



November 3, 2014

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

Re: Staff Consultation Paper, *Auditing Accounting Estimates and Fair Value Measurements*

Dear Ms. Brown:

The Independent Directors Council and the Investment Company Institute<sup>1</sup> appreciate the opportunity to comment on the Staff Consultation Paper, *Auditing Accounting Estimates and Fair Value Measurements* (“Staff Paper”). IDC and ICI strongly support the Public Company Accounting Oversight 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.

We commend the Board’s information gathering approach as it considers changes to audit standards relating to auditing accounting estimates and fair value measurements. We believe the Pricing Sources Task Force, on which representatives from several mutual fund advisers participated, provided valuable input to the Board regarding funds’ use of pricing vendors and the information those vendors make available to funds and auditors. Further, we believe that the Staff Paper, which describes several alternative

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<sup>1</sup> IDC serves the fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC’s activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the world’s leading association of regulated funds, 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 U.S. fund members manage total assets of \$17.2 trillion and serve more than 90 million U.S. shareholders, and there are approximately 1,900 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

approaches to possible standards changes, and the related Roundtable with the Standing Advisory Group evidence a thoughtful and deliberative approach to standard-setting.

The Staff Paper is of considerable interest to fund directors who are responsible for the valuation of the fund's securities<sup>2</sup> and fund adviser personnel who make the day-to-day valuation determinations. Fund audit committee directors are responsible for overseeing the fund's financial reporting process and the audit of the fund's financial statements. Given that substantially all of an investment company's assets are comprised of investment securities, auditing fair value measurements is of paramount importance to ensuring that the fund's audited financial statements fairly present the fund's results and financial position.

We have concerns that the Staff Paper suggests a change from the current risk-based approach to planning and performing audits, and a change from the way audit firms use national level pricing groups to support audit engagement teams. We believe these changes would result in a substantial increase in the audit procedures to be performed on audit evidence obtained from third-party pricing sources, but that such increase would not necessarily improve audit quality or the level of assurance provided. We also encourage the PCAOB, as it considers changes to its audit standards, to take into account the unique nature of investment companies. We elaborate on these points below.

#### *Risk Based Testing Approach*

Auditors to SEC-registered investment companies typically obtain fair value measurements for the fund's securities from third-party pricing vendors different than the pricing vendor used by the fund.<sup>3</sup> Such fair value measurements represent independent estimates which are used by the auditor to corroborate the fair value measurements used by the fund.

Consistent with the PCAOB's risk assessment standards, auditors use a risk-based approach to plan the nature and extent of audit procedures to be performed. For example, under a risk-based testing approach the auditor may stratify the fund's portfolio by the degree of measurement uncertainty and focus on those securities with the greatest degree of measurement uncertainty. We believe such risk-based testing approach provides a high level of assurance in a cost-effective manner.

The Staff Paper indicates that the staff is considering how a potential new standard could address audit evidence obtained from third-party sources. Under the contemplated approach, the auditor would first evaluate the reliability of the evidence by considering factors such as the expertise of the third-party pricing

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<sup>2</sup> See Section 2(a)(41)(B) and Rule 2a-4 under Investment Company Act.

<sup>3</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).

vendor in the asset class, the methods used by the third-party and whether the methods are consistent with the valuation framework. The auditor would then evaluate the relevance of the evidence obtained from the third-party source by making a number of determinations set forth in the Staff Paper (*e.g.*, when the fair values are based on transactions in comparable assets, how those transactions are identified and considered comparable).

We are concerned that the specific language describing the auditor's evaluation of evidence obtained from third-party sources suggests that the auditor would be required to evaluate the relevance of the evidence for *each* fair value measurement obtained from the third-party pricing vendor to the same extent regardless of the measurement uncertainty posed by the security. In particular, the Staff Paper indicates that the auditor should evaluate whether the evidence provided by the third-party source is relevant to *the fair value measurement* (emphasis added). A requirement to do a "deep dive" to evaluate the relevance of the evidence for *each* fair value measurement obtained from the third-party pricing vendor would substantially increase the audit procedures to be performed and related audit documentation on securities with low measurement uncertainty. Such a requirement would increase audit fees, without a commensurate increase in audit quality.

#### *Reliance on National Level Pricing Groups*

We understand many audit firms have established a national level pricing group that supports engagement teams conducting audits. The national level group assists audit engagement teams to determine that the valuations provided by the third-party pricing vendor for corroborative purposes are consistent with the required fair value measurement framework. For example, the national level group may perform an analysis of prices obtained from third-party pricing vendors, interact with the pricing vendor to obtain a better understanding of its controls and methodologies, or assist the audit engagement team's evaluation of audit differences. In certain instances the national level pricing group may itself develop estimates of fair value for particular securities.

The Staff Paper, at Question 2, indicates that the staff is considering the interaction between national level pricing groups and audit engagement teams and how that interaction may comport with the engagement partner's responsibility under the PCAOB's risk assessment standards. We believe the use of national level pricing groups may enhance the audit firm's understanding of third-party pricing vendors and the fair value measurements they provide. Further, these groups may facilitate consistent application of audit standards across different engagement teams. Audit standards should not discourage the establishment of national level pricing groups and audit engagement teams' reliance on their work. Without the audit engagement team's ability to rely on the specialized expertise of national level pricing groups, we are concerned audit quality would decrease. If each audit engagement team were to hire additional staff, the cost of the audit would increase, thereby increasing fund expenses and reducing fund returns to the detriment of fund shareholders.

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*Unique Nature of Investment Companies*

We encourage the Board, as it considers changes to its audit standards, to consider the unique nature of investment companies and fund families. Investment companies calculate their net asset value daily for purposes of issuing and redeeming fund shares. Funds have well established controls designed to ensure that their securities are valued consistent with SEC requirements and generally accepted accounting principles. Fund families typically have several different funds organized and offered by an investment adviser and the funds may collectively hold hundreds or thousands of different securities.

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If you have any questions, please contact the undersigned, Amy Lancellotta, at (202) 326-5824 or amy@ici.org, or Gregory Smith, at (202) 326-5851 or smith@ici.org.



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