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ISCA Audit Bulletin 8

AB 8:
Key Considerations in Auditing Valuation of Unquoted Equity Investments

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1. Background

Unquoted equity investments can take various forms and possess unique characteristics and risks to financial reporting. These investments are typically not quoted in an active market (i.e. not listed on public stock exchanges) and involve ownership interest in private companies whose shares are not publicly traded, as well as in private equity funds. Due to the general lack of observable market data or information relevant to the valuation of these investments, auditing the valuation of such investments can involve professional judgement and present significant challenges.

2. Scope of this Audit Bulletin

This Audit Bulletin (AB) highlights key considerations for the auditor when designing and performing procedures over the valuation of unquoted equity investments measured at fair value.

This bulletin does not provide guidance on how the auditor should perform risk assessment in accordance with SSA 315 (Revised 2021)[1] and SSA 540 (Revised)[2]. The auditor's risk assessment would depend on the facts and circumstances of the investments, including the complexity and subjectivity inherent in the valuation. The audit responses outlined in this bulletin are not intended to be prescriptive or exhaustive and should be tailored in accordance with the auditor's risk assessment. In assessing the valuation, the auditor should understand the type of investment and the valuation methods typically applied to that investment[3].

Except in limited situations where recent transaction prices for the same instrument are available, there are generally complexities and significant judgement involved in estimating the fair value of unquoted equity investments that lack observable information. Auditors should not assume management's responsibility of providing estimates of the fair value for inclusion in the financial statements, as this may create a self-review threat that undermines the auditor's independence.

While this AB is focused on auditing valuation, examples of some common classification errors are included under the Appendix for reference.

3. Overview of Fair Value Framework

Under FRS 113 / SFRS (I) 13[4], fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.

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[1] SSA 315 (Revised 2021), *Identifying and Assessing the Risks of Material Misstatement*

[2] SSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

[3] Below resources relevant for preparers may also be useful for auditors:
- **For valuation standards, refer to International Valuation Standards**, which are standards for undertaking valuation assignments using generally recognised concepts and principles that promote transparency and consistency in valuation practice [Link].
- **IFRS Foundation's educational material** on fair value measure for further guidance on valuation techniques [Link].
- **IPEV Valuation Guidelines** [Link]. This additional resource, which is non-authoritative, set out recommendations intended to represent best practice, on the valuation of private capital investments.
- **ACRA Business Valuation Resources** which provides information on key developments in the valuation profession and expectations of a Chartered Valuer and Appraiser (CVA) [Link].

[4] FRS 113 / SFRS (I) 13, *Fair Value Measurement*

Below are valuation approaches[5] used in the valuation of unquoted equity investments:

(a) Market approach – this could include recent transaction price paid for an identical instrument of the investee, recent transaction price (e.g. from fund raising) involving a similar instrument of the investee or comparable companies, or market multiples of listed comparable companies.

(b) Income approach –this could include models such as discounted cash flow (DCF) method, dividend discount model (DDM), constant-growth DDM, capitalisation model, option pricing model (OPM) for a company with complex capital structure or probability-weighted expected return method (PWERM) for entities with multiple potential exit scenarios.

(c) Cost approach, which is applied only in limited circumstances.

Reference may be made to internationally recognised valuation standards and industry best practices to provide further insights into valuation assumptions and methodologies in practical application[6].

This AB does not address which valuation approach should be used to measure fair value of unquoted equity investments. Ultimately, management needs to adopt an appropriate valuation technique that results in a fair value measurement that is in accordance with FRS 113 / SFRS (I) 13[7].

<u>Management's responsibilities</u>

Management is responsible for preparing valuations in accordance with the applicable financial reporting framework. This includes engaging qualified valuers where necessary and ensuring that the valuation techniques and inputs used are appropriate.

It is recognised that for certain investments, such as minority shareholdings or interests in private funds, management may face restrictions in obtaining detailed information. Nevertheless, management retains ultimate responsibility for ensuring that sufficient and appropriate information is available to support the valuations and related disclosures in the financial statements.

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[5] Para 130 of the *IFRS Foundation's educational material* provides an overview of common oversights when applying valuation techniques.

[6] See resources listed under footnote 3.

[7] Para 23 of the *IFRS Foundation's educational material* states that the fair value measurement of those equity instruments must reflect current market conditions (see paragraphs 15 and 24 of FRS 113 / (SFRS (I) 13). An entity might ensure that the valuation techniques reflect current market conditions by calibrating them at the measurement date. At initial recognition, if the transaction price represented fair value and an investor will use a valuation technique to measure fair value in subsequent periods that uses unobservable inputs, the investor must calibrate the valuation technique so that it equals the transaction price (see paragraph 64 of FRS 113 / (SFRS (I) 13). The use of calibration when measuring the fair value of the unquoted equity instruments at the measurement date is a good exercise for an entity to ensure that the valuation technique reflects current market conditions and to determine whether an adjustment to the valuation technique is necessary (for example, there might be a characteristic of the instrument that is not captured by the valuation technique or a new fact that has arisen at the measurement date that was not present at initial recognition). Refer to para 24 for an example that illustrates the use of calibration.

While calibration helps ensure that the valuation technique reflects current market conditions, valuers should also consider, where appropriate, the use of multiple valuation methods to enhance the reliability and robustness of the fair value measurement. Paragraph 13.4 of the Institute of Valuers and Appraisers Singapore (IVAS) Practice Note 1 (which is compliant with IVS) indicates that valuers are not required to use more than one method for the valuation of an asset, particularly when the valuer has a high degree of confidence in the accuracy and reliability of a single method given the facts and circumstances of the valuation engagement. However, valuers should consider the use of multiple approaches and methods and more than one valuation approach or method should be considered and may be used to arrive at an indication of value, particularly when there are insufficient factual or observable inputs for a single method to produce a reliable conclusion. Where more than one approach and method is used, or even multiple methods within a single approach, the conclusion of value based on those multiple approaches and/or methods should be reasonable and the process of analysing and reconciling the differing values into a single conclusion, without averaging, should be described by the valuer in the report.

It is important to note that cost does not necessarily equate to fair value, and management should apply appropriate valuation methodologies rather than relying solely on initial investment amounts (see Section 3.1).

Where information access is limited, management is encouraged to take steps, such as negotiating information rights upfront, seeking clarification through board representation or investor reporting channels, or engaging their own experts, to facilitate accurate financial reporting and the audit process.

Fair value measurements for unquoted equity investments that rely on significant unobservable inputs are categorised within Level 3 of the fair value hierarchy and involve a high level of estimation uncertainty. Auditors should consider this in their risk assessment and design of audit procedures.

3.1 Using Cost to Approximate Fair Value for Unquoted Equity Investments

FRS 109 / SFRS(I) 9[8] requires all equity investments that are within scope to be measured at fair value even if those instruments are not quoted in an active market. If the auditor observes that unquoted equity investments are recorded at cost, they should obtain an understanding of management's rationale for determining that the cost of investment approximates fair value at initial recognition and on the subsequent measurement date, and how management has complied with the requirements of the financial reporting standards[9]. Difficulties in obtaining the fair value of such investments do not provide a sufficient basis for measuring them at cost[10].

In limited circumstances, the cost of investment (i.e., entry price) may be considered an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range[11]. For example, an entity holds an unquoted equity investment in an early-stage startup[12] that has not generated any revenue and has no market transactions since the initial investment. Because the startup is in its infancy, there is insufficient observable data or financial

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[8] FRS 109 / SFRS(I) 9, *Financial Instruments*

[9] Under the IASB's *Basis for Conclusions to IFRS 9* (January 2022), paragraph BC5.18 notes that "*circumstances in which cost might be representative of fair value would never apply to equity investments held by particular entities such as financial institutions and investment funds*." While narrow exceptions where cost may approximate fair value could exist, such situations would be rare and require careful assessment of whether sufficient basis exists to support such exceptions.

[10] Para 3 of the IFRS Foundation's educational material (see footnote 3) emphasises that "*An entity can comply with the measurement objective in IFRS 13 even when limited information is available. Although an ownership interest in another entity presumes the availability of some financial and other information about the investee, including publicly available information, it is occasionally the case that such information is incomplete or out of date.*" The education material includes examples that illustrate how, despite an investor having limited financial information, the fair value of an unquoted equity instrument can nevertheless be measured by applying the valuation techniques described.

[11] FRS 109 / SFRS(I) 9 para B5.2.3

[12] It should not be assumed that the use of cost as an estimate of fair value is automatically appropriate because an investee is a start-up or early-stage entity. The determination of fair value requires an assessment of all relevant facts and circumstances at the measurement date.

For start-ups, there may be observable indicators that could affect fair value, such as:
- Achievement or failure of key development or commercial milestones;
- Transactions involving comparable companies or investments; and
- Market developments affecting the sector or business model.

When a start-up performs in line with its original plans, for example, by launching a new product as expected, this may lead to a significant increase in fair value because uncertainty over those events has been removed. Accordingly, cost may not be an appropriate estimate of fair value even in the absence of major deviations from plans.

information to support a reliable valuation. Valuation models produce a wide range of possible outcomes due to significant uncertainty about future performance and timing of cash flows. Given this lack of reliable inputs and the absence of more recent transaction data, the investment cost may be considered an estimate of fair value until further information becomes available. However, it is important to remain mindful of indicators that cost might not be representative of fair value, as discussed further below.

While cost may serve as a reasonable starting point in estimating the fair value of unquoted equity instrument in limited circumstances, management should take steps to ensure that the cost represents the fair value of the equity instrument at initial recognition in accordance with FRS 113 / SFRS(I) 13 and that management has incorporated all reasonably available information about the investee's performance and operations from the date of initial recognition up to the measurement date.

Management can do so by establishing a due process and conducting sufficient evaluation, including ensuring that indicators signalling that cost might not be representative of fair value at the measurement date are not present. In assessing management's evaluation, the auditor should look out for indicators included in the following non-exhaustive list:

(a) a significant change in the performance of the investee compared with budgets, plans or milestones (for e.g. the investee's progression through the business cycle, such as, moving from an early-stage, pre-revenue phase to a commercial stage).
(b) changes in expectation that the investee's technical product milestones will be achieved.
(c) a significant change in the market for the investee's equity or its products or potential products.
(d) a significant change in the global economy or the economic environment in which the investee operates.
(e) a significant change in the performance of comparable entities, or in the valuations implied by the overall market.
(f) internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.
(g) evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties[13].

In cases where such factors exist, they may indicate that cost might not be representative of fair value and management must measure the investment at fair value[14].

If management is unable to provide their assessment or the auditor is unable to obtain sufficient appropriate audit evidence that cost might not be representative of fair value, the auditor shall evaluate the implications for the audit or the auditor's opinion on the financial statements in accordance with SSA 705 (Revised)[15].

[13] Indicators (a)–(g) can be found under FRS 109 / SFRS(I) 9 para B5.2.4. Para 29 of the *IFRS Foundation's educational material* also highlights that "an investor must consider the existence of factors such as whether the environment in which the investee operates is dynamic, whether there have been changes in market conditions, or the passage of time itself. Such factors might undermine the appropriateness of using the transaction price (the cost) as a means of measuring the fair value of unquoted equity instruments at the measurement date.

[14] FRS 109 / SFRS(I) 9 para B5.2.5.

[15] SSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

3.2 Using Net Asset Value to Approximate Fair Value for Unquoted Equity Investments

Under FRS 113 / SFRS(I) 13, net asset value (NAV) is not a valuation technique in itself and its use as an approximation of fair value should be carefully assessed[16].

When determining the fair value of unquoted equity investments such as non-controlling interests in funds and unit trusts, management ordinarily relies on the NAV reported in a NAV statement provided by the intermediary. If the NAV reported is derived from the underlying fair value of investments held by the funds or unit trusts, it may serve as an appropriate starting point for estimating fair value in accordance with FRS 113 / SFRS(I) 13[17].

To determine whether the NAV is a reasonable and appropriate estimate of fair value, management should evaluate whether adjustments are necessary to reflect an exit price from the perspective of market participants. The following factors (which are not exhaustive) may indicate that an adjustment to NAV is required:

- Significant time has elapsed between the measurement date of the fund NAV or the date of the most recent redemption made at NAV and the reporting entity's measurement date. This would be further exacerbated by:
  - the fund making subsequent investments or achieving realisations;
  - the reporting entity becoming aware of subsequent changes in the fair value of underlying investee companies;
  - subsequent market changes or other economic conditions changing to impact the value of the fund's portfolio;
- Information from an orderly secondary transaction if sufficient and transparent;
- The appropriate recognition of potential performance fees or carried interest in the fund NAV;
- Waived management fees included in NAV;
- Impact of claw back provisions;
- Any features of the fund agreement that may affect distributions, but which are not captured in the NAV;
- Materially different valuations by different general partners (GPs) for common companies and identical securities;
- Any other facts and circumstances which might impact underlying fund value; and
- Applying non-controlling interest discount when measuring the fair value of a non-controlling equity interest if the investor has concluded that there is a benefit associated with control.

4. Valuation of Unquoted Equity Investments

4.1 Equity investments in private companies that do not give rise to control or significant influence

For non-controlling shareholding in private companies, management may either perform an internal valuation or engage an external valuer to perform the valuation. In testing how management has determined the valuation of the unquoted equity investment, auditors should

[16] Para 20 of the *IFRS Foundation's educational material* states that the adjusted NAV method is not categorised within any of the three valuation approaches outlined in FRS 113 / (SFRS (I) 13, *Fair Value Measurement*, because the application of this method often involves the simultaneous use of various valuation techniques. See para 125–129 further information on this valuation approach. Section 4.2 of *IPEV Valuation Guidelines* also contains guidance on this valuation approach.

[17] When assessing the fair value of investments in funds with multiple share classes, it is important to consider the unit of account. For example, the NAV for each share class may differ from the NAV of the entire fund, particularly if the classes have distinct rights or priorities (for example, voting rights, dividends, or liquidation preferences). Therefore, the NAV for each class of shares may need to be evaluated separately, rather than relying solely on the NAV of the entire fund, to ensure that the fair value estimation reflects the specific rights associated with each class.

consider performing a walkthrough of management's processes around valuations. Specifically, auditors should obtain sufficient appropriate audit evidence regarding the risks of material misstatement relating to the selection and application of the methods, significant assumptions, and the data used by management in the accounting estimate, and how management selected the point estimate and developed disclosures about estimation uncertainty, with the overall objective of determining whether the valuation and related disclosures in the financial statements are reasonable in the context of FRS 113 / SFRS(I) 13.

Below are some considerations for the auditor's assessment:

- **Valuation method[18]** – The auditor should evaluate whether the valuation method selected by management is appropriate in the context of the FRS 113 / SFRS(I) 13 and whether the judgements made in selecting the method give rise to indicators of possible management bias.

  FRS 113 / SFRS(I) 13 does not contain a hierarchy of preferred valuation techniques nor does it prescribe the use of a specific valuation technique for meeting the objective of a fair value measurement. However, FRS 113 / SFRS(I) 13 acknowledges that, given specific circumstances, one valuation technique might be more appropriate than another. Some of the factors that an investor will need to consider when selecting the most appropriate valuation technique(s) include (this list is not exhaustive)[19]:

  - the information that is reasonably available to an investor;
  - the market conditions (i.e. bullish or bearish markets might require an investor to consider different valuation techniques);
  - the investment horizon and investment type (for example, the market sentiment when measuring the fair value of a short-term financial investment might be better captured by some valuation techniques than by others);
  - the life cycle of an investee (i.e. what may trigger value in different stages of an investee's life cycle might be better captured by some valuation techniques than by others);
  - the nature of an investee's business (for example, the volatile or cyclical nature of an investee's business might be better captured by some valuation techniques than by others); and
  - the industry in which an investee operates.

  In addition, specific characteristics of the investee's capital structure may influence how the valuation method should be applied. For example, where the investee company has multiple classes of shares with different rights and preferences, such as liquidation preferences, anti-dilution rights or participation rights, the auditor should consider whether the selected valuation method appropriately reflects these rights through a reasonable allocation of the total equity value to the respective share classes.

  Ultimately, the valuation method should reflect how market participants would price the asset, using information that are reasonably available in accordance with FRS 113 / SFRS (I) 13.

[18] Refer to requirements under SSA 540 (Revised) para 23. In evaluating the valuation method, IVS 105 *Valuation Approaches and Methods* may provide guidance on the consideration to the relevant and appropriate valuation approaches.

[19] Para 18 of *IFRS Foundation's educational material*

Other considerations when assessing the valuation method include:

- o Where there has been a change in valuation method applied since the last valuation, the auditor should also consider if such a change is reasonable and supportable by the circumstances (for e.g. based on new information available). Arbitrary changes result in inconsistent financial statements over time and may give rise to financial statement misstatements or may be an indicator of possible management bias.

- o When management has determined that different methods result in a range of significantly different estimates, the auditor should understand how management has investigated the reasons for these differences.

As valuations typically involve models and spreadsheets, the auditor's further audit procedures should also address whether the calculations are applied in accordance with the method and are mathematically accurate.

- **Significant assumptions[20]** – Significant assumptions in the context of SSA 540[21] refer to those where a reasonable variation in the assumption would materially affect the fair value.

  Auditors should also evaluate whether significant assumptions are appropriate in the context of FRS 113 / SFRS(I) 13, whether the judgement applied in selecting significant assumptions gives rise to indicators of possible management bias, and whether the significant assumptions are consistent with related assumptions and aligned with the specific facts and circumstances of each investment. For example, changing assumptions year on year, such as adjusting the peer group by selecting higher-value peers or switching from using the median to the average within a range of valuation multiples, because it results in a value that is more beneficial to the entity, may indicate potential bias or inconsistency.

  Where valuations involve significant assumptions, sensitivity analyses may be necessary to show how variations in these assumptions could impact the valuation outcome.

  Income approach

  Under this approach, entities estimate the future expected cash flows of an investee. For practical purposes, when an investee is expected to have an indefinite life, most models estimate cash flows over a discrete forecast period, typically extending until the company reaches a stable or mature state, and then estimate a terminal value using either a constant growth model, a discount rate applied to the cash flow immediately following the end of the discrete period or an exit multiple.

  Significant assumptions used in the estimation may include, but are not limited to, financial performance, market conditions, growth projections, risk premiums, estimates and timing of future cash flows and discount rates.

  When the significant assumptions used inherently have a high level of estimation uncertainty, such as those related to financial performance, market conditions, or growth projections, or when they involve unobservable inputs and are therefore difficult for management to develop, such as forward-looking financial metrics, including but not limited to forecasted earnings before interest, taxes and amortisation (EBITDA), revenue growth in early-stage or start-up entities, or discount rates used for entities operating in volatile markets, it may indicate that the estimate of fair value is subject to a high degree

[20] Refer to the requirements under SSA 540 (Revised) para 24.

[21] SSA 540 (Revised) para A42.

of estimation uncertainty. The auditor's procedures should then address whether management has taken appropriate steps to understand and address the estimation uncertainty by selecting an appropriate point estimate from reasonably possible measurement outcomes and by providing related disclosures about estimation uncertainty[22].

Market approach[23]

When market approach is adopted, there could also be significant judgement related to the use of comparables and related adjustments to reflect the characteristics of the investment, which may lead to a high degree of estimation uncertainty:

- Selection of comparable companies or transactions – including similarity in terms of industry, size (in terms of revenue, assets etc), growth profile, diversity of product ranges, diversity and quality of customer base, profitability and market conditions, level of borrowing (particularly when earnings or revenue multiples are used[24]) and their locations (for example, where comparable company peers from developed markets are used in the valuation of investees in emerging markets).

- Selection of inputs from a range of data from comparable company transactions – including whether management has applied a justifiable methodology in their selection process.

- Adjustments for illiquidity – including whether a discount for lack of marketability has been applied when using public market comparables to value a private investment. The expected method of exit may influence the magnitude of illiquidity adjustments, as different exit routes have varying degrees of marketability constraints and transaction costs.

- Application of control premium / minority discount – including whether a control premium should be applied where the investor holds or would obtain a controlling interest, or whether a discount for lack of control should be applied where a minority interest is held.

- Timing and substance of recent transactions – including evaluating whether the transaction was conducted at arm's length, the timing relative to the valuation date, and whether the terms reflect fair value.

- Changes in investor rights or structure – including evaluating how changes in the rights of investors (for example, preferential treatment for new investors, dilution of existing investors, or changes in control) can lead to significant adjustments or estimation uncertainty in the comparables and impact the overall valuation.

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[22] SSA 540 (Revised) para 16a, A72, 26, A109–A114.

[23] Recent transaction price should not be considered a standalone valuation technique. Refer to Section 3.10 of *IPEV Valuation Guidelines* for guidance on calibrating to the price of a recent investment.

[24] How this may be done in practice:
1) Select the performance measure that is most relevant to assessing the value for the investee (i.e. the performance measure that market participants would use to price the investee). This would typically be by reference to measures of, for example, earnings, book value of equity or revenue.
2) Once the performance measure is selected, derive and analyse possible valuation multiples and select the most appropriate one. Apply the appropriate valuation multiple to the relevant performance measure of the investee to obtain an indicated fair value of the investee's equity value or the investee's enterprise value (EV).

As mentioned above, the auditor's procedures should similarly address whether management has taken appropriate steps to understand and address the estimation uncertainty by selecting an appropriate point estimate from reasonably possible measurement outcomes and by developing related disclosures about estimation uncertainty[22].

- **Data**[25] – The auditor should assess the reliability and relevance of the data used in the valuation:

  - **Reliability of data used**: The auditor should consider whether the data is sufficiently reliable for the auditor's purpose. In order for the auditor to obtain reliable audit evidence, information produced by the entity that is used for performing audit procedures needs to be sufficiently complete and accurate. For example, if a historical EBITDA multiple is used in the market approach, the auditor should cross-check the EBITDA figures against the investee's audited financial statements and the EBITDA multiples used against independent and reputable databases or industry reports.

  - **Relevance of data used**: The data used should reflect current market and industry conditions, as well as the specific circumstances of the asset and not be selectively chosen to support a favourable conclusion for management.

Further considerations

- **Evaluate the work of management's expert**[26] – Where management's expert is used, the auditor should evaluate the competence, capabilities and objectivity of that expert, obtain an understanding of the work of that expert and evaluate the appropriateness of that expert's work as evidence for the relevant assertion (valuation)[27].

- **Engage the auditor's expert**[28] – When a significant risk of material misstatement is identified regarding the fair value of an unquoted investment, the auditor may need to engage the assistance of an expert to obtain sufficient appropriate audit evidence on the reasonableness of the fair value estimate. Factors that may contribute to the auditor's determination of whether to use the work of an auditor's expert include:

  - Valuation complexity beyond the auditor's expertise, requiring specialised skills, knowledge and experience. This may be the case for funds investing in complex derivatives or structured products with valuations involving complex financial modelling.

  - Significant judgement requiring specialised skills, knowledge and experience (e.g. in products, industry or valuation) in addressing whether management's valuation method or significant assumptions or data used are appropriate in the context of FRS 113 / SFRS(I) 13 due to high degree of estimation uncertainty regarding the valuation

[25] Refer to requirements under SSA 540 (Revised) para 25 and A44.

[26] Refer to requirements under SSA 500, *Audit Evidence* para 8.

[27] Refer to requirements under SSA 540 (Revised) para 30. In the evaluation, the auditor should consider whether the valuation was conducted independently by qualified and competent valuation professionals, including considering the valuers' track record in any questionable past transactions as well as the valuers' credentials. Such considerations include whether the valuers are members of a professional business valuation body or authority, such as whether they are registered with IVAS as a Chartered Valuer and Appraiser, and have the relevant experience in performing valuations for the assets under consideration. The auditor should also consider if the valuation is performed in line with recognised valuation standards, such as the IVS.

[28] For audit requirements relating to the auditor's expert, refer to SSA 620, *Using the Work of an Auditor's Expert*. When an auditor's expert is involved, it is important to clearly define the scope of the expert's work. For example, if the auditor's expert does not cover business assumptions used in the valuation, the audit engagement team would need to perform the necessary work in those areas.

of investments or where the range of possible fair values is very wide relative to the materiality threshold. This may be the case for funds investing in early-stage start-ups with limited financial history or observable market data.

- **Consideration of contrary evidence** –The auditor is required to evaluate whether sufficient appropriate audit evidence has been obtained by taking into account all relevant evidence obtained, whether corroborative or contradictory. While not required to perform an exhaustive search for contrary evidence, contrary evidence affecting valuations may be identified in market fluctuations, regulatory changes, or significant news about the investee. For example, the auditor may perform market sentiment analysis on portfolio companies or the relevant industry, and review for any adverse news or significant positive developments that could influence fair value assessments.

- **Performing analytical procedures** – Analysis of the fair value changes from prior year can provide insights into the underlying factors driving valuation movements and help identify unusual fluctuations.

4.2 Investments where information on valuation is provided by intermediaries[29]

(a) When NAV represents fair value

When management assessed that the NAV reported by intermediaries in their NAV statements represents fair value in accordance with FRS 113 / SFRS (I) 13 (see Section 3.2), the auditor, in applying SSA 500[30], shall consider the relevance and reliability of the NAV statements before relying on them as audit evidence. Some of the factors for consideration may include:

- **Appropriateness of the data used** - The NAV is typically derived from the underlying fair value of investments held by the funds or unit trusts which the auditor can check against the fund's or unit trust's audited financial statements (if available) to look out for any modifications or disclaimers of audit opinion that could materially affect fair value. Consideration should also be given to contingent liabilities that may have a material effect on fair value.

  If the audited financial statements are not available at the time of the audit and the auditor intends to rely on the unaudited financial statements, additional procedures may include retrospective review, for example, comparison of prior year unaudited and audited NAV to identify if any significant adjustments were made, or whether past redemptions are comparable with unaudited NAV figures.

- **Competence and reputation** of the intermediary, **past experience** of the auditor and **evidence of general market acceptance by users** of the reliability of the NAV statement. This may include information about the intermediary's qualifications or other forms of external recognition, and whether the intermediary's work is subject to any technical performance standards or professional or industry requirements, accreditation standards or requirements imposed by law or regulation. In addition, the auditor should consider the objectivity of the intermediary, such as when the intermediary is also the counterparty to the investment and whether this could affect the reliability of the valuation.

[29] The term "intermediary" is used broadly in this AB. In practice, multiple layers of intermediaries may be involved. For example, a bank provides fair value information in its bank statement, which is extracted from reports or statements from other intermediaries, such as custodians. These custodian reports, in turn, are based on data provided by the counterparty to the investment. Hence, management should consider whether it is necessary to trace the information back to its original source when relying on the valuation provided by the intermediary to record the fair value in the financial statements. Management should also ensure that the dates of the information sources relied by the intermediary is the same as the financial reporting date.

[30] SSA 500, *Audit Evidence* para 7

- The nature and extent of **disclaimers or other restrictive language** in the NAV statement.

- Whether **management has any processes in place** to review the intermediary's work in relation to the reliability of the NAV statement produced by the intermediary. This may include review mechanisms such as oversight by an investment or risk committee. If the intermediary is a service organisation[31], a Type II System and Organisation Controls (SOC) report or other similar assurance report can provide assurance over the operating effectiveness of controls.

External Confirmation Procedures to Obtain Audit Evidence[32]

In certain circumstances, depending on the risks of material misstatement, the auditor may seek external confirmation directly from intermediaries to obtain evidence regarding the accuracy and completeness of the NAV statements and/or the existence and completeness of those investments. The external confirmation may also include confirmation of any material events, outstanding contingencies, pending litigation and claims etc. that may affect the NAV of the funds or unit trusts. When external confirmations are obtained as audit evidence, the auditor should assess the relevance and reliability of the results of the confirmation as audit evidence, in accordance with SSA 505[33].

(b) When NAV does not represent fair value and adjustments are needed

After receiving the NAV statements from the intermediaries, management may determine that adjustments to NAV are necessary to estimate the fair value of the investments in the funds and unit trusts *(see adjustment factors to NAV in Section 3.2 above).* Management may either perform an internal valuation or engage an external valuer. Please refer to Section 4.1 above for further considerations.

Investments that have characteristics indicating higher valuation risk include, but are not limited to, multi-layered structures such as funds-of-funds, closed-end funds with limited liquidity and funds that invest in complex asset portfolios. These characteristics add complexity to the valuation process and warrant heightened audit attention.

5 Obtaining Audit Evidence from Events Occurring up to the Date of the Auditor's Report[34]

The auditor's further audit procedures may include obtaining audit evidence from events occurring up to the date of the auditor's report. Where applicable, the auditor may consider the impact of subsequent events and whether they indicate the need for adjustments to the fair value or further disclosures.

6 Developing Auditor's Point Estimate or Range[35]

SSA 540 (Revised) emphasises that accounting estimates are ultimately the responsibility of management and the auditor's role is to obtain sufficient appropriate audit evidence about whether the accounting estimates and related disclosures in the financial statements are

[31] For relevant audit considerations, refer to SSA 402, *Audit Considerations Relating to an Entity Using a Service Organisation*.

[32] Refer to Illustration 3 of AB 7: *Considerations over External Confirmation Procedures* for specific considerations.

[33] SSA 505, *External Confirmations*

[34] SSA 540 (Revised) para 18

[35] Refer to paragraphs 27 – 29 of SSA 540 (Revised) for related requirements. Paragraph A118 provides examples of when this may be necessary to address estimation uncertainty.

reasonable in the context of the applicable financial reporting framework (i.e. FRS 113 / SFRS(I) 13). While it is not always necessary for the auditor to develop their own point estimate or range, this will be required, to the extent practicable, when management has not taken appropriate steps to understand or address estimation uncertainty and has not sufficiently responded to the auditor's request to address the estimation uncertainty[36].

In considering whether it is practicable to develop a point estimate or range, the auditor should also take into account whether doing so would risk compromising independence requirements and relevant ethical requirements that prohibit the auditor from assuming management responsibilities. If, after considering management's responses, the auditor determines that it is not practicable to develop an auditor's point estimate or range, the auditor is required to evaluate the implications for the audit or the auditor's opinion on the financial statements in accordance with SSA 705 (Revised).

This approach to develop a point estimate or range may also be appropriate when management controls over the estimation process are not expected to be effective based on past review of similar accounting estimates in the prior period financial statements or when those controls are not properly designed or implemented.

Auditors should consider engaging an expert to explore the feasibility of developing the auditor's point estimates or ranges, considering the factors such as the availability of information that would be needed to derive the fair value.

7. Overall Evaluation Based on Audit Procedures Performed

If sufficient appropriate audit evidence cannot be obtained despite the auditor's attempts to obtain an understanding of management's and / or the intermediary's assumptions or methodology, or perform other procedures to respond to the risks of material misstatement, such as developing a point estimate or range to evaluate management's point estimate[37], the auditor should consider if there is a limitation of scope to the audit and assess the impact on the audit opinion in accordance with SSA 705 (Revised).

[36] SSA 540 (Revised) para 27(b)

[37] SSA 540 (Revised) para 33 – 35.

Appendix: Examples of Investments Misclassified as Equity

Investments are sometimes incorrectly classified as equity instruments in scope of FRS 109 / SFRS (I) 9, which can lead to the misapplication of measurement and disclosure requirements.

Some examples of such misclassification include:

- Fixed-term investments, such as fixed term equity instruments (for example, funds structured as equity but with a limited life) or debt instruments that do not meet the definition of equity instruments[38] (for example, bonds, money market funds or debt securities) are sometimes wrongly classified as equity investments. These instruments represent contractual rights to deliver cash or another financial asset to another entity and do not grant ownership interests. Therefore, they should be assessed based on their contractual cash flow characteristics and the business model under which they are held.

- An investment may qualify as an associate following a step-up acquisition, where an increase in ownership results in the investor gaining significant influence and where the exemptions from application of the equity method does not apply. In such cases, the investment should be accounted for under FRS 28 / SFRS(I) 1-28[39], rather than an equity instrument under FRS 109 / SFRS(I) 9[40]. Incorrect classification may result in the inappropriate use of fair value measurement when the equity method should be applied instead. Similar considerations apply to other investments that fall within the scope of financial reporting standards other than FRS 109 / SFRS(I) 9.

Depending on the assessed risk of misstatement associated with misclassification, auditors are reminded to review management's classification of investments carefully, considering factors such as the contractual terms, cash flow characteristics, the entity's business model for managing the investment, indicators of trading intent, relative rights and obligations and other interests in the investee. Auditors are also reminded that proper classification is essential to ensure accurate measurement and disclosure in accordance with applicable standards.

[38] Refer to FRS 32 / SFRS(I) 32, *Financial Instruments: Presentation*

[39] FRS 28 / SFRS(I) 1-28, *Investments in Associates and Joint Ventures*.

[40] However, when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, in accordance with paragraph 18 of FRS 28 / SFRS(I) 1-28, the entity may elect to measure that investment at fair value through profit or loss in accordance with FRS 109.

For reference: ISCA Auditing and Assurance Pronouncements and Publications

The table below summarises the formal categorisation, degrees of authority and due process for issuance of ISCA's auditing and assurance standards and guidances. This provides credence to ISCA's technical content, promulgates ISCA's views on the application of auditing and assurance standards as well as promotes best practices and consistency in auditing and assurance.

Category	Nature	Degree of authority	Due Process	Highest level of approval
1. a) Singapore Standard on Auditing (**SSA**) b) Singapore Standard on Assurance Engagements (**SSAE**) c) Singapore Standard on Review Engagements (**SSRE**) d) Singapore Standard on Related Services (**SSRS**) e) Singapore Standard on Quality Control (**SSQC**) f) Statement of Auditing Practice (**SAP**)	Authoritative pronouncements	Required to comply	Public consultation required	ACRA's Public Accountants Oversight Committee
2. a) Audit Guidance Statement (**AGS**) b) Singapore Auditing Practice Note (**SAPN**)	Provide interpretive and practical guidance to auditors Non-authoritative	Expected to apply or explain departures	Public consultation required	ISCA Council
3. Audit Bulletin (**AB**)	Informative / educational publications to highlight pertinent topical issues to auditors Non-authoritative	For information and educational purposes	Public consultation not required	ISCA AASC