must be agreed and set out in the Engagement Letter. The term "forced sale value" must not be used, for the basis of this term is not supported by the HKIS.

10. If a Member has to prepare a Report based on limited/restricted information, the Member shall agree with his client regarding the nature of the limitation/restriction and the possible valuation implications of the limitation/restriction before his issuing the Report.

2.3 A Member shall not critically or negatively comment or criticise a Report prepared by another Valuer that is intended for public disclosure or publication purpose unless the Member possesses all the necessary facts and information on which the first Valuer has relied on, except in the following circumstances:

(a) Where a director of the client or an Internal Valuer prepares a Report which, due to the special requirement of the client, requires endorsement or comments from an External or Independent Valuer; or

(b) Where a Member is asked to co-ordinate the work with other Valuers, and to express support for others' approach and/or range of value they have adopted; or

(c) Where a Member is instructed by the client to produce a separate independent valuation which may be used by the client to publicly challenge the first Valuer's valuation.

Appendix PS 1.1

Types of Valuers

Members shall note that there are different types of Valuers defined below. Members must satisfy themselves that they meet the requirements laid down when accepting instructions for various purposes referred to in the Standards.

1. Valuer

A Member is a Valuer qualified to prepare a Report if he satisfies the requirements of Part III, PS 1 - 1. Qualifications of Valuer of the Standards.

2. External Valuer

An "External Valuer" is a Valuer who is not an Internal Valuer and, where neither he nor any of his associates are directors or employees of the client's company or group or have a Significant Financial Interest (as defined in Part II, 2. Definition of the Standards) in the client's company or group, and where neither the client's company nor group has a Significant Financial Interest in the Valuer's firm. For the purpose of the Standards, "company" includes sole proprietor, partnership, limited company and any other form of entity or organisation, e.g. a trust.

3. Internal Valuer

An "Internal Valuer" is a Valuer who is a director (or of equivalent status) or an employee of the client who has no Significant Financial Interest in the company.

4. Joint Valuers

The term "Joint Valuers" should only be used on occasions where two or more Valuers are jointly or severally appointed to provide a Report. In such cases, a single Report should be provided by having the signatures of the Joint Valuers together with their names and addresses.

5. Additional Valuers

Where the appraised asset(s) to be included in the Valuer's instructions include a category of asset in respect of which the Valuer does not possess the requisite knowledge and experience, and for which he would not, therefore, be qualified under Part III, PS 1 - 1. Qualifications of Valuer of the Standards to perform a valuation, then:

(a) the Valuer may employ (with the consent of his client) a sub-agent or any person whom the Valuer regards as having the requisite knowledge and experience; or

(b) the Valuer may advise that qualified Additional Valuer be appointed by the client to value the particular asset(s).

6. Independent Valuer

An "Independent Valuer" is an External Valuer who has no other recent or foreseeable potential fee earning relationship concerning the subject asset(s) apart from the valuation fee for being an Independent Valuer and who has, by exercising reasonable judgement, disclosed any past or present relationship with any of the interested parties or any previous involvement with the subject asset(s).

7. Contributing Valuer

A "Contributing Valuer" is a Valuer who has provided significant valuation assistance in the valuation-related assignment but, for some reasons, did not sign the Report.

Appendix PS 1.2

Procedures for engagement

1. The engagement acceptance procedures reflect the Member's understanding of the needs and requirements of the client and the ways that he may guide the client to choose the most appropriate advices to satisfy the client's needs and requirements. Also, these procedures will assist the Member to understand the risk behind each engagement and to conduct an effective management of risk to protect his interest, the reputation of the HKIS and the valuation profession. The engagement acceptance procedures cover the process from submission of a proposal to the client, finalisation of an Engagement Letter, acceptance of the assignment and job arrangement procedures.

2. Prior to the submission of a proposal, the Member shall conduct an engagement risk assessment to identify any potential risk behind the prospective engagement. The risk assessment areas include, but not limited to,

    (a) The background of the project, such as the nature of the prospective client and the purpose of the engagement;

    (b) The scope of practice risks, such as a lack of the requisite knowledge and experience, requirement to comply with any laws, rules and regulations, impairment of the Member's independency and conflict of interest;

    (c) Project management, such as identification of key client's personnel, supervision of or work with other professional practitioner(s), tight working schedule and monitoring of sub-agent(s)/sub-contractor(s);

    (d) Business risks, such as the use of Member's work by a third party, potential litigation threat, client's concerns/influence, limited information and marketing constraints; and

    (e) Client arrangement, such as potential contingent billing, and inflexible contractual terms which will result in imposition of penalties.

    The above listed risk assessment areas are not exhaustive and care should be taken to identify any potential risks that may be incurred during the course of valuation.

    Should the engagement risk assessment indicate that certain risks exist, the Member shall base on his own professional judgement, and in accordance with the Rules and the Standards, prepare a risk management plan to control the identified risk(s) before submission of a proposal. The proper way of handling should include, but not limited to, formulating a set of particularly agreed-upon procedures, considering whether there is any work need to be reviewed by legal counsel, or even declining the invitation to engagement.

3. An effective proposal/Engagement Letter should contain, as a minimum, the following contents, namely: the client's needs, scope of services, description of deliverables (and number of copies and the language to be used in the report), timing of performance, quotations/confirmation of professional fees and expenses, billing schedule, and contractual terms and conditions. The Engagement Letter shall include a clause stating that any additional services requested by the client other than the agreed scope of services will be separately arranged and agreed by the parties. If the standard terms and conditions of the Member's firm are attached to the Engagement Letter, such should be referred to as an integral part of the proposal/Engagement Letter. Should other professional adviser(s) be involved in the proposed engagement, relevant terms and conditions may be included in the proposal/ Engagement Letter.

4. Restrictions on the distribution of the Report shall be specifically mentioned in the proposal/ Engagement Letter. The purpose of such a restriction is to avoid unwarranted or unintended reliance on the Report by any persons other than the client and any third parties expressly authorised by the client. A Report is generally restricted to be available to and be relied upon by the client and any third parties expressly authorised by the client. Where a third party's reliance is clearly intended or the client seeks permission to distribute a restricted Report to a third party, indemnification clause should be included in the proposal/ Engagement Letter and the proposal/Engagement Letter should refer to such third party, by name, if possible.

5. The circumstances of each engagement should be carefully reviewed to assure the Member and his associates that there is no existing or potential conflict with another existing client. If a potential conflict exists but the Member believes that such potential conflict will not impair his impartiality in providing his service, and both clients are prepared to confirm that they have no objection to engaging the Member even if a potential conflict exists, the proposal/Engagement Letter should set forth the understanding of these facts clearly.

6. When the client has accepted the Member's proposal, or an Engagement Letter has been confirmed by the client, steps must be taken to ensure that the engagement is recorded in the Member's firm's accounting and record keeping system. This is to ensure that the Member and his associates will keep a close monitoring of the engagement to protect the client and their interests.

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Part III

Practice Statement 2 - Valuation Bases and Applications to Business Enterprise Valuations

1. Use of appropriate basis

1.1 The Member must use a Basis of Valuation recognised by the Standards as being appropriate for the purpose of the valuation.

Commentary:

1. Business valuations are commonly sought and performed on the Market Value basis of valuation. Where the purpose of the valuation requires a Market Value estimate, the Member shall apply definitions, processes, and methodologies consistent with the provisions in the International Valuation Standard 1 (IVS 1) published by the IVSC.

2. Whilst the Institute does not encourage the use of bases other than the Market Value basis of valuation in performing engagement related to business valuations, there will be occasions where it is necessary to adopt a value basis other than Market Value in order to advise the client properly. The use of a different basis of value other than Market Value does not by itself constitute a Departure (see Part I, 5. Departure notes), but the Member shall clearly identify and state, in both the Engagement Letter and Report, the type of value involved, define such value, and take steps necessary to distinguish the value estimate from a Market Value estimate. Where different bases of value are used, the provisions of the International Valuation Standard 2 shall be applied.

3. If this PS 2 - 1 is not followed, and the Member's selections are called into question, the Member will be asked to justify the reasons he took and the procedures he applied, and the justification may be taken into account in any disciplinary action.

2. Market Value

2.1 Valuation based on Market Value shall adopt the definition (see Part II, 2. Definition) and the interpretive commentary (as published in IVS 1), settled by the IVSC.

Commentary:

1. The basis of Market Value is an internationally recognised definition. Members need to ensure that in all cases the basis of Market Value is set out clearly in both the Engagement Letter and the Report.

2. In order to apply Market Value in a valuation, it may be necessary to add a statement clarifying both what is being valued and any Assumptions that are inherent in the valuation. Although additional words may be required to clarify the application of Market Value in the circumstance, this is not a different basis; rather, it is the same core basis with additional Assumptions.

3. The premise of a going concern serves as an alternative to the premise of liquidation. Adoption of a going concern premise allows the business to be valued above liquidation value and is essential to the development of the Market Value of the business.

3. Use of appropriate valuation approaches and methods

3.1 The Member must use one or more methods under one or more valuation approaches recognised by the Standards as the appropriate approaches for the purpose of the valuation and, through reconciliation processes, arrive at a conclusion of value.

Commentary:

1. There are three internationally recognised valuation approaches for valuing a business enterprise, namely: the Asset-based Approach (see Appendix PS 2.1), the Income Approach (see Appendix PS 2.2) and the Market Approach (see Appendix PS 2.3). Members shall ensure that in all cases the valuation approach and its related method(s) to be used in the engagement are set out clearly in both the Engagement Letter and the Report.

2. All the valuation approaches are, to a certain extent, interrelated. Examples are: the Income Approach derives cost of capital from market data; the Market Approach uses multiples of either income variable or asset values; and the Asset-based Approach derives various asset values from market evidences. While some business enterprises can be readily appraised by all three approaches, certain approaches may provide more reliable results than others for particular types of business enterprise.

3. The HKIS, based on the international valuation practice, recognises several commonly used methods under each approach in valuations of business enterprises in Appendix PS 2.4 of the Standards. However, this does not imply that the Member shall use this appendix as a defence to his selection of valuation method when his selection is being questioned; rather, the Member shall exercise his own judgement on the selection of and reliance on one or more appropriate approaches and methods and shall not rely on any prescribed formula. In order to consider properly which method(s) or approach(es) shall be adopted, the Member shall assess whether the data and information available to him are adequate or not. For the avoidance of doubt, the reasons for his selection must be revealed in the Report.

4. In each method, there are various techniques (procedures) guiding the Valuer to arrive at an indicative value. Examples are: Free Cash Flows to the Firm and Free Cash Flows to Equity within the Discounted Cash Flow Method of the Income Approach; and, price-to-earnings multiples or price-to-sales multiples within the Guideline Publicly Traded Company Method of the Market Approach. For the avoidance of doubt, the procedures followed in the application of the method(s) selected must be described in the Report.

5. Business enterprise valuation is a complex exercise and it may not be objective enough for Members to employ a single method under a single approach. Members are advised to use two or more approaches and/or methods in performing valuation of a business enterprise, and having considered the relevant valuation approaches, methods and procedures, the information available, and appropriate premiums and discounts (if any), to reconcile different value indications into a single value, or a range of values, to be reported in the Report.

6. In using the Asset-based Approach, valuations of properties and trade-related business assets shall be made in accordance with the HKIS Valuation Standards on Properties and PS 3 of the Standards, respectively.

7. In using the Discounted Cash Flow Method of the Income Approach, the Valuer has the responsibility to ensure that all the assumptions and variables (examples being: growth rates, discount rates and capitalisation rates) to be used in his analysis are consistent with market evidence and should be supported by market-derived data. The result of the discounted cash flow analysis should be tested and checked to avoid errors and ensure reasonableness.

8. If this PS 2 - 3. is not followed, and the Member's selections are called into question, the Member will be asked to justify the reasons he took and the procedures he applied, and the justification may be taken into account in any disciplinary action.

Appendix PS 2.1

Asset-based Approach

The purpose of this Appendix is to provide an aid to the Members for the use of the Asset-based Approach in the valuations of business enterprises, including, but not limited to, business ownership interests and securities.

Valuations under this approach shall be in accordance with IVSC International Valuation Guidance Note No. 6, para. 5.14.1, which is reproduced as follows:

1. In business valuations, the asset-based approach may be similar to the cost approach used by Valuers of different types of assets.

2. The asset-based approach is founded on the principle of substitution, i.e., an asset is worth no more than it would cost to replace all of its constituent parts.

3. In the execution of the asset-based approach, the cost basis balance sheet is replaced with a balance sheet that reports all assets, tangible and intangible, and all liabilities at Market Value or some other appropriate current value. Taxes may need to be considered. If market or liquidation values apply, costs of sale and other expenses may need to be considered.

4. The asset-based approach should be considered in valuations of controlling interests in business entities that involve one or more of the following:

    4.1 An investment or holdings business, such as a property business or a farming business; and

    4.2 A business valued on a basis other than as a going concern.

5. The asset-based approach should not be the sole valuation approach used in engagements relating to operating businesses appraised as going concerns unless it is customarily used by sellers and buyers. In such cases, the Valuer must support the selection of this approach.

6. If the valuation of an operating business is not on a going concern basis, the assets should be valued on a Market Value basis or on a basis that assumes a shortened time period for exposure in the market, if that is appropriate. All costs related to the sale of the assets or the closing of the business need to be taken into account in this type of valuation. Intangible assets such as goodwill may not have value under these circumstances, although other intangible assets such as patents, or brands may retain their value.

7. If the holding business simply holds property and receives investment income from the property, Market Value should be obtained for each property.

8. If an investment holding business is to be valued, the securities (both quoted and unquoted), the liquidity of the interest, and the size of the interest may be relevant and may lead to a deviation from the quoted price.

Appendix PS 2.2

Income Approach

The purpose of this Appendix is to provide an aid to the Members for the use of the Income Approach in the valuations of business enterprises, including, but not limited to, business ownership interests and securities.

Valuations under this approach shall be in accordance with IVSC International Valuation Guidance Note No. 6, para. 5.14.2, which is reproduced as follows:

1. The income capitalisation approach estimates the value of a business, business ownership interest or security by calculating the present value of anticipated benefits. The two most common income approach methods are capitalisation of income and discounted cash flow analysis or dividends method.

    1.1 In (direct) capitalisation of income, a representative income level is divided by a capitalisation rate or multiplied by an income multiple to convert the income into value. In theory, income can be a variety of definitions of income and cash flow. In practice, the income measured is usually either pre-tax income or post-tax income. The capitalisation rate must be appropriate for the definition of income used.

    1.2 In discounted cash flow analysis and/or dividends method, cash receipts are estimated for each several future periods. These receipts are converted to value by the application of a discount rate using present value techniques. Many definitions of cash flow could be used. In practice, net cash flow (cash flow that could be distributed to shareholders), or actual dividends (particularly in the case of minority shareholders) are normally used. The discount rate must be appropriate for the definition of cash flow used.

    1.3 Capitalisation rates and discount rates are derived from the market and are expressed as a price multiple (derived from data on publicly traded businesses or transactions) or an interest rate (derived from data on alternative investments).

2. Anticipated income or benefits are converted to value using calculations that consider the expected growth and timing of the benefits, the risk associated with the benefits stream, and the time value of money.

    2.1 Anticipated income or benefits should be estimated considering the capital structure and historical performance of the business, expected outlook for the business, and industry and economic factors.

    2.2 The income approach requires the estimation of a capitalisation rate, when capitalising income to arrive at value, or a discount rate, when discounting cash flow. In estimating the appropriate rate, the Valuer should consider such factors as the level of interest rates, rates of return expected by investors on similar investments, and the risk inherent in the anticipated benefit stream.

2.3 In capitalisation methods that employ discounting, expected growth is explicitly considered in the estimate of the future benefit stream.

2.4 In capitalisation methods that do not employ discounting, expected growth is included in the capitalisation rate. The relationship, stated as a formula, is discount rate minus long-term growth rate equals capitalisation rate (R=Y – ▲a where R is the capitalisation rate; Y is the discount, or yield, rate; and ▲a is the annualised change in value).

2.5 The capitalisation rate or discount rate should be consistent with the type of anticipated benefits used. For example, pre-tax rates should be used with pre-tax benefits; net after-income-tax rates benefit streams; and net cash flow rates should be used with net cash flow benefits.

2.6 When the forecast income is expressed in nominal terms (current prices), nominal rates must be used, and when the forecast income is expressed in real terms (level prices), real rates must be used. Similarly, the expected long-term growth rate of income should be documented and clearly expressed in nominal or real terms.

Appendix PS 2.3

Market Approach

The purpose of this Appendix is to provide an aid to the Members for the use of the Market Approach in the valuations of business enterprises, including, but not limited to, business ownership interests and securities.

Valuations under this approach shall be in accordance with IVSC International Valuation Guidance Note No. 6, para. 5.14.3, which is reproduced as follows:

1. The market approach compares the subject to similar businesses, business ownership interests, and securities that have been sold in the (open) market.

2. The three most common sources of data used in the market approach are public stock markets in which ownership interests of similar businesses are traded, the acquisition market in which entire businesses are bought and sold, and prior transactions in the ownership of the subject business.

3. There must be a reasonable basis for comparison with and reliance upon the similar businesses in the market approach. These similar businesses should be in the same industry as the subject or in an industry that responds to the same economic variables. The comparison must be made in a meaningful manner and must not be misleading. Factors to be considered in whether a reasonable basis for comparison exists include:

   3.1 Similarity to the subject business in terms of qualitative and quantitative business characteristics.

   3.2 Amount and verifiability of data on the similar business.

   3.3 Whether the price of the similar business represents an arm's-length transaction

      3.3.1 A thorough, unbiased search for similar businesses is necessary to establish the independence and reliability of the valuation. The search should include simple, objective criteria for selecting similar businesses.

      3.3.2 A comparative analysis of qualitative and quantitative similarities and differences between similar businesses and the subject business must be made.

   3.4 Through analysis of the publicly traded businesses or acquisitions, the Valuer often computes valuation ratios, which are usually price divided by some measure of income or net assets. Care must be used in calculating and selecting these ratios.

      3.4.1 The ratio must provide meaningful information about the value of the business.

      3.4.2 The data from the similar businesses used to compute the ratio must be accurate.

3.4.3 The calculation of ratios must be accurate.

3.4.4 If the data are averaged, the time period considered and averaging method must be appropriate.

3.4.5 All calculations must be done in the same way for both the similar businesses and the subject business.

3.4.6 The price data used in the ratio must be valid as of the valuation date.

3.4.7 Where appropriate, adjustments may need to be made to render the similar businesses and the subject businesses more comparable.

3.4.8 Adjustments may need to be made for unusual, non-recurring, and non-operating items.

3.4.9 The selected ratios must be appropriate given the differences in risk and expectations of the similar businesses and the subject business.

3.4.10 Several value indications may be derived since several valuation multiples may be selected and applied to the subject business.

3.4.11 Appropriate adjustments for differences in the subject ownership interest and interests in the similar businesses with regard to control or lack of control, or marketability or lack of marketability, must be made, if applicable.

3.5 When prior transactions in the subject business are used to provide valuation guidance, adjustments may need to be made for the passage of time and for changed circumstances in the economy, the industry, and the business.

3.6 Anecdotal valuation rules, or rules of thumb, may be useful in the valuation of a business, business ownership interest, or security. However, value indications derived from the use of such rules should not be given substantial weight unless it can be shown that buyers and sellers place significant reliance on them.

Appendix PS 2.4

Valuation methods under each valuation approach

1. Asset-based Approach

1.1 Asset Accumulation Method

1.2 Capitalised Excess Earnings Method

2. Income Approach

2.1 Discounted Cash Flow Method

2.2 Direct Capitalisation Method

3. Market Approach

3.1 Guideline Publicly Traded Company Method

3.2 Guideline Merged and Acquired Company Method

3.3 Analysis of prior transactions, offers, or buy-sell agreements in the subject business enterprise

The methods listed in the above do not contain an exhaustive list of the possible methods that may be used in valuing a business enterprise under a particular valuation approach. The Member is allowed, subject to the condition that he has sufficient relevant knowledge and experience, to use other appropriate method under a particular valuation approach to arrive at his own opinion of value. By doing so, he shall follow the disclosure requirements as imposed under this PS. If his selection of a method other than the above recognised methods is called into question, the Member will be asked to justify the reasons he took and the procedures he applied, and the justification may be taken into account in any disciplinary action.

With Effect from 31 August 2004
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Part III

Practice Statement 3 - Valuation Bases and Applications to Trade-related Business Assets Valuations

This Practice Statement to be released soon.

Part III

Practice Statement 4 - Business Valuation Reporting

1. Minimum contents of a Report

1.1 A Report shall cover and set out all the matters agreed in the Engagement Letter, clearly communicate pertinent information, valuation approaches and methods, and conclusions in a logical order, and incorporate other specific requirements of the Standards, including, but not limited to the signature provision.

Commentary:

1. The Report shall convey to the intended user and/or reader a clear understanding of the opinions expressed by the Valuer and should be couched in terms which can be read and understood by any person who has no prior knowledge of the subject being valued. A satisfactory Report shall neither contain any ambiguous information or opinion nor mislead the intended user and/or reader in any way.

2. The format and detail of the Report is a matter at the Valuer's discretion, provided that it contains the following minimum required information:

   (a) Identity of the client;

   (b) Definition of the valuation assignment;

   (c) Business description;

   (d) Valuation approaches and methods used;

   (e) Assumptions;

   (f) Restrictions and valuation comments;

   (g) Conclusion of value;

   (h) Warning statement; and

   (i) Signature.

   Appendix PS 4.1 contains further information on the minimum matters to be included in a Report.

3. In some cases, the Valuer may be required to produce a letter of value prior to the issue of a Report to assist his clients in coping with their immediate need, for example, during a negotiation stage, the client needs a valuation for discussion with their management and/or their professional adviser(s). Provided that the letter of value contains the following two clauses, the letter of value can be issued to the client. They are:

   (a) the letter is prepared in advance of a detailed Report which is to be followed, and

   (b) the letter is restricted to the client for their internal management reference purpose and shall not be used for any other purpose, in particular for the use of public circulation.

   Subject to the above, and as a minimum, a letter of value must contain the following information:

   (a) Identity of the client;

   (b) Definition of the valuation assignment;

   (c) Valuation approaches and methods used;

   (d) Assumptions;

   (e) Restrictions and valuation comments;

   (f) Conclusion of value;

   (g) Warning statement; and

   (h) Signature.

   Appendix PS 4.2 contains further information on the minimum matters to be included in a letter of value.

4. There is no major difference on the minimum matters to be included in a Report prepared for a publicly traded company or a privately owned company save that some special requirements may be imposed by SFC, HKEx, the HKIS, the client or the client's professional adviser(s) from time to time. Valuers should be aware of such special requirements when preparing a Report.

5. Notwithstanding any other provisions of the Standards, a Valuer is reminded that in providing any valuation advice to client, in whatever format, it creates a potential liability owed to the client or, under certain circumstances, to third parties.

6. Valuers are discouraged from using the terms, either 'formal' or 'informal', in any letter of value or Report, as such terms may create misunderstanding of undefined Assumptions applicable in either case.

7. Valuers must exercise great caution before permitting valuations to be used for purposes other than those originally agreed. It is possible that a recipient or reader does not fully appreciate or understand the restricted character of the valuation and any qualifications in the Report, and the information of the Report may be misquoted out of context.

8. In some cases, the client may request the Valuer to prepare a Report at a language other than English. Due care must be taken to ensure that the requirements set out in the Standards have been fully complied with and reflected in such Report, and that the approved text of the Standards is rightly interpreted.

2. Assumptions

2.1 A Member shall obtain client's consent for his including any Assumptions in the Report and shall record such agreement in the Engagement Letter.

Commentary:

1. A Valuer should use his best efforts to carry out investigations on the Assumptions made on the Report. However, if Assumptions have been made by the Valuer at the request of the client or when investigations are not practicable, a Valuer can assume that certain information is correct or accurate without the need of carrying out further investigation provided that he discloses the limitation he has (as the case may be) in the Report.

2. If Assumptions are made in order to limit a Valuer's liability when it is impossible or impracticable for the Valuer to carry out full investigation within the context of the client's instruction, then, unless the client has accepted such Assumptions in advance, they may not be legally binding on the client and the Valuer may not be able to rely on such Assumptions in case a Report prepared by him is called into question.

3. If, after investigation, a Valuer considers that an Assumption which has been previously agreed by the client is proved to be inappropriate, or, instead it is more appropriate to adopt a Special Assumption, the Valuer shall discuss with his client the revised Assumption and approach he wishes to take prior to his concluding the valuation and finalising the Report.

4. In some cases, it is after investigation or in the course of valuation analysis that the Valuer will consider that Assumptions shall be made to reflect the actual circumstances. The suggested Assumptions must be discussed with the client prior to the conclusion of the valuation and the delivery of the final Report.

5. Should an Assumption be called into question, the Valuer will be asked to justify the reason(s) he took, and the justification may be taken into account in any disciplinary action.

3. Special Assumptions

3.1 Where Special Assumptions are necessary in order to satisfy the client's needs in carrying out the valuation required, these must be agreed and confirmed in writing with the client before any Report is issued. Save for those that are imposed or required by any laws, rules or regulations, Special Assumptions may only be made if they can reasonably be regarded as realistic, relevant and valid, in connection with the particular circumstances of the valuation.

Commentary:

1. In order that the Valuer and the client both understand the exact nature of an agreed Special Assumption, the Valuer shall ensure that such agreement is confirmed in writing by the client before the Report is issued.

2. If a client requests a valuation be carried out on the basis of adopting a Special Assumption (other than those that are imposed or required by statutes or regulations) that the Member considers being unreasonable or unrealistic, the instruction should be declined.

3. As Special Assumptions are hypothesis, either supposed or unconfirmed, which, if not true, can substantially alter the Valuer's opinion, advice or valuation conclusion, the Valuer shall exercise extreme caution in making Special Assumptions in his valuation analysis. Should a Special Assumption be called into question, the Valuer will be asked to justify the reason(s) he took, and the justification may be taken into account in any disciplinary action.

4. Verification of information

4.1 The Valuer must take reasonable steps to verify that the information relied upon by him are reliable and appropriate in the preparation of the valuation and, if not already agreed, clarify with the client any necessary Assumptions that will be relied upon by him.

Commentary:

1. The Valuer shall state clearly in his Report the information that he has relied on and, where appropriate, its source. In many instances it may be beyond the scope of the Valuer's services or his ability to perform a complete verification of secondary or tertiary sources of information. Accordingly, the Valuer shall verify the accuracy and reasonableness of data sources as is customary in the markets and locale of the valuation. It is recommended for the Valuer to disclose in the Report which data was verified and which data was not verified.

2. Valuers must always take into account information received from client or from a client's representatives. The source of any such data relied upon shall be cited by the Valuer in the Report, and the data shall be reasonably verified wherever possible.

3. In each individual case, the Valuer must judge whether the information supplied is reliable and if it is reliable, to what extent. If there is no option but to accept information that may not be reliable, an appropriate Assumption shall be set out in the Report and, where possible, communicate to the client before issuing the Report.

4. When preparing a valuation for Financial Statements, the Valuer should be prepared to discuss the appropriateness of any Assumptions that were made with the client's auditor, other professional adviser, or regulatory bodies with regard to verification of information.

5. Clients may expect Valuers to express opinions (and, in turn, Valuers will wish to express their opinions) on legal issues which may affect their valuations. Therefore, Valuers shall set out clearly in the Reports if there are any opinion expressed by him which must be verified by the client's or other interested parties' legal advisers before the valuation can be relied upon or published.

4.2 Where the services or works of other experts, including, but not limited to, other Valuers and/or other professionals, must be relied upon, the Valuer shall take verification steps as are necessary to ensure that such services or works are competently performed and that the conclusions relied upon are reasonable and credible.

Commentary:

1. If there is no option (for example, the other services or works were commissioned directly by the client, or the Valuer does not have the necessary skill or knowledge on a particular type of asset valuation) but to accept the services or works of other experts, the Valuer shall disclose the fact that no such steps have been taken to verify accuracy of such information and an appropriate Assumption shall be set out in the Report.

5. Publication statement

5.1 If a client wants to have a Report in order to quote part of the Report in a publication for reference purpose only, then the Valuer shall state clearly in the publication that the Report is not published in full in the publication.

Commentary:

1. Reports may be produced in full in other documents; for example, it may be produced in the client's financial report or in a shareholder's memorandum for public circulation purpose. However, Reports are also often being quoted as a reference in most of the publications. In both cases, a Valuer shall review the publications to ensure that all references to the Reports are accurate, and that the intended user and/or reader would not be misled.

2. If the Report will not be published in full, the publication statement should be prepared as a separate document and be provided at the same time when the Report is published. In such case, the Valuer shall make this publication statement together with the Report and submit them to the client. The publication statement should contain the following information, as a minimum. They are:

   (a) the name and qualification of the Valuer or the Valuer's firm, and a description of its nature;

   (b) an indication of whether the Valuer is an Internal or External Valuer, or where required, an Independent Valuer;

   (c) the date of valuation, basis of valuation, valuation approach and its method;

   (d) any departures and Special Assumptions;

   (e) confirmation that the valuation has been made in accordance with the Standards and other applicable standards, or the extent of, and reason(s) for, departure from the Standards;

   (f) a statement indicating parts of the Report which have been prepared by another Valuer or a specialist, if any;

   (g) a statement indicating that the publication statement is issued on the basis that a Report has been submitted simultaneously to the client.

   In some cases, at the request of SFC or HKEx, additional information may be required to be included in the publication statement, and the Valuer shall try his best effort to satisfy such requirements. If the Valuer's response is called in question, the Valuer will be asked to justify the reasons he took, and the justification may be taken into account in any disciplinary action.

3. The Valuer shall take all reasonable steps to ensure that all information and description related to the subject to be valued and the contents of the Report are accurate before the Report is published. The Valuer shall read the whole document in which the Report would be published or which the Report would be made as a reference therein to ensure that no misleading statement or misrepresentation is made in the publication.

4. The Valuer shall insist on obtaining a copy of the final version of the publication in which the Report would be published or which the Report would be made as a reference therein for record purpose and shall attach a copy of it to the letter of consent to be signed by him. The Valuer shall use his best efforts to resist any undue pressure from other parties, pressing him to, or delegating his authority to, give consent to the final version of the said publication.

5. The Report may include information about a company's trading information which would not usually be available in the public domain. Such information is considered as 'commercially sensitive' and the client must decide, subject to the approval of the auditors and any regulatory body, whether it should be included in the publication if the Report needs to be reproduced in full in the publication.

6. In any published documents, the Valuer shall declare any omission(s) that he has made in the Report as a result of the express instructions of the client and the approval given by the regulatory body and/or auditors. Without such declaration, the Valuer may not be able to justify his omission when the Report prepared by him is called into question later.

7. If a full Report will not be published, sufficient reference to the departure(s) and any Special Assumption(s) should be made in the relevant published document. In each case the onus is rest upon the Valuer to determine what would constitute a 'sufficient reference'. A reference would not be regarded as 'sufficient' if it fails to alert the intended user and/or reader on matters of fundamental importance (such as the basis or amount of the valuation) or there is a risk that the intended user and/or reader might be misled.

6. Departure notes

6.1 Departure(s) from the Mandatory Parts of the Practice Statements of the Standards in each Report shall be made in accordance with Section 5 of Part I of the Standards.

Commentary:

1. The HKIS regards Section 5 of Part I of the Standards as mandatory requirements imposed on Members undertaking business valuations.

2. A Member who makes a departure from the Mandatory Parts of the Standards may be required to justify the reasons for such departure to the HKIS. If the HKIS is not satisfied with the reason(s) advanced and/or the manner in which the departure is declared, the HKIS is entitled to take appropriate disciplinary actions.

7. Draft Reports

7.1 Where a Report is being prepared, a Valuer may provide the client with a draft advice, a Report or valuation before his completing the Report. The Valuer may provide such draft advice, Report or valuation to his client provided that the document includes the following information:

(a) the draft is provided for the client's internal use only;

(b) it is a draft version only and so contents of same may be different from the final Report; and

(c) the draft is provided on the condition that it would not be published or disclosed.

If the Valuer omits any important matters in the draft advice, Report or valuation, the Valuer shall state such omissions in the said draft.

Commentary:

1. It is rather common that, when a Report is being prepared, the Valuer may have to discuss with the client various issues related to the Report, such issues include, but not limited to, ascertaining the details and accuracy of the facts and information provided by the client (such as, confirming the revenue received or clarifying the cash inflow and outflow), before the Valuer is able to come up with a preliminary view on the value of the subject.

2. If the above-mentioned discussions have taken place, the Valuer shall ensure that, other than to rectify any mistakes, errors or discrepancies or obtain further information related to the Report, his view on preparing the Report has not been influenced by such discussions. The Valuer shall keep record of such discussions with his client on draft advice, Reports or valuations to be prepared by him. This record shall include:

   (a) details of the information provided or suggestions made by the client related to the Report;

   (b) why and how information is used to justify the Valuer to make a change in the value of the subject, if a change has taken place; and

   (c) the reasons why the Valuer, after taking into account the information provided or suggestion made by the client, believes that there is no need to make any change to the value of the subject.

3. The purpose of the above procedures is to ensure that there are sufficient records to prove that the discussions made between a Valuer and his client have not compromised the Valuer's independence and impartiality. Upon request, the Valuer shall produce such records to auditors or any other person who has a legitimate and material interest in the valuation of the subject or the Report.

8. Documentation and retention

8.1 The Valuer shall retain sufficient documentation and working papers which reasonably evidence the nature and extent of the work done in respect of any professional engagement for a reasonable time after completion of the engagement.

Commentary:

1. For all Reports, sufficient documentation must be kept in the working files to support the results and conclusions of the valuation and such documentation must be held for at least six (6) years after completion of the engagement or two (2) years after final disposition of any judicial proceeding in which testimony was given, whichever period expires last.

2. The working files must include the name of the client and the identity, by name or type, of any other intended users; true copies of any written reports, documented on any type of media; summaries of any oral reports or testimony, or a transcript of testimony; the Valuer's signed and dated certification; all other data, information, and documentation which are necessary to support the Valuer's opinions and conclusions and to prove compliance with the Standards, or reference to the location(s) of such other documentation.

3. If a Valuer is unable to retain a copy of the Report and its working papers, whether by reason of an employer's internal rules or by change of employer, all reasonable steps must be taken by the Valuer to ensure the availability of such data when requested. In this regard, the Valuer should obtain written commitment from his employer that such data will be made available when required by regulatory authorities. If the employer refuses to provide such written commitment, the Valuer shall keep a record of such refusal and provide it to the HKIS, upon receipt of request from the HKIS.

4. Valuers are under a general duty to treat information relating to a client as confidential when the information is disclosed to the Valuer as a result of the professional relationship and the disclosed information is not available in the public domain. Reasonable care must be taken to prevent a third party from gaining access to the engagement working files without the client's authorisation. It is the best practice to have a statement made by the Valuer's firm in the Report regarding its documentation and retention policy of the engagement working files.

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Appendix PS 4.1

Minimum contents of a Report

This Appendix provides further information on the minimum contents to be included in a Report as specified in Part III, PS 4 - 1. Minimum contents of a Report. The HKIS may from time to time specify additional contents that should be included in a Report by amending a Practice Statement. The minimum contents to be included in a Report are:

1. Identity of the client

The Report must be addressed to the client or the client's authorised representatives. The source of the instructions and the identity of the client must be stated, if such are different from the addressee.

2. Defining the scope of the valuation assignment

The following disclosures and/or description shall be included in each Report:

(a) A statement of the nature of the instruction;

(b) A description of the subject being valued;

(c) The basis of valuation and its Assumption(s);

(d) Departure, if any;

(e) Special Assumption, if any;

(f) The purpose and the use of the valuation; and

(g) The date of valuation and the date of the Report.

3. Business description

The HKIS encourages its Members to disclose the following information, as much as possible, in a Report:

(a) Status of the entity (incorporated companies, partnership etc.);

(b) History of the entity;

(c) Products and/or services, including factors that may affect the business such as competition and market trend;

(d) Markets and customers;

(e) Corporate structure and shareholders of the entity;

(f) Major assets, both tangible and intangible, and major liabilities;

(g) Economic and industry outlook bearing on the business being valued;

(h) Recent major and significant corporate events of the entity which may affect the valuation;

(i) Financial information of the entity such as financial results, adjustments on financial statements, projections of balance sheet and income statements; and

(j) Other information as may be required to present a clear description of the business, and the general context within which it operates.

4. Valuation approaches and methods used

The following information shall be included in each Report:

(a) The valuation approach or approaches selected, and the reasons for their selection;

(b) The valuation method or methods selected, and the reasons for their selection;

(c) The procedures followed in the application of the method(s) selected. The description of the methodology and the procedures followed must contain sufficient details to allow the intended user and/or the reader of the report to understand how the Valuer reached his valuation conclusion; and

(d) An explanation on how the variables such as discount rates, capitalisation rates, or valuation multiples are determined and used. The rationale and/or supporting data for any premiums or discounts must be clearly presented.

5. Assumptions

Assumptions made in the valuation should be disclosed and elaborated in the Report in accordance with Part III, PS 4 - 2. Assumption.

6. Restrictions and valuation comments

The following information, where appropriate and applicable, shall be included in each Report:

(a) A statement that the Valuer and/or his associates and/or the Valuer's firm have no interest in the subject being valued, or other conflict that could cast doubt on the Valuer's independence or objectivity; or, if such an interest or conflict exists, it must be disclosed;

(b) A statement that the Valuer has relied on information supplied by others, without further verification by the Valuer, as well as the sources that were relied on;

(c) A statement that a valuation is valid only for the date of the valuation indicated and for the purpose stated;

(d) A statement that restricts the use of the Report by the client for whom the Report was prepared and addressed to;

(e) A statement that disclaims liabilities and responsibility for losses and damages that may be suffered by any person or entity resulting from unauthorised or improper use of the Report;

(f) A statement that the Valuer has no obligation to revise the valuation and the Report due to the reason that wrong, incorrect or insufficient information have been provided and/or additional information has been provided to or obtained by the Valuer after the issue of the Report;

(g) A statement that discloses the extent of the Valuer's investigations and his limitation in conducting the investigations, if any;

(h) A statement that the Valuer has confirmed his compliance of the Standards in arriving at his valuation;

(i) A statement that the Valuer has acted as an External Valuer or Independent Valuer who is qualified to provide the subject valuation. If the Valuer has undertaken the valuation as an Independent Valuer, the specific criteria and confirmation that the Valuer complies with this status must be confirmed;

(j) A statement that the Valuer's firm has adopted a proper documentation system and a record keeping policy on the client's working files and, without the client's specific permission or direction, no person other than the client will have access to the engagement working files unless such access is ordered by a court of competent jurisdiction or an investigation committee appointed by the HKIS; and

(k) A statement that publication of the Report without prior consent of the Valuer and/or Valuer's firm is strictly prohibited.

The following information shall be considered as recommendations which the HKIS encourages its Members, where appropriate and applicable, to be disclosed in the Report:

(a) Where the Valuer has reviewed the un-audited financial statements of the subject being valued, a statement that the Valuer has not been engaged to perform an audit procedure and that an audit opinion would not be given is required;

(b) If a valuation involves a currency other than that of the country or area in which the Report will be used, the exchange rate adopted, and its source, shall be revealed; and

(c) Any other reservation or limitation on the Valuer's responsibility in preparing his valuation and the Report.

7. Conclusion of value

The conclusion of value shall be presented in words, as well as in figures. A statement that the conclusion of value includes the transaction costs or not is required.

8. Warning Statement

A statement that warns the readers of the Report that the conclusion of value is made based on generally accepted appraisal procedures and practices that may have relied extensively on Assumptions and considerations, not all of which can be easily quantified or ascertained exactly. As a range of values may be reached depending upon the Assumptions and considerations made, the readers are urged to consider carefully the nature of such Assumptions and considerations in interpreting the Report.

9. Signature

The Report must be signed by an appropriately qualified Member, who is a Valuer as defined in the Standards and accepts full responsibility for it (see Part III, PS 1 (1.1)). To comply with this Practice Statement, the Valuer must sign the Report personally even though he is acting for and on behalf of the Valuer's firm. The qualification of the Valuer must be disclosed in the signature section of the Report. For the avoidance of doubt, the name and qualification of any Joint Valuer(s) and/or Contributing Valuer(s) together with their signature(s), where appropriate, must also be disclosed in the signature section.

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Appendix PS 4.2

Minimum contents of letter of value

This Appendix provides further information on the minimum contents to be included in a letter of value as specified in Part III, PS 4 - 1. Minimum contents of a Report. The HKIS may from time to time requires additional contents to be included in the letter of value by amending a Practice Statement. The minimum contents to be included in a letter of value are:

1. Identification of the client

The letter of value must be addressed to the client or the client's representatives. The source of the instructions and the identity of the client must be stated, if such are different from the addressee.

2. Defining the scope of the valuation assignment

The following information shall be included in each letter of value:

(a) A statement of the nature of the instruction;

(b) Conditional clauses for issuing the letter of value;

(c) A description of the subject being valued;

(d) The basis of valuation and its Assumption(s);

(e) Departure, if any;

(f) Special Assumption, if any;

(g) The purpose and the use of the valuation; and

(h) The date of valuation and the date of the letter of value.

3. Valuation approaches and methods used

The following shall be included in each letter of value:

(a) The valuation approach or approaches selected; and

(b) The valuation method or methods selected.

4. Assumptions

Any Assumption that has been made in the valuation should be disclosed in the letter of value in accordance with Part III, PS 4 - 2. Assumptions.

5. Restrictions and valuation comments

The following information shall, where appropriate and applicable, be disclosed in each letter of value:

(a) A statement that the Valuer and/or his associates and/or the Valuer's firm have no interest in the subject being valued, or other conflict that could cast doubt on the Valuer's independence or objectivity; or, if such an interest or conflict exists, it must be disclosed;

(b) A statement that the Valuer has relied on information supplied by others, without further verification by the Valuer, as well as the sources that were relied on;

(c) A statement that a valuation is valid only for the date of the valuation indicated and for the purpose stated;

(d) A statement that restricts the use of the letter of value by the client for whom the letter was prepared and addressed to;

(e) A statement that disclaims liabilities and responsibility for losses and damages that may be suffered by any person or entity resulting from unauthorised or improper use of the letter of value;

(f) A statement that the Valuer has confirmed to adopt the Standards in preparing the followed Report;

(g) A statement that gives the Valuer the right to make revisions and/or further support of the reported value in the letter of value under certain specified circumstances before issuing the Report. For examples, the Valuer has obtained more information from the client, after his further investigation or change of market situation, etc;

(h) A statement that discloses the extent of the Valuer's investigations and his limitation in conducting the investigations, if any;

(i) A statement that the Valuer has acted as an External Valuer or Independent Valuer who is qualified to provide the subject valuation. If the Valuer has undertaken the valuation as an Independent Valuer, the specific criteria and confirmation that the Valuer complies with this status must be confirmed; and

(j) A statement that publication of the letter of value without the prior consent of the Valuer and/or Valuer's firm is strictly prohibited.

The following information shall be considered as recommendations which the HKIS encourages its Members, where appropriate and applicable, to disclose in the letter of value:

(a) Where the Valuer has reviewed the un-audited financial statements of the subject being valued, a statement that the Valuer has not been engaged to perform an audit procedure and that an audit opinion would not be given is required;

(b) If a valuation involves a currency other than that of the country or area in which the letter of value will be used, the exchange rate adopted, and its source, shall be noted; and

(c) Any other reservation or limitation on the Valuer's responsibility in preparing his valuation and the letter of value.

6. Conclusion of value

The conclusion of value shall be presented in words, as well as in figures. A statement that the conclusion of value includes the transaction costs or not is required.

7. Warning Statement

A statement that warns the readers of the letter of value that the conclusion of value is made based on generally accepted appraisal procedures and practices that may have relied extensively on Assumptions and considerations, not all of which can be easily quantified or ascertained exactly. As a range of values may be reached depending upon the Assumptions and considerations made, the readers are urged to consider carefully the nature of such Assumptions and considerations in interpreting the letter of value.

8. Signature

The letter of value must be signed by an appropriately qualified Member, who is a Valuer as defined in the Standards and accepts full responsibility for it (see Part III, PS 1 (1.1)). To comply with this Practice Statement, the Valuer must sign the letter of value personally even though he is acting for and on behalf of the Valuer's firm. The qualification of the Valuer must be disclosed in the signature section of the letter of value.

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Part III

Practice Statement 5 - Professional Ethics and Disciplinary Procedures

1. Codes of ethics

1.1 In order to ensure, maintain and preserve the general public's trust in professional valuation practice, the Members must observe the highest standards of professional ethics.

Commentary:

1. The Members shall at all times remain honest, maintain a high standard of integrity and conduct their activities in a manner that is not detrimental to their clients, the public, the HKIS and their profession.

2. The HKIS regards the rules in Part 1 - Standard of Conduct published in the HKIS Guidance Notes as mandatory requirements which shall be imposed on the Members undertaking valuations or preparing Reports under the Standards.

3. Both the HKIS Bye-Laws and the HKIS Guidance Notes allow the HKIS to investigate any breaches of them. Disciplinary action may be brought against any Member for any breach of the HKIS Bye-Laws and/or the HKIS Guidance Notes.

2. Disciplinary procedures

2.1 Whenever a complaint is lodged against a Member, alleging that he has committed a breach of the Standards in providing valuation services, or if it has come to the attention of the HKIS that a Member may be in breach of the Standards in providing valuation services, the President of the HKIS shall take appropriate actions against the Member in accordance with the disciplinary procedures set out in Part 3 - Disciplinary Bodies and Part 4 - Disciplinary Procedure of the HKIS Guidance Notes.

Commentary:

1. The authority of the HKIS Guidance Notes comes from Part VI of the HKIS Bye-Laws. Under Part VI 6.1 of the HKIS Bye-Laws, the General Council of the HKIS may issue guidance notes governing the standards of the professional conduct of the Members from time to time provided that such guidance notes are approved by the HKIS in accordance with proper procedures.

2. Any person may lodge a complaint about a misconduct or alleged misconduct of a Member provided that the complaint must be made in writing, signed by the complainant, and reasonable particulars of the grounds for the complaint are given. If any person wishes to lodge a complaint against a Member for committing a breach under the Standards, such complaint shall be addressed or referred to the President of the HKIS.

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Appendix PS 5.1

Disciplinary powers of the HKIS

This Appendix provides further information to the Members to understand the disciplinary power of the HKIS in carrying investigation against him, in case a complaint is lodged against him when he, acted as a Valuer, has carried out a valuation and signed off a Report or letter of value.

The following section has been extracted from the HKIS Guidance Notes, and may be amended from time to time by the General Council of the HKIS.

PART 2. DISCIPLINARY POWERS

2.1 In accordance with the provision of Part VI of the Bye-Laws, if a Member has been found by the Disciplinary Board under Rule 4 to have contravened the Standard of Conduct or any provisions of the Bye-Laws, the General Council shall have power to take any one or more of the following courses of action:-

2.1.1 To reprimand or severely reprimand the Member;

2.1.2 To require the Member to give a written undertaking to refrain from continuing or repeating the conduct which is found to have constituted the contravention;

2.1.3 To suspend the Member from Membership of the Institute for such periods as the General Council may determine;

2.1.4 To expel the Member from the Institute.

2.2 If, in respect of a Member, there is produced to the General Council:-

2.2.1 Evidence of conviction by a Court of competent jurisdiction for any criminal offence involving embezzlement, theft, corruption, fraud or dishonesty of any kind or any other criminal offence carrying on first conviction a maximum sentence of not less than twelve months imprisonment (whether the sentence is suspended or not); or

2.2.2 A legal notice that he has been adjudicated bankrupt or a certified copy of a deed of arrangement he has entered into with or for the benefit of his creditors; and

2.2.3 A copy of a letter sent by the Institute to the Member

2.2.3.1 Informing him of the powers of the General Council under the Bye-Laws or these Rules of Conduct;

2.2.3.2 Giving him not less than 21 days notice of the date of the meeting of the General Council at which the matter is to be considered; and

2.2.3.3 Inviting him to make such submissions in writing as he may think fit.

The General Council after considering any submission as aforesaid may either:

(a) Refer the matter to the Committee of Investigation hereinafter mentioned for enquiry and action. (In such event, the General Council may, if they think fit, temporarily suspend the Member from membership of the Institute pending such enquiry); or

(b) Without further enquiry forthwith expel the Member from the Institute.

2.3 All decisions of the General Council under Rule 2 shall take immediate effect and shall be duly recorded; and the General Council may cause to be published in the Journal and in such newspapers or other publications as the General Council may think fit notice of reprimand or severe reprimand; suspension or expulsion of a Member together with such particulars, as the General Council shall think desirable, of the misconduct, breach of Bye-Laws, conviction or other matter for which the penalty in question was imposed.

2.4 If a Member is expelled, his name shall be removed from the Register and he shall thereupon cease for all purposes to be a Member of the Institute. That Member shall immediately return his diplomas of Membership to the Institute and he shall not be entitled to use any designation or description which implies membership or former membership of the Institute.

2.5 If a Member is suspended, he shall not be entitled during the period of his suspension to exercise any of the rights or privileges of membership of the Institute. He shall however remain in all other respects subject to the provisions of these Bye-Laws and to the exercise of the Institute's disciplinary powers in respect of any contravention of those provisions committed by him including that committed during the period of his suspension.

2.6 If a Member has been notified that a complaint or allegation has been made against him or that a conviction, bankruptcy or other matter mentioned in these Rules has been notified to the Institute, he shall not be entitled to resign from membership of the Institute, and any such proceedings may be continued notwithstanding his attempted resignation.

With Effect from 31 August 2004
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Part IV

Guidance Note 1 - Procedures to entering into a valuation engagement

This Guidance Note intends to provide guidance to the Members regarding the procedures that the Members shall follow in entering into a valuation engagement:

1. Engagement

1.1 The Member shall obtain clear instructions from the client regarding the terms and conditions of the engagement either by signing an Engagement Letter or a confirmation letter with the client. If the client does not agree to sign the Engagement Letter or confirmation letter, an e-mail confirmation from client shall be obtained and records of such e-mail shall be kept.

2. Gathering information and carrying out researches

2.1 When the engagement is confirmed, the Member, as a Valuer, must have the following information in hand in order to be able to commence the process of valuation:

(a) Sufficient understanding of the subject of the valuation;

(b) Sufficient understanding of the underlying business operations;

(c) Sufficient financial information relating to the past results, future prospects and present financial situation regarding the underlying business operations;

(d) Sufficient understanding of the relevant industry(ies) in which the underlying business operates; and

(e) Sufficient information relating to the general economic conditions affecting the underlying business operations.

The above can be obtained through client interviews and researches.

3. Valuation conclusion

3.1 The Member shall determine the following matters before drawing a valuation conclusion:

(a) The appropriate valuation approach and method to be adopted;

(b) The appropriate valuation techniques to be employed. The Member shall also consider the key valuation components and assumptions to be adopted at this stage;

(c) The Member shall consider the necessity of obtaining the advice and assistance from an Additional Valuer and/or Contributing Valuer and/or an expert in any business industry which the Member may not be able to arrive at a valuation conclusion on his own.

4. Reporting

4.1 The Member shall record his findings and conclusion of value of the business operations in a Report.

4.2 Where appropriate, the Member shall send a draft Report to the client to obtain his comment on the valuation approaches, methods and techniques that he has adopted before he signs the Report.

4.3 If the client provides any comments to the draft Report, the Member shall incorporate the client's comments into the Report and document the changes made in a reference paper. If the Member believes that the comments from the client are not appropriate to be included in the Report, the Member shall explain the reasons for his belief to the client and record such explanation in writing.

4.4 The Member shall issue the signed Report to the client on or before a date mutually agreed by the parties. If the parties have not reached agreement on the date that the Member shall issue the signed Report to the client, the Member shall issue such signed Report to the client within a reasonable period of time after his confirming the engagement with the client.

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Part IV

Guidance Note 2 - Use and analysis of Financial Statements

This Guidance Note intends to provide an aid to the Members regarding the use and analysis of Financial Statements in the valuations of business enterprises, including, but not limited to, business ownership interests and securities.

This Guidance Note is extracted from IVSC International Valuation Guidance Note No. 6, para. 5.11 and 5.12 and reproduced as follows:

5.11 Use of financial statements

5.11.1 There are three goals of financial analysis and adjustment:

5.11.1.1 Understanding of the relationships existing in the profit and loss statement and the balance sheet, including trends over time, to assess the risk inherent in the business operations and the prospects for future performance;

5.11.1.2 Comparison with similar businesses to assess risk and value parameters;

5.11.1.3 Adjustment of historical financial statements to estimate the economic abilities of and prospects for the business.

5.12 To aid in understanding the economics of and risk in business interest, financial statements should be analysed in terms of 1) money, 2) percentages (percentage of sales for items in the income statement and percentage of total assets for items in the balance sheet), and 3) financial ratios.

5.12.1 Analysis in terms of money as stated in the financial statements is used to establish trends and relationships between income and expense accounts in a business interest over time. These trends and relationships are used to assess the expected income flow in the future, along with the capital needed to allow the business to provide that income flow.

5.12.2 Analysis in terms of percentages compares accounts in the profit and loss statement to revenues, and accounts in the balance sheets to total assets. Percentage analysis is used to compare the trends in relationships, i.e. between revenue and expense items, or between balance sheet amounts, for the subject business over time and among similar businesses.

5.12.3 Analysis in terms of financial ratios is used to compare the relative risk of the subject business over time and among similar businesses.