September 18, 2002

Technical Director
International Federation of Accountants
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Subject:  Exposure Draft “Auditing Fair Value Measurements and Disclosures.”

Dear Sir/Madam,

In response to your request for comments, I am pleased to transmit on behalf of the International Actuarial Association (IAA), a final version of our comments on the Exposure Draft entitled “Auditing Fair Value Measurements and Disclosures.” The only difference between this version and the draft version sent to you on 15 January is an editorial clarification of our comments regarding paragraph 56 of the Exposure Draft.

The International Actuarial Association (IAA) is the organization representing professional actuarial associations internationally. We are not a trade association and we do not represent the interests of either clients or employers. As actuaries, we have developed significant experience and expertise in the assessment of the value of contingent cash flows. Using this experience, actuaries hope, as a profession, to continue to provide assistance to those involved in the enhancement of the standards of accounting on an international level, through the development of objective and meaningful standards which will command respect from users of financial statements. We stand willing to provide assistance deemed appropriate in the furtherance of this objective.

We encourage the pursuit of the overall objectives as set forth in this paper and believe that the final version of this Exposure Draft represents a reasonable approach to this important auditing issue. We hope that our comments were of value and we look forward to providing further assistance to the IFAC in the future.

These comments were prepared by a committee of the IAA, the members of which are listed in the submission by name and association, and were approved by the Full Member associations of the IAA listed in Appendix 1, as part of our due process procedures.

Yours sincerely,

Edward J. Levay, FIA
President

attachment
International Actuarial Association  
Comments on the Proposed International Standard on Auditing on  
*Auditing Fair Value Measurements and Disclosures*  
Prepared by the International Auditing Practices Committee of  
the International Federation of Accountants  

**THE INTERNATIONAL ACTUARIAL ASSOCIATION**  
The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our forty-five Full Member actuarial associations represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact upon the areas of expertise of actuaries.  

The IAA appreciates this and other opportunities to provide input to and assistance in the development of accounting standards. We commend the continuing efforts of the IFAC to enhance the accounting and auditing standards of the public sector.  

**DUE PROCESS**  
This is the final version of the IAA’s comments that was been prepared by the Insurance Accounting Standards Committee of the IAA, the members of which are listed below by name and association. The Full Member associations of the IAA are also listed below (in an Appendix to this statement).
MEMBERS OF THE
INSURANCE ACCOUNTING COMMITTEE OF THE IAA

Sam Gutterman (Chairperson)
Francis Ruygt (Co-Vice-chairperson)
Paul McCrossan (Co-Vice-chairperson)
Clive Aaron Institute of Actuaries of Australia
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Dan Barron Israel Association of Actuaries
Ralph Blanchard Casualty Actuarial Society
Guy Castognoli Association Suisse des Actuaires
Morris W Chambers Canadian Institute of Actuaries
Paolo De Angelis Istituto Italiano degli Attuari
Mariano Gongora Roman Instituto de Actuarios Españoles
Eva Gustafson Svenska Aktuarieföreningen
Steve Handler Actuarial Society of South Africa
Eckhard Hütter Deutsche Aktuarvereinigung e.V.
Tony Jeffery Society of Actuaries in Ireland
Liyaquat Khan Actuarial Society of India
Ad Kok Het Actuarieel Genootschap
Jean-Pierre Lassus Institut des Actuaires
Won How Lo Actuarial Institute of the Republic of China
Jose Manuel Mendez Colegio Nacional de Actuarios A.C.
Bruce D. Moore American Academy of Actuaries
Craig Murison Faculty of Actuaries
Markku Paakkanen Suomen Aktuaariyhdistys
Richard S Robertson Society of Actuaries
Bjarni Thordarson Félag Islenskra Triggingastærdfraændinga
Wilma Torres Instituto Brasileiro de Atuária
Gérard Vandenbosch Association Royale des Actuaires Belges
Robert E Wilcox Conference of Consulting Actuaries

Overall, we believe that the Exposure Draft on Auditing Fair Value Measurements and Disclosures (“Exposure Draft”) prepared by the International Auditing Practices Committee provides excellent guidance for the auditor and a good context toward which other related professionals can look in conjunction with the ever-increasing use of fair values in financial statements of companies around the world. However, there are several specific areas in which further clarification or change might be appropriate. The following identifies the most significant ones (note that several are simply editorial suggestions).

1. **Scope and entity-specific values.** We recommend that IFAC consider discussing the applicability of this standard to what has been referred to as “entity-specific” values. We believe that the concepts included here apply equally to the entity-specific case. The recognition and measurement of these values are being considered by the IASB Insurance project and have been addressed by the ‘value in use’ methods in the UK. This might be discussed in the introduction and in Appendix 1 of the Exposure Draft. We note that there is already some discussion of the entity-specific case, e.g., in paragraph 7.
2. **Paragraphs 14 and 53.** Although a minor point, we note that the words “assess” and “evaluate” are used in paragraphs 19 and 53, respectively. We are uncertain as to whether there is a difference in guidance meant by these words. If it is intended that these words carry the same meaning, then it might be preferred to use the same word. Conversely, if it is intended that they indicate different concepts, then it would be useful to explain the difference.

3. **Paragraph 15.** For clarity, we suggest that in the third sentence the first “of” be replaced with “that” and “resulting” be replaced with “will result”.

4. **Paragraph 18.** The guidance provided appears to be incomplete. Although in certain cases reliable methods to measure a fair value may not be appropriate or workable, if the value cannot be quantified and it is potentially material, this fact should be disclosed.

5. **Paragraph 19.** Although paragraph 20 discusses both intent and ability to carry out specific relevant courses of action, paragraph 19 only refers to intent. It would be appropriate that both concepts be mentioned in paragraph 19. We note that it might enhance the discussion in paragraph 20 to provide an example of “ability” to pursue a specific course of action.

6. **Paragraphs 21-23.** The acceptability of the method used is determined by whether the “basis of measurement is reasonable.” Although we do not disagree with the general description used (it could be more precisely stated in terms of being reliable and relevant), it might be more appropriate to refer to the reasonableness of both the method and the results achieved by its application, rather than just the method itself. We are familiar with several measurement methods which, although in concept they should produce reasonable results when applied, do not.

7. **Paragraphs 23 and 46.** We believe that it would be more appropriate to use “significant” and “significantly” rather than “wide” and “widely.” We are not at all certain of the relevance of the latter pair of words in the auditing context.

8. **Paragraph 23.** Appropriate disclosure of the case in which “different valuation methods indicate widely different conclusions” should be referenced in either paragraphs 23 or in the disclosure section, paragraphs 53-57.

9. **Paragraphs 24-25.** We suggest that the intent of these two paragraphs be clarified to indicate that they refer to both consistency over time and consistency of the valuation of different measurements and disclosures at the same time. Paragraph 25 focuses on the change in methods over time, rather than consistency of the method applied to different items at the same time. In addition, in certain circumstances it may be appropriate to be inconsistent at different points in time if a change in circumstance justifies it. This may not imply that the previous method used is unreasonable; but rather, that a more preferable one has become available or is more appropriate at the time of the current valuation. Blind consistency is not a desirable characteristic of accounting values.

10. **Paragraphs 26-30.** Consideration should be given to moving the section on “Using the Work of an Expert” prior to paragraph 14, as the discussion of the use of an expert follows from an understanding of the internal controls applied.
11. **Paragraph 29.** In the first sentence, it may be more appropriate to indicate that the auditor should consider whether the expert’s understanding of the definition of fair value or method to be used differs from that of the requirements of the applicable financial reporting framework, either in addition to or rather than, that of management. As well, guidance might be provided to deal with the circumstance under which these understandings differ.

12. **Paragraph 30.** Although it is important for the auditor to understand the significant assumptions and methods used, this understanding needs to be supplemented by an understanding of the reasonableness of the effect of the assumptions and methods (see paragraph 40). We also do not understand the value of the reference to “complete” and suggest that this either be clarified (i.e., is this with respect to the consideration of each and every relevant and significant assumption?) or be eliminated.

Although mentioned elsewhere, it would be of value to repeat here that the auditor should also assess that the assumptions and methods are consistent with the definition and method to be used to measure fair values. In particular, where the expert is subject to a set of professional standards, the auditor should seek a written opinion from the expert that the work has been done in accordance with those standards. Nevertheless, even in such case, the auditor should personally satisfy him/herself that such standards have been followed.

13. **Paragraph 33 (a).** It is unclear as to the intent of the reference to assumptions here. Does it mean “significant” as compared to “not significant” assumptions? We believe that it would clarify the intent of (a) if the expression “management has considered all significant assumptions” were used.

14. **Paragraph 33 (e).** We recommend revising the wording used to “management has used relevant and reliable information that was reasonably available at the time.” The requirement to confirm that such information was “best” can be at times quite difficult and burdensome to validate, may not be a particularly valuable conclusion, and might serve as a disincentive to develop more relevant information useful for this purpose. It might be desirable to include an encouragement that management seek relevant and reliable information that can support the measurement of fair values.

15. **Paragraph 41.** The criteria for determining which assumptions are significant should concentrate on the sensitivity of effect on fair value measurement rather than the sensitivity or the inconsistency of the assumptions themselves. For instance in (a), the sensitivity to variation or uncertainty is important only to the extent that this sensitivity will lead to a significant effect on the fair value measurement. In addition, we note that although it is appropriate to consider the inconsistency of current assumptions with historical experience or prior assumptions as a starting point in an analysis, in some cases, particularly in the situation of changed circumstances, forced consistency would lead to an inappropriate or unreasonable assumption. It is just as, if not more, important to focus on the changes in circumstances than on the inconsistency noted. We also suggest the addition of “(e): suitable in the context of the valuation methodology chosen.”

16. **Paragraphs 45-46.** We believe that the points made in paragraphs 45 and 46 overlap and the reference in the first sentence of paragraph 46 is confusing. We suggest that they be better tied together.
17. **Paragraph 56.** Although we recognize the importance of disclosure regarding uncertainty, in certain instances this can be problematic. In addition, there may not be sufficient guidance provided in this area; for example, no guidance has been provided on what should be done when management and the auditor disagree with respect to the extent of the range of probable values. In cases where there is great uncertainty about the fair value of an item, a statement about the range in which it is likely to lie (e.g., a confidence interval) may also be quite difficult to determine and to obtain audit evidence. A proper balance is needed in the assessment of the extent and nature of disclosures required.

In addition, we believe that a better approach to many types of uncertainty in the determination of fair values is through the use of a market value margin (i.e., adjustment for parameter risk) in the assumptions. Such a margin reflects the fact that in the real market, a greater uncertainty about a fair value most likely implies a greater likelihood that management would not be able to obtain their best estimate based value in disposing of the asset or the liability. For example, if the financial reporting framework for insurance contracts requires fair values, there can be significant uncertainty associated with a number of assumptions and values. For this reason what has been referred to as a market value margin would be appropriately included.

18. **Public sector perspective.** Although we recognize the issue addressed in paragraph 3, we would consider it more important that such determinations be made on the basis of the facts and circumstances of the item involved, rather than the sector involved.

19. **Public sector perspective, paragraph 3.** The reference should be to paragraph 8 and not to paragraph 7.

We would be pleased to provide the IFAC with elaboration or clarification of any of the comments we have presented. We are eager to provide continued objective assistance to the IFAC.
IAA FULL MEMBER ASSOCIATIONS

Full Members
Consejo Profesional de Ciencias Económicas de La Ciudad Autónoma de Buenos Aires (Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
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