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

Alert
Updates on financial reporting, auditing and ethics

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Dear practising members,

Valuation on acquisitions and disposals

On 4 July 2019, the Securities and Futures Commission (SFC) issued the Statement on the Conduct and Duties of Directors When Considering Corporate Acquisitions or Disposals outlining recurring types of misconduct in relation to corporate acquisitions and disposals that have given rise to concerns and, in some cases, led to intervention by the SFC. The recurring types of misconduct highlighted are:

- Lack of independent professional valuation
- Lack of independent judgment and accountability
- Quality of earnings
- Fair presentation of comparables
- Impact on financial position
- Compensation
- Suspicious connected parties
- Proper investigation and due diligence

Most of the issues concern the valuation aspects of the transactions.

Although auditors are not usually involved in the consideration of the deals for corporate acquisitions or disposals, they are required to report on the financial statements for the periods in which those transactions took place and assess whether the related assets acquired and liabilities assumed and, where applicable, the goodwill arising were fairly stated at the reporting date. The recurring types of misconduct highlighted in the SFC statement are matters worth considering by auditors so that adequate audit responses can be made if those matters as described were identified – or are considered likely to be present – in the relevant transactions. In applicable cases, auditors should heighten their professional scepticism when carrying out work on the relevant valuations.

The Institute, through its practice review programme, has also identified cases where the auditors did not sufficiently evaluate or challenge valuations when assessing (1) the accounting for a business combination, and (2) possible goodwill and asset impairment at the reporting date. In many of those cases, professional valuers were involved in the audit work. The involvement of professional valuers does not absolve the auditors from their responsibility to carry out sufficient and appropriate work before placing reliance on the work of valuers, regardless of whether the valuers were involved in performing the valuations directly or assisting the auditors to evaluate the work of the management's experts. In a few cases where significant deficiencies were identified in the auditors' work on valuations, disciplinary complaints have been raised against the auditors.

Deficiencies in work on valuations are one of the most commonly encountered issues in practice reviews. Related common findings have been covered in previous Quality Assurance Department Annual Reports. Practices might find it useful to revisit those common deficiencies to prevent them from occurring in their audits. One of the most common deficiencies is that practices placed undue reliance on valuation reports prepared by valuers without properly evaluating their independence and competence, critically assessing the appropriateness of their valuation method and key assumptions used, and adequately testing against data inputs into the valuations for reasonableness. Auditors should bear in mind that they take ultimate responsibility for their opinion given on the financial statements and this responsibility will not be reduced if other professional experts, including valuers, are involved in the audit work.

If you have any questions, please contact the QA hotline 2287-7850 or email qualityassurance@hkicpa.org.hk.

Sincere regards,

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