

**STATEMENT OF AUDITING STANDARDS
421
AUDITING FAIR VALUE MEASUREMENTS AND DISCLOSURES**

*(Effective for audits of financial statements for periods beginning before 15 December 2004)**

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* HKSA 545 "Auditing Fair Value Measurements and Disclosures" is effective for audits of financial statements for periods beginning on or after 15 December 2004.

STATEMENT OF AUDITING STANDARDS
421
AUDITING FAIR VALUE MEASUREMENTS AND DISCLOSURES

*Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

Introduction

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance on auditing fair value measurements and disclosures contained in financial statements. In particular, this SAS 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 SAS provides guidance on auditing fair value measurements and disclosures, evidence obtained from other audit procedures also may provide 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 evidence about its valuation (such as the physical condition of an investment property).
3. ***The auditors should obtain sufficient appropriate audit evidence that fair value measurements and disclosures are in accordance with the entity's identified financial reporting framework. (SAS 421.1)***
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 identified 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 auditors' consideration of such assumptions is based on information available to the auditors at the time of the audit and the auditors are 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. SAS 420 "Audit of accounting estimates" provides guidance on auditing accounting estimates. This SAS, however, addresses considerations similar to those in SAS 420 as well as others in the specific context of fair value measurements and disclosures in accordance with an identified 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 SAS 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 SAS 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, Hong Kong SSAPs, such as SSAP 24 "Accounting for investments in securities" 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 auditors consider whether the auditors' report needs modification to comply with SAS 600 "Auditors' reports on financial statements".

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

10. *The auditors should obtain an understanding of the entity's process for determining fair value measurements and disclosures and of the relevant control procedures sufficient to develop an effective audit approach. (SAS 421.2)*
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 auditors' understanding of the measurement process, including its complexity, helps determine the nature, timing and extent of the audit procedures.
12. When obtaining an understanding of the entity's process for determining fair value measurements and disclosures, the auditors consider, for example:
 - the relevant control procedures 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 auditors comply with the requirements of SAS 480 "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 paragraphs 29-33 below);
 - 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; and
 - the controls over the consistency, timeliness and reliability of the data used in valuation models.
13. SAS 300 "Audit risk assessments and accounting and internal control systems" requires the auditors to obtain an understanding of the control procedures, sufficient to develop the audit plan. In the specific context of this SAS, the auditors obtain such an understanding related to the determination of the entity's fair value measurements and disclosures in order to plan the nature, timing and extent of the audit procedures.
14. *After obtaining an understanding of the entity's process for determining fair value measurements and disclosures, the auditors should assess inherent and control risk related to the fair value measurements and disclosures in the financial statements to determine the nature, timing and extent of the audit procedures. (SAS 421.3)*
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 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.
16. SAS 300 discusses the inherent limitations of internal controls. As fair value determinations often involve subjective judgments by management, this may affect the nature of control procedures 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 auditors consider the inherent limitations of controls in such circumstances in assessing control risk.

Evaluating the Appropriateness of Fair Value Measurements and Disclosures

17. *The auditors should evaluate whether the fair value measurements and disclosures in the financial statements are in accordance with the entity's financial reporting framework. (SAS 421.4)*
18. The auditors' understanding of the requirements of the 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 financial reporting framework.

19. The evaluation of the appropriateness of the entity's fair value measurements under its financial reporting framework and the evaluation of audit evidence depend, in part, on the auditors' 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 financial reporting framework. Also, the auditors' 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 financial reporting framework.
20. Where the method for measuring fair value is specified by the 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 auditors consider 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 auditors obtain sufficient appropriate audit evidence to support such determination, and whether the item is properly accounted for under the financial reporting framework.
22. ***The auditors should obtain 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 financial reporting framework. (SAS 421.5)***
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 financial reporting framework may require it to do so. While the extent of evidence to be obtained about management's intent is a matter of professional judgment, the auditors' procedures ordinarily include enquiries 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; and
 - 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 auditors also consider 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 financial reporting framework.

24. ***Where alternative methods for measuring fair value are available under the entity's financial reporting framework, or where the method of measurement is not prescribed, the auditors should evaluate whether the method of measurement is appropriate in the circumstances under the entity's financial reporting framework. (SAS 421.6)***

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 financial reporting framework, the auditors obtain an understanding of management's rationale for its selection by discussing with management its reasons for selecting the valuation method. The auditors consider whether:
 - (a) management has sufficiently evaluated and appropriately applied the criteria, if any, provided in the 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 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 auditors evaluate how the entity has investigated the reasons for these differences in establishing its fair value measurements.
27. ***The auditors should evaluate whether the entity's method for its fair value measurements is applied consistently. (421.7)***
28. Once management has selected a specific valuation method, the auditors evaluate 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 financial reporting framework. If management has changed the valuation method, the auditors consider 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 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 auditors should determine the need to use the work of an expert. (SAS 421.8)***
30. The auditors 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 auditors consider the matters discussed in paragraph 8 of SAS 520 "Using the work of an expert".
31. If the use of such an expert is planned, the auditors obtain sufficient appropriate audit evidence that such work is adequate for the purposes of the audit, and comply with the requirements of SAS 520.
32. When planning to use the work of an expert, the auditors consider 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 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 financial reporting framework. Accordingly, the auditors consider such matters, often by discussing, providing or reviewing instructions given to the expert or when reading the report of the expert.
33. In accordance with SAS 520, the auditors assess 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 auditors obtain an understanding of the significant assumptions and methods used, and consider whether they are appropriate, complete and reasonable, based on the auditors' knowledge of the business and the results of other audit procedures. The auditors often consider these matters by discussing them with the expert. Paragraphs 40 through 50 below discuss the auditors' evaluation of significant assumptions used by management, including assumptions relied upon by management based on the work of an expert.

Testing the Entity's Fair Value Measurements and Disclosures

34. *Based on the assessment of inherent and control risk, the auditors should test the entity's fair value measurements and disclosures. (SAS 421.9)*
35. Because of the wide range of possible fair value measurements, from relatively simple to complex, the auditors' planned audit procedures can vary significantly in nature, timing and extent. For example, substantive tests of the fair value measurements may involve (a) testing management's significant assumptions, the valuation model, and the underlying data (see paragraphs 40-50 below), (b) developing independent fair value estimates to corroborate the appropriateness of the fair value measurement (see paragraph 53 below), or (c) considering the effect of subsequent events on the fair value measurement and disclosures (see paragraphs 54-56 below).
36. The existence of published price quotations in an active market ordinarily is the best 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 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; and
 - lack of objective data when highly subjective factors are used.
37. The auditors' understanding of the measurement process, including its complexity, helps guide the auditors' determination of detection risk and, accordingly, 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 test 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 financial reporting framework if the holding is significantly large in size or is subject to restrictions in marketability.
 - When using evidence provided by a third party, the auditors consider its reliability. For example, when information is obtained through the use of external confirmations, the auditors consider 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 procedures will vary according to the audit risk associated with the fair value measurements. The auditors comply with SAS 402 "External confirmations" in this regard.
 - 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 auditors obtain 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 auditors obtain 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 consider whether appropriate disclosures about the collateral have been made under the entity's financial reporting framework.
- In some situations, additional procedures, such as the inspection of an asset by the auditors, 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

38. The auditors' 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 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 testing the entity's fair value measurements and disclosures, the auditors evaluate 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.
39. Estimation techniques and assumptions and the auditors' consideration and comparison of fair value measurements determined in prior periods, if any, to results obtained in the current period may provide evidence of the reliability of management's processes. However, the auditors also consider whether such variances result from changes in economic circumstances.
40. *Where applicable, the auditors 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. (SAS 421.10)*
41. 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 25 of SAE 200 "High level assurance engagements" describes these characteristics in more detail.
42. 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.
43. Assumptions ordinarily are supported by differing types of evidence from internal and external sources that provide objective support for the assumptions used. The auditors assess the source and reliability of 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.

44. 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 auditors perform 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.
45. Identifying those assumptions that appear to be significant to the fair value measurement requires the exercise of judgment by management. The auditors focus 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.
46. The auditors consider the sensitivity of the valuation to changes in significant assumptions, including market conditions that may affect the value. Where applicable, the auditors encourage management to use such techniques as sensitivity analysis to help identify particularly sensitive assumptions. In the absence of such management analysis, the auditors consider whether to employ such techniques. The auditors also consider 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 financial reporting framework (see paragraph 9 above).
47. 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 auditors consider whether management has identified the significant assumptions and factors influencing the measurement of fair value.
48. 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 auditors consider whether they are consistent with the entity's plans and past experience (see paragraphs 22 and 23 above).

49. If management relies on historical financial information in the development of assumptions, the auditors consider 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.

50. For items valued by the entity using a valuation model, the auditors are not expected to substitute their judgment for that of the entity's management. Rather, the auditors review the model, and evaluate 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.
51. *The auditors should test 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. (SAS 421.11)*
52. The auditors evaluate 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 auditors' tests also may include, for example, procedures such as verifying the source of the data, mathematical re-computation 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 above.

Developing Independent Fair Value Estimates for Corroborative Purposes

53. The auditors 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 auditors evaluate those assumptions as discussed in paragraphs 40 to 50 above. Instead of using management's assumptions the auditors may develop separate assumptions to make a comparison with management's fair value measurements. In that situation, the auditors nevertheless understand management's assumptions. The auditors use that understanding to determine that the auditors' model considers the significant variables and to evaluate any significant difference from management's estimate. The auditors also test the data used to develop the fair value measurements and disclosures as discussed in paragraphs 51 and 52 above. The auditors consider the guidance contained in SAS 410 "Analytical procedures" when performing these procedures during an audit.

Subsequent Events

54. *The auditors should consider the effect of subsequent events on the fair value measurements and disclosures in the financial statements. (SAS 421.12)*
55. 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.
56. 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 auditors comply with SAS 150 "Subsequent events" when evaluating audit evidence relating to such events.

Disclosures about Fair Values

57. *The auditors should evaluate whether the disclosures about fair values made by the entity are in accordance with its financial reporting framework. (SAS 421.13)*
58. 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 financial reporting framework, some entities disclose voluntary additional fair value information in the notes to the financial statements.

59. When auditing fair value measurements and related disclosures included in the notes to the financial statements, whether required by the financial reporting framework or disclosed voluntarily, the auditors ordinarily perform essentially the same types of audit procedures as those employed in auditing a fair value measurement recognized in the financial statements. The auditors obtain sufficient appropriate audit evidence that the valuation principles are appropriate under the entity's 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 financial reporting framework. The auditors also consider 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.
60. The auditors evaluate 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 auditors assess whether the disclosures are sufficient to inform users of such uncertainty. For example, the auditors 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 financial reporting framework, when management considers a single amount presentation not appropriate. Where applicable, the auditors also consider whether the entity has complied with the accounting and disclosure requirements relating to changes in the valuation method used to determine fair value measurements.
61. 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 auditors evaluate the adequacy of disclosures required in these circumstances. If the entity has not appropriately disclosed fair value information required by the financial reporting framework, the auditors evaluate whether the financial statements are materially misstated by the departure from the financial reporting framework.

Evaluating the Results of Audit Procedures

62. *In making a final assessment of whether the fair value measurements and disclosures in the financial statements are in accordance with the entity's financial reporting framework, the auditors should evaluate the sufficiency and appropriateness of the audit evidence obtained as well as the consistency of that evidence with other evidence obtained and evaluated during the audit. (SAS 421.14)*
63. When assessing whether the fair value measurements and disclosures in the financial statements are in accordance with the entity's financial reporting framework, the auditors evaluate 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 auditors consider 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

64. *The auditors 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. (SAS 421.15)*
65. SAS 440 "Representations by management" 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 financial reporting framework;
- the completeness and appropriateness of disclosures related to fair values under the entity's financial reporting framework; and
- whether subsequent events require adjustment to the fair value measurements and disclosures included in the financial statements.

Communication with Those Charged with Governance

66. SAS 610 "Communications 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 auditors consider 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 auditors consider the guidance contained in SAS 610 when determining the nature and form of communication.

Compliance with International Standards on Auditing

67. Compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 545 "Auditing Fair Value Measurements And Disclosures".

Effective Date

68. This SAS is effective for audits of financial statements for periods beginning before 15 December 2004.

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, International Accounting Standard 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 SAS.
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); and
 - 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 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; and
 - information disclosed in notes to financial statements or presented as supplementary information, but not recognized in the financial statements.