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August 30, 2017

Ms. Phoebe W. Brown  
Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006-2803

Re: Proposed Auditing Standard – *Auditing Accounting Estimates, Including Fair Value Measurements*; Docket Matter No. 043

Dear Ms. Brown:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the Public Company Accounting Oversight Board’s proposed auditing standard, *Auditing Accounting Estimates, Including Fair Value Measurements*.<sup>2</sup> The ICI strongly supports the Board and its mission to oversee audits of public companies, including funds, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. Funds as investors—and investors in funds—rely upon audits to provide independent assurance that financial statements are fairly stated in conformity with generally accepted accounting principles.

The Proposal would replace three auditing standards on accounting estimates and fair value measurements with a single standard. The Proposal includes an appendix that addresses auditing the fair value of financial instruments, including the use of information from pricing services. The Proposal would also amend AS 1105, *Audit Evidence*, by adding an appendix that describes the auditor’s responsibilities for obtaining audit evidence where the fair value measurement of an investment is based on the investee’s financial condition or operating results (*e.g.*, investments in private placements).

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<sup>1</sup> The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US\$20.0 trillion in the United States, serving more than 95 million US shareholders, and US\$6.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> Proposed Auditing Standard, *Auditing Accounting Estimates, Including Fair Value Measurements and proposed Amendments to PCAOB Auditing Standards*, PCAOB Release No. 2017-002 (June 1, 2017) (the “Proposal”).

We commend the Board's approach to developing the Proposal. We believe the Pricing Sources Task Force, in which representatives from several mutual fund advisers participated, and the 2014 Staff Consultation Paper, *Auditing Accounting Estimates and Fair Value Measurements*, demonstrate a thoughtful and deliberative approach to standard setting. We have concerns, however, with the certain aspects of the proposed changes to AS 1105, *Audit Evidence*, as they relate to investment companies. We elaborate on these concerns below.

### *SEC Registered Investment Companies*

Fund investments in debt and equity securities are required to be measured at fair value.<sup>3</sup> Funds often rely on pricing services to obtain fair values for their investment securities for both daily net asset value calculation and financial reporting purposes. In certain circumstances funds may estimate the fair value of an investment based on the investee's financial condition or operating results. Accordingly, the Proposal is of considerable interest to funds.

Auditors to SEC-registered investment companies must independently verify 100 percent of the fair value measurements used by the fund at the balance sheet date.<sup>4</sup> Auditors typically obtain fair value measurements for the fund's securities from pricing services different than the pricing service used by the fund, or develop their own independent estimate. Such fair value measurements represent independent estimates and are used by the auditor to corroborate the fair value measurement used by the fund.

### *AS 1105, Audit Evidence*

Proposed Appendix A to AS 1105 would apply to situations in which the valuation of an investment selected for audit testing is based on the investee's financial condition or operating results. This could include, for example, investments in private placements where the fair value measurement is based on a multiple of revenue or earnings derived from the investee's financial statements. We offer the following comments on Appendix A.

1. Paragraph A2d would require the auditor to determine whether the investee's financial statements were audited under PCAOB standards, and whether the auditor's report expressed an unqualified opinion. We believe it is not uncommon for audits of private companies to be performed under AICPA standards and that audits performed under AICPA standards provide a level of assurance that is substantially similar to those performed under PCAOB standards. We therefore recommend that the Appendix acknowledge that audits of private company financial statements may be performed under AICPA standards and that such audits do not increase the risk of material misstatement or necessitate additional procedures to be performed by the investor's auditor.

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<sup>3</sup> See FASB ASC 946-320-35-1.

<sup>4</sup> See SEC Codification of Financial Reporting Policies Section 404.03, *Accounting, Valuation and Disclosure of Investment Securities*, Accounting Series Release No 118 (December 23, 1970).

2. Paragraph A3 lists procedures the auditor should perform where the valuation of an investment selected for audit testing is based on the investee's financial condition or operating results. Paragraph A3d indicates that if the valuation of the investment reflects factors other than the financial condition or operating results reported in the investee's financial statements, the auditor should perform procedures with respect to those factors. Factors may include, for example, multiples applied to the investee's revenues or earnings. The Proposal, however, does not describe the procedures to be performed with respect to the factors or multiples. We recommend that the Appendix describe the types of procedures the Board would expect the auditor to perform. Such procedures could include, for example, ensuring that peer companies used to develop multiples applied to the investee's revenues or earnings are appropriate comparisons, and that revenues or earnings for those peer companies are calculated in a similar fashion (*e.g.*, "adjusted earnings" versus earnings calculated pursuant to generally accepted accounting principles).
3. If the investee's audited financial statements are significant to the valuation of the investment, paragraph A4 would require the auditor to obtain and evaluate information about the professional reputation and standing of the investee's auditor, and obtain information about the procedures the investee's auditor performed and the related results, or review the audit documentation of the investee's auditor.

We are concerned that the proposed requirement to obtain information about the procedures the investee's auditor performed and the related results, or to alternatively review the investee auditor's audit documentation, may not be practical. Where the investor is a fund that invests in many different private placement securities, we believe the proposed requirement would add significantly to the work performed by the investor fund's auditor. We also question whether the investor fund's auditor would have access to the investee auditor's audit documentation as contemplated by the Proposal.

Instead, we recommend that the final standard enable auditors to apply a risk-based approach to determine whether they should obtain information about the procedures the investee's auditor performed. Under such an approach, the auditor could consider the size of the investment in relation to the risk of material misstatement of the investor's financial statements, and determine that obtaining information about the procedures performed by the investee's auditor is unnecessary. In lieu of obtaining that information, the auditor could instead examine management's process for determining that the information obtained from the investee's financial statements is reliable and can be used in its valuation model.

4. The note to paragraph A4 addresses investment company investments in other funds. The note indicates that, unless the investor fund's auditor has doubt about the investee fund's auditor, the investor fund's auditor may test the investor fund's procedures for understanding and assessing the investee fund's valuation process, rather than obtaining information about the audit of the investee fund or reviewing audit documentation.

We believe the approach described in the note is consistent with current practice relating

to audits of certain investment companies. We understand funds investing in unaffiliated funds typically obtain information about the investee fund's valuation process at the time of initial investment in an effort to understand the investee fund's valuation process and assess whether it complies with FASB ASC 946.

We note that the practical expedient at FASB ASC 820-10-35-59 enables a fund investing in a fund that does not have a readily determinable fair value<sup>5</sup> (e.g., a private fund) to value its investment at net asset value per share, provided the net asset value per share of the investee fund is calculated consistent with the measurement principles in FASB ASC 946.

We support the approach described in the note to paragraph A4 enabling the investor fund's auditor to test the investor fund's procedures for understanding and assessing the investee fund's valuation process. We recommend, however, that the note be clarified to indicate that it does not apply to fund investments in funds that have a readily determinable fair value. That is, where the investee fund is a mutual fund and the mutual fund's net asset value per share is published and is the basis for current transactions, then the practical expedient would not apply and the investee fund's financial statements would not be significant to the investor fund's valuation of its investment.

*AS 2501, Auditing Accounting Estimates, Including Fair Value Measurements*

The Proposal includes, as an appendix to AS 2501, requirements for determining whether pricing information obtained from third-party pricing sources, including pricing services and broker dealers, provides sufficient appropriate audit evidence. Paragraph A4c of the appendix indicates that the reliability of information obtained from a pricing service is dependent on, among other things, whether the pricing service has a relationship with company management whereby management is able to directly or indirectly control or significantly influence the pricing service.

An investment company that obtains prices from a pricing service may "challenge" a price provided by the service in instances when the fund believes that price does not reflect the current market. For example, the fund may provide information about a recent observable transaction in the particular security to the pricing service and request that the service update its price to reflect that information. We recommend that any final standard clarify that a price challenge by management based on substantive information that causes the pricing service to change its price is not deemed significant influence.

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<sup>5</sup> According to the FASB master glossary, the fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

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If you have any questions on our comments or require additional information, please contact the undersigned at 202-326-5851 or [smith@ici.org](mailto:smith@ici.org).

Sincerely,

A handwritten signature in black ink that reads "Gregory M. Smith". The signature is written in a cursive style with a large, prominent "G" and "S".

Senior Director –  
Fund Accounting & Compliance