

# Fair Value Measurement & Disclosure

30 November 2007



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## The Relevance of Fair Value



- For financial reporting, fair value is used or mentioned in most HKFRSs and HKASs
- For audit, an auditor has responsibility
  - To obtain sufficient appropriate audit evidence that fair value measurements and disclosures are in accordance with the entity's applicable financial reporting framework (HKSA 545.3 and 17)

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## Definition of Fair Value in HKFRSs

- **Fair value** is defined as:

- the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction

Knowledgeable,  
Willing Parties

Arm's length  
transactions

- The same definition is used in different HKFRSs,

- The application to different assets and liabilities may not be the same, for example:
  - HKAS 16 *Property, plant and equipment*
  - HKAS 18 *Revenue*
  - HKAS 39 *Financial instruments: recognition and measurement*
  - HKAS 40 *Investment property*
  - HKFRS 2 *Share-based payment*

## Characteristics of Fair Value



Knowledgeable,  
Willing Parties

Arm's length  
transactions

- Under HKFRSs, there are the following characteristics embedded in fair value:
  - Normally transaction price, unless consideration is for something other than the assets/liabilities involved
  - Between knowledgeable, willing parties
  - In arm's length transactions
  - No deduction for transaction costs, which may be incurred on sale or other disposal
  - Time-specific as of a given date

## Characteristics of Fair Value



- The best evidence for fair value is the current bid price in an active market
- If no such price in an active market, the information from a variety of sources can be considered, for example:
  - a) prices of most recent transactions
  - b) current prices in a less active market
  - c) value derived from valuation techniques, including
    - using recent arm's length market transactions between knowledgeable, willing parties
    - discounted cash flow analysis
    - option pricing models
    - other valuation techniques commonly used in the market

## Initial vs. Subsequent Measurement

### Example

- Fair value can be applied to
  - initial measurement,
  - subsequent measurement, or
  - both

Applied to both initial and subsequent measurement:

- Inventories (HKAS 2)
- Financial assets and liabilities at fair value through P/L (HKAS 39)
- Available for sale financial assets (HKAS 39)
- Agriculture (HKAS 41)

Applied to initial measurement but not subsequent measurement:

- Held-to-maturity (HKAS 39)
- Loans and receivables (HKAS 39)
- Business combination (HKFRS 3)

Not applied to initial measurement but applied to subsequent measurement (incl. selective):

- Property, plant and equipment (HKAS 16)
- Intangible assets (HKAS 38)
- Investment property (HKAS 40)

## Fair Value vs. Revaluation Model

### Fair value model (HKAS 40)

- Refers to fair value
- Changes in fair value recognised in income statement
- Revalued each balance sheet date
- N/A

### Revaluation model (HKAS 16)

- Refers to fair value
- Changes in fair value recognised in equity (or reserve)
- Not clearly defined, only require sufficient regular that no material different from fair value
- Deficit about fair value below depreciated cost is recognised in income statement

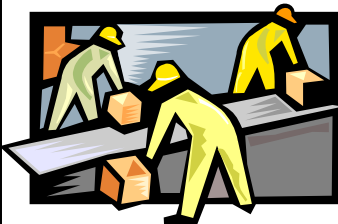
## Current Trend

- From financial reporting perspective,
  - Fair value is considered as more relevant (HKAS 8)  
Fallback from fair value to cost is often not allowed
  - Independent professional valuation is encouraged but not required  
e.g. HKAS 39, 40 & 41 and HKFRS 2
  - Changes in fair value to be recognised in income statement, instead of equity or reserves  
e.g. HKAS 39, 40 & 41 and ED of IFRS for SME
  - Reflect market condition at the balance sheet date, not just annual or regular revaluation  
e.g. HKAS 39 & 40 and HKFRS 2 and 5



## Audit Perspective

- 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. (HKSA 545.10)

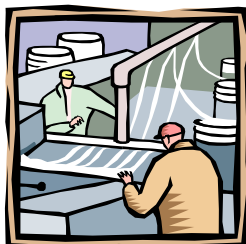


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## Audit Perspective

- 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. (HKSA 545.14)



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## Audit Perspective

- 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. (HKSA 545.24)

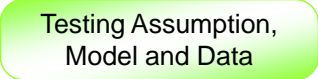

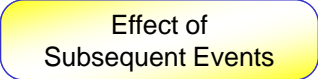


## Audit Perspective



- The auditor should determine the need to use the work of an expert. (HKSA 545.29)
- 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 HKSA 620, “*Using the Work of an Expert*.”

## Audit Perspective

- HKSA 545 requires that: “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.” (HKSA 545.33)
- Audit procedures, for example, may involve:
  1. Testing management’s significant assumptions, the valuation model, and the underlying data 
  2. Developing independent fair value estimates to corroborate the appropriateness of the fair value measurement 
  3. Considering the effect of subsequent events 

## Audit Perspective

- 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, the absence of quoted prices in an active market for a particular item

Testing Assumption,  
Model and Data

Developing Independent  
Fair Value Estimates

Effect of  
Subsequent Events

## Latest and Future Development



- Beyond fair value, more risk-oriented  
e.g. sensitivity analysis on market risk (HKFRS 7)
- More assets and liabilities to be stated at fair value  
e.g. contingent liabilities (proposed in ED to IFRS 3)
- Fair value can only be recognised in income statement (no choice is available)  
e.g. Investment in equity securities with a quote in active market can only be at fair value through profit and loss (proposed in ED to IFRS for SME)

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