

## **Auditing Fair Value Measurements and Disclosures**

This Singapore Standard on Auditing was approved by the Council of the Institute of Certified Public Accountants of Singapore in March 2003.

Auditors are required to comply with the auditing standards contained in this SSA in respect of audits of financial statements for periods beginning on or after 1 April 2003.

SSA 545 supersedes SSA 545 of the same title (approved in March 2003) in June 2004. No substantive changes have been made to the original approved text and all cross references have been updated, as appropriate.

This revised SSA 545 supersedes the SSA of the same title in June 2005.

The Audit Risk Standards, comprising SSA 315 “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement”, SSA 330 “The Auditor’s Procedures in Response to Assessed Risks” and SSA 500 (Revised) “Audit Evidence” gave rise to conforming amendments in this SSA. These amendments are effective for audits of financial statements for periods beginning on or after 15 December 2004.

With effect from 15 December 2009, due to the revised clarified standards, SSA 545 has been superseded by the revised and redrafted SSA 540. Hence, SSA 545 is no longer in effect.

Singapore Standards on Auditing (SSAs) are to be applied in the audit of financial statements. SSAs are also to be applied, adapted as necessary, to the audit of other information and to related services.

SSAs contain the basic principles and essential procedures (identified in bold type black lettering) together with related guidance in the form of explanatory and other material. The basic principles and essential procedures are to be interpreted in the context of the explanatory and other material that provide guidance for their application.

To understand and apply the basic principles and essential procedures together with the related guidance, it is necessary to consider the whole text of the SSA including explanatory and other material contained in the SSA not just that text which is black lettered.

In exceptional circumstances, an auditor may judge it necessary to depart from an SSA in order to more effectively achieve the objective of an audit. When such a situation arises, the auditor should be prepared to justify the departure.

SSAs need only be applied to material matters.

The Public Sector Perspective (PSP) issued is set out at the end of an SSA. Where no PSP is added, the SSA is applicable in all material respects to the public sector.

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**SINGAPORE  
STANDARD  
ON AUDITING**

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**SSA 545****Auditing Fair Value Measurements and Disclosures****Foreword**

This Standard is based on International Standard on Auditing 545.

**Introduction**

1. The purpose of this Singapore Standard on Auditing (SSA) is to establish standards and provide guidance on auditing fair value measurements and disclosures contained in financial statements. In particular, this SSA addresses audit considerations relating to the measurement, presentation and disclosure of material assets, liabilities and specific components of equity presented or disclosed at fair value in financial statements. Fair value measurements of assets, liabilities and components of equity may arise from both the initial recording of transactions and later changes in value. Changes in fair value measurements that occur over time may be treated in different ways under different financial reporting frameworks. For example, some financial reporting frameworks may require that such changes be reflected directly in equity, while others may require them to be reflected in income.
2. While this SSA provides guidance on auditing fair value measurements and disclosures, audit evidence obtained from other audit procedures also may provide audit evidence relevant to the measurement and disclosure of fair values. For example, inspection procedures to verify existence of an asset measured at fair value also may provide relevant audit evidence about its valuation (such as the physical condition of an investment property).
- 2a. SSA 500, "Audit Evidence" paragraph 16 requires the auditor to use assertions in sufficient detail to form a basis for the assessment of risks of material misstatements and the design and performance of further audit procedures in response to the assessed risks. Fair value measurements and disclosures are not in themselves assertions, but may be relevant to specific assertions, depending on the applicable financial reporting framework.
3. The auditor should obtain sufficient appropriate audit evidence that fair value measurements and disclosures are in accordance with the entity's applicable financial reporting framework. Paragraph 22 of SSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" requires the auditor to obtain an understanding of the entity's applicable financial reporting framework.
4. Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation and ensure that the presentation and disclosure of the fair value measurements are in accordance with the entity's applicable financial reporting framework.
5. Many measurements based on estimates, including fair value measurements, are inherently imprecise. In the case of fair value measurements, particularly those that do not involve contractual cash flows or for which market information is not available when making the estimate, fair value estimates often involve uncertainty in both the amount and timing of future cash flows. Fair value measurements also may be based on assumptions about future conditions, transactions or events whose outcome is uncertain and will therefore be subject to change over time. The auditor's consideration of such assumptions is based on information available to the auditor at the time of the audit and the auditor is not responsible for predicting future conditions, transactions or events which,

had they been known at the time of the audit, may have had a significant effect on management's actions or management's assumptions underlying the fair value measurements and disclosures. Assumptions used in fair value measurements are similar in nature to those required when developing other accounting estimates. SSA 540, "Audit of Accounting Estimates" provides guidance on auditing accounting estimates. This SSA, however, addresses considerations similar to those in SSA 540 as well as others in the specific context of fair value measurements and disclosures in accordance with an applicable financial reporting framework.

6. Different financial reporting frameworks require or permit a variety of fair value measurements and disclosures in financial statements. They also vary in the level of guidance that they provide on the basis for measuring assets and liabilities or the related disclosures. Some financial reporting frameworks give prescriptive guidance, others give general guidance, and some give no guidance at all. In addition, certain industry-specific measurement and disclosure practices for fair values also exist. While this SSA provides guidance on auditing fair value measurements and disclosures, it does not address specific types of assets or liabilities, transactions, or industry-specific practices. The Appendix to this SSA discusses fair value measurements and disclosures under different financial reporting frameworks and the prevalence of fair value measurements, including the fact that different definitions of "fair value" may exist under such frameworks. For example, Financial Reporting (FRS) 39, "Financial Instruments: Recognition and Measurement" defines fair value as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction."
7. In most financial reporting frameworks, underlying the concept of fair value measurements is a presumption that the entity is a going concern without any intention or need to liquidate, curtail materially the scale of its operations, or undertake a transaction on adverse terms. Therefore, in this case, fair value would not be the amount that an entity would receive or pay in a forced transaction, involuntary liquidation, or distress sale. An entity, however, may need to take its current economic or operating situation into account in determining the fair values of its assets and liabilities if prescribed or permitted to do so by its financial reporting framework and such framework may or may not specify how that is done. For example, management's plan to dispose of an asset on an accelerated basis to meet specific business objectives may be relevant to the determination of the fair value of that asset.
8. The measurement of fair value may be relatively simple for certain assets or liabilities, for example, assets that are bought and sold in active and open markets that provide readily available and reliable information on the prices at which actual exchanges occur. The measurement of fair value for other assets or liabilities may be more complex. A specific asset may not have an active market or may possess characteristics that make it necessary for management to estimate its fair value (for example, an investment property or a complex derivative financial instrument). The estimation of fair value may be achieved through the use of a valuation model (for example, a model premised on projections and discounting of future cash flows) or through the assistance of an expert, such as an independent valuer.
9. The uncertainty associated with an item, or the lack of objective data may make it incapable of reasonable estimation, in which case, the auditor considers whether the auditor's report needs modification to comply with SSA 700, "The Auditor's Report on Financial Statements."

### **Understanding the Entity's Process for Determining Fair Value Measurements and Disclosures and Relevant Control Activities, and Assessing Risk**

10. As part of the understanding of the entity and its environment, including its internal control, the auditor should obtain an understanding of the entity's process for determining fair value measurements and disclosures and of the relevant control activities sufficient to identify and assess the risks of material misstatement at the assertion level and to design and perform further audit procedures.
11. Management is responsible for establishing an accounting and financial reporting process for determining fair value measurements. In some cases, the measurement of fair value and therefore the process set up by management to determine fair value may be simple and reliable. For example, management may be able to refer to published price quotations to determine fair value for marketable securities held by the entity. Some fair value measurements, however, are inherently

more complex than others and involve uncertainty about the occurrence of future events or their outcome, and therefore assumptions that may involve the use of judgment need to be made as part of the measurement process. The auditor's understanding of the measurement process, including its complexity, helps identify and assess the risks of material misstatement in order to determine the nature, timing and extent of the further audit procedures.

12. When obtaining an understanding of the entity's process for determining fair value measurements and disclosures, the auditor considers, for example:
  - The relevant control activities over the process used to determine fair value measurements, including, for example, controls over data and the segregation of duties between those committing the entity to the underlying transactions and those responsible for undertaking the valuations.
  - The expertise and experience of those persons determining the fair value measurements.
  - The role that information technology has in the process.
  - The types of accounts or transactions requiring fair value measurements or disclosures (for example, whether the accounts arise from the recording of routine and recurring transactions or whether they arise from non-routine or unusual transactions).
  - The extent to which the entity's process relies on a service organization to provide fair value measurements or the data that supports the measurement. When an entity uses a service organization, the auditor complies with the requirements of Addendum 2 to SSA 402, "Audit Considerations Relating to Entities Using Service Organizations."
  - The extent to which the entity uses the work of experts in determining fair value measurements and disclosures (see Using the Work of an Expert, paragraphs 29–32).
  - The significant management assumptions used in determining fair value.
  - The documentation supporting management's assumptions.
  - The methods used to develop and apply management assumptions and to monitor changes in those assumptions.
  - The integrity of change controls and security procedures for valuation models and relevant information systems, including approval processes.
  - The controls over the consistency, timeliness and reliability of the data used in valuation models.
13. SSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement" requires the auditor to obtain an understanding of the components of internal control. In particular, the auditor obtains a sufficient understanding of control activities related to the determination of the entity's fair value measurements and disclosures in order to identify and assess the risks of material misstatement and to design the nature, timing and extent of the further audit procedures.
14. **After obtaining an understanding of the entity's process for determining fair value measurements and disclosures, the auditor should identify and assess the risks of material misstatement at the assertion level related to the fair value measurements and disclosures in the financial statements to determine the nature, timing and extent of the further audit procedures.**
15. The degree to which a fair value measurement is susceptible to misstatement is an inherent risk. Consequently, the nature, timing and extent of the further audit procedures will depend upon the susceptibility to misstatement of a fair value measurement and whether the process for determining fair value measurements is relatively simple or complex.
- 15a Where the auditor has determined that the risk of material misstatement related to a fair value measurement or disclosure is a significant risk that requires special audit considerations, the auditor follows the requirements of SSA 315.

16. SSA 315 discusses the inherent limitations of internal controls. As fair value determinations often involve subjective judgments by management, this may affect the nature of control activities that are capable of being implemented. The susceptibility to misstatement of fair value measurements also may increase as the accounting and financial reporting requirements for fair value measurements become more complex. The auditor considers the inherent limitations of controls in such circumstances in assessing the risk of material misstatement.

## **Evaluating the Appropriateness of Fair Value Measurements and Disclosures**

17. **The auditor should evaluate whether the fair value measurements and disclosures in the financial statements are in accordance with the entity's applicable financial reporting framework.**
18. The auditor's understanding of the requirements of the applicable financial reporting framework and knowledge of the business and industry, together with the results of other audit procedures, are used to assess whether the accounting for assets or liabilities requiring fair value measurements is appropriate, and whether the disclosures about the fair value measurements and significant uncertainties related thereto are appropriate under the entity's applicable financial reporting framework.
19. The evaluation of the appropriateness of the entity's fair value measurements under its applicable financial reporting framework and the evaluation of audit evidence depends, in part, on the auditor's knowledge of the nature of the business. This is particularly true where the asset or liability or the valuation method is highly complex. For example, derivative financial instruments may be highly complex, with a risk that differing interpretations of how to determine fair values will result in different conclusions. The measurement of the fair value of some items, for example "in-process research and development" or intangible assets acquired in a business combination, may involve special considerations that are affected by the nature of the entity and its operations if such considerations are appropriate under the entity's applicable financial reporting framework. Also, the auditor's knowledge of the business, together with the results of other audit procedures, may help identify assets for which management needs to recognize an impairment by using a fair value measurement pursuant to the entity's applicable financial reporting framework.
20. Where the method for measuring fair value is specified by the applicable financial reporting framework, for example, the requirement that the fair value of a marketable security be measured using quoted market prices as opposed to using a valuation model, the auditor considers whether the measurement of fair value is consistent with that method.
21. Some financial reporting frameworks presume that fair value can be measured reliably for assets or liabilities as a prerequisite to either requiring or permitting fair value measurements or disclosures. In some cases, this presumption may be overcome when an asset or liability does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly inappropriate or unworkable. When management has determined that it has overcome the presumption that fair value can be reliably determined, the auditor obtains sufficient appropriate audit evidence to support such determination, and whether the item is properly accounted for under the applicable financial reporting framework.
22. **The auditor should obtain audit evidence about management's intent to carry out specific courses of action, and consider its ability to do so, where relevant to the fair value measurements and disclosures under the entity's applicable financial reporting framework.**
23. In some financial reporting frameworks, management's intentions with respect to an asset or liability are criteria for determining measurement, presentation, and disclosure requirements, and how changes in fair values are reported within financial statements. In such financial reporting frameworks, management's intent is important in determining the appropriateness of the entity's use of fair value. Management often documents plans and intentions relevant to specific assets or liabilities and the applicable financial reporting framework may require it to do so. While the extent of audit evidence to be obtained about management's intent is a matter of professional judgment, the auditor's procedures ordinarily include inquiries of management, with appropriate corroboration of responses, for example, by:

- Considering management's past history of carrying out its stated intentions with respect to assets or liabilities.
- Reviewing written plans and other documentation, including, where applicable, budgets, minutes, etc.
- Considering management's stated reasons for choosing a particular course of action.
- Considering management's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its contractual commitments.

The auditor also considers management's ability to pursue a specific course of action if ability is relevant to the use, or exemption from the use, of fair value measurement under the entity's applicable financial reporting framework.

24. **Where alternative methods for measuring fair value are available under the entity's applicable financial reporting framework, or where the method of measurement is not prescribed, the auditor should evaluate whether the method of measurement is appropriate in the circumstances under the entity's applicable financial reporting framework.**
25. Evaluating whether the method of measurement of fair value is appropriate in the circumstances requires the use of professional judgment. When management selects one particular valuation method from alternative methods available under the entity's applicable financial reporting framework, the auditor obtains an understanding of management's rationale for its selection by discussing with management its reasons for selecting the valuation method. The auditor considers whether:
  - (a) management has sufficiently evaluated and appropriately applied the criteria, if any, provided in the applicable financial reporting framework to support the selected method;
  - (b) the valuation method is appropriate in the circumstances given the nature of the asset or liability being valued and the entity's applicable financial reporting framework; and
  - (c) the valuation method is appropriate in relation to the business, industry and environment in which the entity operates.
26. Management may have determined that different valuation methods result in a range of significantly different fair value measurements. In such cases, the auditor evaluates how the entity has investigated the reasons for these differences in establishing its fair value measurements.
27. **The auditor should evaluate whether the entity's method for its fair value measurements is applied consistently.**
28. Once management has selected a specific valuation method, the auditor evaluates whether the entity has consistently applied that basis in its fair value measurement, and if so, whether the consistency is appropriate considering possible changes in the environment or circumstances affecting the entity, or changes in the requirements of the entity's applicable financial reporting framework. If management has changed the valuation method, the auditor considers whether management can adequately demonstrate that the valuation method to which it has changed provides a more appropriate basis of measurement, or whether the change is supported by a change in the requirements of the entity's applicable financial reporting framework or a change in circumstances. For example, the introduction of an active market for a particular class of asset or liability may indicate that the use of discounted cash flows to estimate the fair value of such asset or liability is no longer appropriate.

## Using the Work of an Expert

29. **The auditor should determine the need to use the work of an expert.** The auditor may have the necessary skill and knowledge to plan and perform audit procedures related to fair values or may decide to use the work of an expert. In making such a determination, the auditor considers the matters discussed in paragraph 7 of SSA 620.
30. If the use of such an expert is planned, the auditor obtains sufficient appropriate audit evidence that such work is adequate for the purposes of the audit, and complies with the requirements of SSA 620.



31. When planning to use the work of an expert, the auditor considers whether the expert's understanding of the definition of fair value and the method that the expert will use to determine fair value are consistent with that of management and the requirements of the applicable financial reporting framework. For example, the method used by an expert for estimating the fair value of real estate or a complex derivative, or the actuarial methodologies developed for making fair value estimates of insurance obligations, reinsurance receivables and similar items, may not be consistent with the measurement principles of the applicable financial reporting framework. Accordingly, the auditor considers such matters, often by discussing, providing or reviewing instructions given to the expert or when reading the report of the expert.
32. In accordance with SSA 620, the auditor assesses the appropriateness of the expert's work as audit evidence. While the reasonableness of assumptions and the appropriateness of the methods used and their application are the responsibility of the expert, the auditor obtains an understanding of the significant assumptions and methods used, and considers whether they are appropriate, complete and reasonable, based on the auditor's knowledge of the business and the results of other audit procedures. The auditor often considers these matters by discussing them with the expert. Paragraphs 39 through 49 discuss the auditor's evaluation of significant assumptions used by management, including assumptions relied upon by management based on the work of an expert.

### **Audit Procedures Responsive to the Risk of Material Misstatement of the Entity's Fair Value Measurements and Disclosures**

33. **The auditor should design and perform further audit procedures in response to assessed risks of material misstatement of assertions relating to the entity's fair value measurements and disclosures.** SSA 330, "The Auditor's Procedures in Response to Assessed Risks" discusses the auditor's responsibility to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risk of material misstatement at the assertion level. Such further audit procedures include tests of control and substantive procedures, as appropriate. Paragraphs 34-55 below provide additional specific guidance on substantive procedures that may be relevant in the context of the entity's fair value measurements and disclosures.
34. Because of the wide range of possible fair value measurements, from relatively simple to complex, the auditor's procedures can vary significantly in nature, timing and extent. For example, substantive procedures relating to the fair value measurements may involve (a) testing management's significant assumptions, the valuation model, and the underlying data (see paragraphs 39–49), (b) developing independent fair value estimates to corroborate the appropriateness of the fair value measurement (see paragraph 52), or (c) considering the effect of subsequent events on the fair value measurement and disclosures (see paragraphs 53–55).
35. The existence of published price quotations in an active market ordinarily is the best audit evidence of fair value. Some fair value measurements, however, are inherently more complex than others. This complexity arises either because of the nature of the item being measured at fair value or because of the valuation method required by the applicable financial reporting framework or selected by management. For example, in the absence of quoted prices in an active market, some financial reporting frameworks permit an estimate of fair value based on an alternative basis such as a discounted cash flow analysis or a comparative transaction model. Complex fair value measurements normally are characterized by greater uncertainty regarding the reliability of the measurement process. This greater uncertainty may be a result of:
  - Length of the forecast period.
  - The number of significant and complex assumptions associated with the process.
  - A higher degree of subjectivity associated with the assumptions and factors used in the process.
  - A higher degree of uncertainty associated with the future occurrence or outcome of events underlying the assumptions used.
  - Lack of objective data when highly subjective factors are used.

36. The auditor's understanding of the measurement process, including its complexity, helps guide the auditor's determination of the nature, timing and extent of audit procedures to be performed. The following are examples of considerations in the development of audit procedures:
- Using a price quotation to obtain audit evidence about valuation may require an understanding of the circumstances in which the quotation was developed. For example, where quoted securities are held for investment purposes, valuation at the listed market price may require adjustment under the entity's applicable financial reporting framework if the holding is significantly large in size or is subject to restrictions in marketability.
  - When using audit evidence provided by a third party, the auditor considers its reliability. For example, when information is obtained through the use of external confirmations, the auditor considers the respondent's competence, independence, authority to respond, knowledge of the matter being confirmed, and objectivity in order to be satisfied with the reliability of the evidence. The extent of such audit procedures will vary according to the assessed risk of material misstatement associated with the fair value measurements. The auditor complies with SSA 505, "External Confirmations" in this regard.
  - Audit evidence supporting fair value measurements, for example, a valuation by an independent valuer, may be obtained at a date that does not coincide with the date at which the entity is required to measure and report that information in its financial statements. In such cases, the auditor obtains audit evidence that management has taken into account the effect of events, transactions and changes in circumstances occurring between the date of fair value measurement and the reporting date.
  - Collateral often is assigned for certain types of investments in debt instruments that either are required to be measured at fair value or are evaluated for possible impairment. If the collateral is an important factor in measuring the fair value of the investment or evaluating its carrying amount, the auditor obtains sufficient appropriate audit evidence regarding the existence, value, rights and access to or transferability of such collateral, including consideration whether all appropriate liens have been filed, and considers whether appropriate disclosures about the collateral have been made under the entity's applicable financial reporting framework.
  - In some situations, additional audit procedures, such as the inspection of an asset by the auditor, may be necessary to obtain sufficient appropriate audit evidence about the appropriateness of a fair value measurement. For example, inspection of an investment property may be necessary to obtain information about the current physical condition of the asset relevant to its fair value, or inspection of a security may reveal a restriction on its marketability that may affect its value.

*Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data*

37. The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of further audit procedures. A reliable process for determining fair value is one that results in reasonably consistent measurement and, where relevant, presentation and disclosure of fair value when used in similar circumstances. When obtaining audit evidence about the entity's fair value measurements and disclosures, the auditor evaluates whether:
- (a) the assumptions used by management are reasonable;
  - (b) the fair value measurement was determined using an appropriate model, if applicable;
  - (c) management used relevant information that was reasonably available at the time.
38. Estimation techniques and assumptions and the auditor's consideration and comparison of fair value measurements determined in prior periods, if any, to results obtained in the current period may provide audit evidence of the reliability of management's processes. However, the auditor also considers whether such variances result from changes in economic circumstances.
39. **Where the auditor determines there is a significant risk related to fair values, or where otherwise applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair values, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.**

40. It is necessary for management to make assumptions, including assumptions relied upon by management based upon the work of an expert, to develop fair value measurements. For these purposes, management's assumptions also include those assumptions developed under the guidance of those charged with governance. Assumptions are integral components of more complex valuation methods, for example valuation methods that employ a combination of estimates of expected future cash flows together with estimates of the values of assets or liabilities in the future, discounted to the present. Auditors pay particular attention to the significant assumptions underlying a valuation method and evaluate whether such assumptions are reasonable. To provide a reasonable basis for the fair value measurements and disclosures, assumptions need to be relevant, reliable, neutral, understandable and complete. Paragraph 45 of SSA 100, "Assurance Engagements" describes these characteristics in more detail.
41. Specific assumptions will vary with the characteristics of the asset or liability being valued and the valuation method used (e.g. replacement cost, market or an income-based approach). For example, where discounted cash flows (an income-based approach) are used as the valuation method, there will be assumptions about the level of cash flows, the period of time used in the analysis, and the discount rate.
42. Assumptions ordinarily are supported by differing types of audit evidence from internal and external sources that provide objective support for the assumptions used. The auditor assesses the source and reliability of audit evidence supporting management's assumptions, including consideration of the assumptions in light of historical information and an evaluation of whether they are based on plans that are within the entity's capacity.
43. Audit procedures dealing with management's assumptions are performed in the context of the audit of the entity's financial statements. The objective of the audit procedures is therefore not intended to obtain sufficient appropriate audit evidence to provide an opinion on the assumptions themselves. Rather, the auditor performs audit procedures to consider whether the assumptions provide a reasonable basis in measuring fair values in the context of an audit of the financial statements taken as a whole.
44. Identifying those assumptions that appear to be significant to the fair value measurement requires the exercise of judgment by management. The auditor focuses attention on significant assumptions. Generally, significant assumptions cover matters that materially affect the fair value measurement and may include those that are:
  - (a) sensitive to variation or uncertainty in amount or nature. For example, assumptions about short-term interest rates may be less susceptible to significant variation compared to assumptions about long-term interest rates;
  - (b) susceptible to misapplication or bias.
45. The auditor considers the sensitivity of the valuation to changes in significant assumptions, including market conditions that may affect the value. Where applicable, the auditor encourages management to use such techniques as sensitivity analysis to help identify particularly sensitive assumptions. In the absence of such management analysis, the auditor considers whether to employ such techniques. The auditor also considers whether the uncertainty associated with a fair value measurement, or the lack of objective data may make it incapable of reasonable estimation under the entity's applicable financial reporting framework (see paragraph 9).
46. The consideration of whether the assumptions provide a reasonable basis for the fair value measurements relates to the whole set of assumptions as well as to each assumption individually. Assumptions are frequently interdependent, and therefore, need to be internally consistent. A particular assumption that may appear reasonable when taken in isolation may not be reasonable when used in conjunction with other assumptions. The auditor considers whether management has identified the significant assumptions and factors influencing the measurement of fair value.
47. The assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows) ordinarily will reflect what management expects will be the outcome of specific objectives and strategies. To be reasonable, such assumptions, individually and taken as a whole, also need to be realistic and consistent with:

- (a) the general economic environment and the entity's economic circumstances;
- (b) the plans of the entity;
- (c) assumptions made in prior periods, if appropriate
- (d) past experience of, or previous conditions experienced by, the entity to the extent currently applicable;
- (e) other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts other than those relating to fair value measurements and disclosures; and
- (f) if applicable, the risk associated with cash flows, including the potential variability of the cash flows and the related effect on the discounted rate.

Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience (see paragraphs 22 and 23).

- 48. If management relies on historical financial information in the development of assumptions, the auditor considers the extent to which such reliance is justified. However, historical information might not be representative of future conditions or events, for example, if management intends to engage in new activities or circumstances change.
- 49. For items valued by the entity using a valuation model, the auditor is not expected to substitute his or her judgment for that of the entity's management. Rather, the auditor reviews the model, and evaluates whether the model is appropriate and the assumptions used are reasonable. For example, it may be inappropriate to use a discounted cash flow method in valuing an equity investment in a start-up enterprise if there are no current revenues on which to base the forecast of future earnings or cash flows.
- 50. **The auditor should perform audit procedures on the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions.**
- 51. The auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of an expert, are accurate, complete and relevant; and whether the fair value measurements have been properly determined using such data and management's assumptions. The auditor's procedures also may include, for example, audit procedures such as verifying the source of the data, mathematical recalculation and reviewing of information for internal consistency, including whether such information is consistent with management's intent to carry out specific courses of action discussed in paragraphs 22 and 23.

#### *Developing Independent Fair Value Estimates for Corroborative Purposes*

- 52. The auditor may make an independent estimate of fair value (for example, by using an auditor-developed model) to corroborate the entity's fair value measurement. When developing an independent estimate using management's assumptions, the auditor evaluates those assumptions as discussed in paragraphs 39 to 49. Instead of using management's assumptions the auditor may develop separate assumptions to make a comparison with management's fair value measurements. In that situation, the auditor nevertheless understands management's assumptions. The auditor uses that understanding to determine that the auditor's model considers the significant variables and to evaluate any significant difference from management's estimate. The auditor also performs audit procedures on the data used to develop the fair value measurements and disclosures as discussed in paragraphs 50 and 51. The auditor considers the guidance contained in SSA 520, "Analytical Procedures" when performing these procedures during an audit.

#### *Subsequent Events*

- 53. **The auditor should consider the effect of subsequent events on the fair value measurements and disclosures in the financial statements.**

54. Transactions and events that occur after period-end but prior to completion of the audit, may provide appropriate audit evidence regarding the fair value measurements made by management. For example, a sale of investment property shortly after the period-end may provide audit evidence relating to the fair value measurement.
55. In the period after a financial statement period-end, however, circumstances may change from those existing at the period-end. Fair value information after the period -end may reflect events occurring after the period-end and not the circumstances existing at the balance sheet date. For example, the prices of actively traded marketable securities that change after the period-end ordinarily do not constitute appropriate audit evidence of the values of the securities that existed at the period-end. The auditor complies with SSA 560, "Subsequent Events" when evaluating audit evidence relating to such events.

## Disclosures about Fair Values

56. **The auditor should evaluate whether the disclosures about fair values made by the entity are in accordance with its financial reporting framework.**
57. Disclosure of fair value information is an important aspect of financial statements in many financial reporting frameworks. Often, fair value disclosure is required because of the relevance to users in the evaluation of an entity's performance and financial position. In addition to the fair value information required by the applicable financial reporting framework, some entities disclose voluntary additional fair value information in the notes to the financial statements.
58. When auditing fair value measurements and related disclosures included in the notes to the financial statements, whether required by the applicable financial reporting framework or disclosed voluntarily, the auditor ordinarily performs essentially the same types of audit procedures as those employed in auditing a fair value measurement recognized in the financial statements. The auditor obtains sufficient appropriate audit evidence that the valuation principles are appropriate under the entity's applicable financial reporting framework, are being consistently applied, and the method of estimation and significant assumptions used are properly disclosed in accordance with the entity's applicable financial reporting framework. The auditor also considers whether voluntary information may be inappropriate in the context of the financial statements. For example, management may disclose a current sales value for an asset without mentioning that significant restrictions under contractual arrangements preclude the sale in the immediate future.
59. The auditor evaluates whether the entity has made appropriate disclosures about fair value information as called for by its financial reporting framework. If an item contains a high degree of measurement uncertainty, the auditor assesses whether the disclosures are sufficient to inform users of such uncertainty. For example, the auditor might evaluate whether disclosures about a range of amounts, and the assumptions used in determining the range, within which the fair value is reasonably believed to lie is appropriate under the entity's applicable financial reporting framework, when management considers a single amount presentation not appropriate. Where applicable, the auditor also considers whether the entity has complied with the accounting and disclosure requirements relating to changes in the valuation method used to determine fair value measurements.
60. When disclosure of fair value information under the applicable financial reporting framework is omitted because it is not practicable to determine fair value with sufficient reliability, the auditor evaluates the adequacy of disclosures required in these circumstances. If the entity has not appropriately disclosed fair value information required by the applicable financial reporting framework, the auditor evaluates whether the financial statements are materially misstated by the departure from the applicable financial reporting framework.

## Evaluating the Results of Audit Procedures

61. **In making a final assessment of whether the fair value measurements and disclosures in the financial statements are in accordance with the entity's applicable financial reporting framework, the auditor should evaluate the sufficiency and appropriateness of the audit evidence obtained as well as the consistency of that evidence with other audit evidence obtained and evaluated during the audit.**

62. When assessing whether the fair value measurements and disclosures in the financial statements are in accordance with the entity's applicable financial reporting framework, the auditor evaluates the consistency of the information and audit evidence obtained during the audit of fair value measurements with other audit evidence obtained during the audit, in the context of the financial statements taken as a whole. For example, the auditor considers whether there is or should be a relationship or correlation between the interest rates used to discount estimated future cash flows in determining the fair value of an investment property and interest rates on borrowings currently being incurred by the entity to acquire investment property.

## Management Representations

63. **The auditor should obtain written representations from management regarding the reasonableness of significant assumptions, including whether they appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity where relevant to the fair value measurements or disclosures.**
64. SSA 580, "Management Representations" discusses the use of management representations as audit evidence. Depending on the nature, materiality and complexity of fair values, management representations about fair value measurements and disclosures contained in the financial statements also may include representations about:
- The appropriateness of the measurement methods, including related assumptions, used by management in determining fair values within the applicable financial reporting framework, and the consistency in application of the methods.
  - The basis used by management to overcome the presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework.
  - The completeness and appropriateness of disclosures related to fair values under the entity's applicable financial reporting framework.
  - Whether subsequent events require adjustment to the fair value measurements and disclosures included in the financial statements.

## Communication with Those Charged with Governance

65. SSA 260, "Communication of Audit Matters with Those Charged with Governance" requires auditors to communicate audit matters of governance interest with those charged with governance. Because of the uncertainties often involved with some fair value measurements, the potential effect on the financial statements of any significant risks may be of governance interest. For example, the auditor considers communicating the nature of significant assumptions used in fair value measurements, the degree of subjectivity involved in the development of the assumptions, and the relative materiality of the items being measured at fair value to the financial statements as a whole. The auditor considers the guidance contained in SSA 260 when determining the nature and form of communication.

## Effective Date

66. This SSA is effective for audits of financial statements for periods beginning on or after 1 April 2003. Earlier application of the provisions of this SSA is permissible.

The conforming amendments are effective for audits of financial statements for periods beginning on or after December 15, 2004.

## Public Sector Perspective

1. *Many governments are moving to accrual accounting and are adopting fair value as the basis of valuation for many classes of the assets and liabilities that they hold, or for disclosures of items in the financial statements. The broad principles of this SSA are therefore applicable to the consideration of the audit of fair value measurements and disclosures included in the financial statements of public sector entities.*

2. *Paragraph 3 of the SSA states that when fair value measurements and disclosures are material to the financial statements, the auditor should obtain sufficient appropriate audit evidence that such measurements and disclosures are in accordance with the entity's applicable financial reporting framework. The International Public Sector Accounting Standards accounting framework include a number of standards that require or allow the recognition or disclosure of fair values.*
3. *As noted in paragraph 8 of the SSA, determining the fair value of certain assets or liabilities may be complex where there is no active market. This can be a particular issue in the Public Sector, where entities have significant holdings of specialized assets. Furthermore many assets held by public sector entities do not generate cash flows. In these circumstances a fair value or similar current value may be estimated by reference to other valuation methods including, but not limited to, depreciated replacement cost and indexed price method.*

## APPENDIX

### Fair Value Measurements and Disclosures under Different Financial Reporting Frameworks

1. Different financial reporting frameworks require or permit a variety of fair value measurements and disclosures in financial statements. They also vary in the level of guidance that they provide on the basis for measuring assets and liabilities or the related disclosures. Some financial reporting frameworks give prescriptive guidance, others give general guidance, and some give no guidance at all. In addition, certain industry-specific measurement and disclosure practices for fair values also exist.
2. Different definitions of fair value may exist among financial reporting frameworks, or for different assets, liabilities or disclosures within a particular framework. For example, Financial Reporting Standard (FRS) 39, "Financial Instruments: Recognition and Measurement" defines fair value as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction". The concept of fair value ordinarily assumes a current transaction, rather than settlement at some past or future date. Accordingly, the process of measuring fair value would be a search for the estimated price at which that transaction would occur. Additionally, different financial reporting frameworks may use such terms as "entity-specific value", "value in use", or similar terms, but may still fall within the concept of fair value in this SSA.
3. Different financial reporting frameworks may treat changes in fair value measurements that occur over time in different ways. For example, a particular financial reporting framework may require that changes in fair value measurements of certain assets or liabilities be reflected directly in equity, while such changes might be reflected in income under another framework. In some frameworks, the determination of whether to use fair value accounting or how it is applied is influenced by management's intent to carry out certain courses of action with respect to the specific asset or liability.
4. Different financial reporting frameworks may require certain specific fair value measurements and disclosures in financial statements and prescribe or permit them in varying degrees. The financial reporting frameworks may:
  - Prescribe measurement, presentation and disclosure requirements for certain information included in the financial statements or for information disclosed in notes to financial statements or presented as supplementary information.
  - Permit certain measurements using fair values at the option of an entity or only when certain criteria have been met.
  - Prescribe a specific method for determining fair value, for example, through the use of an independent appraisal or specified ways of using discounted cash flows.
  - Permit a choice of method for determining fair value from among several alternative methods (the criteria for selection may or may not be provided by the financial reporting framework).
  - Provide no guidance on the fair value measurements or disclosures of fair value other than their use being evident through custom or practice, for example, an industry practice.
5. Some financial reporting frameworks presume that fair value can be measured reliably for assets or liabilities as a prerequisite to either requiring or permitting fair value measurements or disclosures. In some cases, this presumption may be overcome when an asset or liability does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly inappropriate or unworkable.
6. Some financial reporting frameworks require certain specified adjustments or modifications to valuation information, or other considerations unique to a particular asset or liability. For example, accounting for investment properties may require adjustments to be made to an appraised market value, such as adjustments for estimated closing costs on sale, adjustments related to the property's condition and location, and other matters. Similarly, if the market for a particular asset is not an active market, published price quotations may have to be adjusted or modified to arrive at a more suitable



measure of fair value. For example, quoted market prices may not be indicative of fair value if there is infrequent activity in the market, the market is not well established, or small volumes of units are traded relative to the aggregate number of trading units in existence. Accordingly, such market prices may have to be adjusted or modified. Alternative sources of market information may be needed to make such adjustments or modifications.

## **Prevalence of Fair Value Measurements**

7. Measurements and disclosures based on fair value are becoming increasingly prevalent in financial reporting frameworks. Fair values may occur in, and affect the determination of, financial statements in a number of ways, including the measurement at fair value of:
  - Specific assets or liabilities, such as marketable securities or liabilities to settle an obligation under a financial instrument, routinely or periodically “marked-to-market”.
  - Specific components of equity, for example when accounting for the recognition, measurement and presentation of certain financial instruments with equity features, such as a bond convertible by the holder into common shares of the issuer.
  - Specific assets or liabilities acquired in a business combination. For example, the initial determination of goodwill arising on the purchase of an entity in a business combination usually is based on the fair value measurement of the identifiable assets and liabilities acquired and the fair value of the consideration given.
  - Specific assets or liabilities adjusted to fair value on a one-time basis. Some financial reporting frameworks may require the use of a fair value measurement to quantify an adjustment to an asset or a group of assets as part of an asset impairment determination, for example, a test of impairment of goodwill acquired in a business combination based on the fair value of a defined operating entity or reporting unit, the value of which is then allocated among the entity’s or unit’s group of assets and liabilities in order to derive an implied goodwill for comparison to the recorded goodwill.
  - Aggregations of assets and liabilities. In some circumstances, the measurement of a class or group of assets or liabilities calls for an aggregation of fair values of some of the individual assets or liabilities in such class or group. For example, under an entity’s applicable financial reporting framework, the measurement of a diversified loan portfolio might be determined based on the fair value of some categories of loans comprising the portfolio.
  - Transactions involving the exchange of assets between independent parties without monetary consideration. For example, a non-monetary exchange of plant facilities in different lines of business.
  - Information disclosed in notes to financial statements or presented as supplementary information, but not recognized in the financial statements.