

MEMO# 25515

September 22, 2011

Draft ICI Letter on PCAOB Concept Release on Changes to Auditor's Reporting Model; Comments Requested by September 28

[25515]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 13-11 RE: DRAFT ICI LETTER ON PCAOB CONCEPT RELEASE ON CHANGES TO AUDITOR'S REPORTING MODEL; COMMENTS REQUESTED BY SEPTEMBER 28

As you know, the PCAOB recently released a concept release describing possible changes to the auditor's reporting model intended to enhance the utility of auditor's reports to investors. [\[1\]](#) The concept release notes that auditors often have significant information regarding a company's financial statements that is not included in the standard auditor's opinion. This information may be useful to investors and other financial statement users and could lead to more efficient markets and allocations of capital. The changes described in the concept release are focused on enhancing communication to investors by improving the content of the auditor's report, rather than on changing the fundamental role of the auditor in performing an audit of financial statements.

The concept release describes four alternatives under consideration: 1) a supplement to the auditor's report in which the auditor would provide additional information about the audit and the company's financial statements (an Auditor's Discussion and Analysis or AD&A); 2) required and expanded use of emphasis paragraphs in the auditor's report; 3) auditor reporting on information outside the financial statements; and 4) clarification of certain concepts included in the auditor's report. The concept release notes that these alternatives are not intended to be mutually exclusive and that a revised auditor's report could include one or a combination of these alternatives.

The attached draft comment letter indicates that the first three alternatives would provide little if any benefit to fund investors and recommends against their application to audits of investment companies. The draft letter indicates that SEC registered investment company financial statements and related audits are less complex in comparison to operating companies because of the limited nature of fund operations (i.e., issuing shares and investing in securities). As a result, neither an AD&A nor an emphasis paragraph would be

beneficial. Further, investment companies do not provide MD&A, earnings releases, or non-GAAP pro forma earnings. Accordingly, there is no need for auditors to report on information outside the financial statements.

The attached draft comment letter supports the fourth alternative – clarification of concepts included in the auditor’s report – and recommends that it be enhanced to include a discussion of the auditor’s examination of the fund’s internal controls relating to valuation of securities. The draft letter notes that the primary audit risks for investment companies relate to the existence and valuation of the investment portfolio. The auditor’s opinion for a SEC registered investment company is unique in that it must state specifically that securities have been confirmed or physically examined to substantiate their existence. The audit opinion, however, does not directly address the auditor’s work with respect to confirming the value of securities at period end, or the auditor’s examination of internal controls relating to security valuation for purposes of planning the audit procedures to be performed.

The draft letter indicates that SEC registered investment companies have well developed internal controls relating to valuation of their investment portfolios and that auditors perform extensive testing of these controls as part of the financial statement audit. The draft letter recommends that the Board consider, as part of the contemplated enhancements to the audit opinion, a more fulsome description of the auditor’s work pertaining to evaluation and testing of the internal controls relating to security valuation. For example, the enhancements could require the auditor to describe its examination of the internal controls relating to security valuation and the results of testing of the controls.

Comments on the concept release are due to the PCAOB by September 30, 2011. Please provide any comments on the attached draft letter to the undersigned by Wednesday, September 28.

Gregory M. Smith
Director - Operations/Compliance & Fund Accounting

[Attachment](#)

endnotes

[1] Accounting/Treasurers [Memorandum](#) No. 18-11, June 24, 2011 [25303].