IDC
INDEPENDENT DIRECTORS COUNCIL

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September 28, 2015

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

Re: Concept Release on Audit Quality Indicators; PCAOB Rulemaking Docket Matter No. 041

Dear Ms. Brown:

The Investment Company Institute[1] and the Independent Directors Council[2] appreciate the opportunity to comment on the Public Company Accounting Oversight Board's concept release on audit quality indicators.[3] ICI and IDC commend the Board's efforts to improve audit quality for the benefit of investors and other stakeholders that may rely on audited financial statements when making investment and related decisions. We also support the development of resources that better enable audit committees to oversee the independent auditor and assess the quality of the auditor's work.[4] We therefore support in concept the Board's project to develop a portfolio of quantitative measures (audit quality indicators or AQIs) whose use may enhance stakeholders' ability to assess audit quality. Notwithstanding this support, we question the utility and advisability of including investment companies in this project, given the significant differences in audits of investment companies and audits

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[1] The Investment Company Institute (ICI) is a leading, global 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 $18.2 trillion and serve more than 90 million U.S. shareholders.

[2] 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 ICI member funds. There are almost 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.

[3] *See* Concept Release on Audit Quality Indicators; PCAOB Release No. 2015-005 (July 1, 2015) ("Release").

[4] *See* Audit Committee Annual Evaluation of the External Auditor prepared by the Audit Committee Collaboration, including the IDC (October, 2012).

of operating companies. We elaborate on this point below and address other issues discussed in the Release.

Exclude Investment Companies. Investment company financial statements, and therefore audits of investment company financial statements, are inherently less complex than those of operating companies. Unlike an operating company, an investment company's activities are limited to investing in a portfolio of securities with the objective of earning a return for its shareholders. As a result, fund assets consist entirely of investment securities and cash items. Consequently, the principal objectives of an investment company audit are to provide reasonable assurance that the fund has ownership and accounting control over its investments and that the fund's assets are valued properly.

Further, investment companies do not raise the same concerns as operating companies because funds have significantly fewer choices in the application of accounting policies. For example, generally accepted accounting principles require funds' investment securities to be recognized at fair value, with changes in value reflected in earnings,[5] rather than allowing securities to be classified as available for sale or held to maturity. These differences affect the nature, timing, and extent of audit procedures performed and cause AQIs calculated based on audits of investment companies to differ substantially from AQIs calculated based on audits of operating companies. Including investment companies within the scope of the project will diminish the utility of the AQIs and raise comparability concerns. For example, firm-level AQIs for an audit firm that audits only investment companies would not be comparable to AQIs for an audit firm that audits only operating companies. We therefore recommend that investment company audits be excluded from the AQI project. If PCAOB determines to include them, however, it is imperative for the success of the project that AQIs for investment company audits be calculated separately from AQIs for audits of other companies.

Establish Relationship to Audit Quality. We encourage the Board to continue its work on identifying the root causes of audit successes and deficiencies.[6] We understand Board staff is working closely with audit firms to identify factors that differentiate high quality audits from deficient audits. As the Release acknowledges, the root cause project has informed the AQI project so that there is a significant overlap in the areas on which the two projects focus. We encourage the Board to continue its work on the root causes project so that it can fully establish the relationship between the indicators and successful audits.

Implement over Time. We recommend that the Board consider a phased approach for the implementation of AQIs. For example, a phased approach could initially involve the Board's support of voluntary use of AQIs by engagement teams, audit firms, and audit committees. A phased approach

[5] *See* FASB ASC 946-320-35-1 and 946-225-45-1.

[6] *See* PCAOB Strategic Plan: Improving the Quality of the Audit for the Protection and Benefit of Investors, 2014-2018, (Nov. 2014), available at http://pcaobus.org/About/Ops/Documents/Strategic%20Plans/2014-2018.pdf.

would provide time for the PCAOB to study the indicators and their effectiveness. It is critical that the PCAOB, once it has collected and analyzed the data, determine the AQIs' correlation to audit quality before it takes steps to make the data publicly available to audit committees or investors. Absent such a correlation, we believe that the use of AQIs would be confusing to audit committees and investors. Only after the PCAOB demonstrates a correlation with audit quality should it consider disclosure of AQIs to audit committees or investors. We believe a phased approach also would enable the Board to evaluate initial experience with the indicators and adjust them as necessary.

Reiterate Characterization of AQIs as Tools. As the PCAOB moves forward with the AQI project, we recommend that it continue to issue affirmative statements that the AQIs are tools best used to stimulate inquiries and guide discussions and decision-making of audit committees and investors; they should *not* be considered best practices or benchmarks for determining the quality of a particular audit or whether an auditor has met its obligations. As the Release prudently notes, analysis of AQI data requires context and the evaluation of audit quality depends on the facts and circumstances of each audit.

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If you have questions concerning our comments, please do not hesitate to contact Amy Lancellotta, IDC Managing Director, at 202/326-5824, or Greg Smith, ICI Senior Director of Fund Accounting and Compliance, at 202/326-5851.

Sincerely,

Amy Lancellotta

Amy B.R. Lancellotta
IDC Managing Director

Gregory M. Smith

Gregory M. Smith
ICI Senior Director – Fund Accounting and Compliance

cc: James R. Doty, PCAOB Chairman
Lewis H. Ferguson, PCAOB Board Member
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Martin F. Baumann, PCAOB Chief Auditor and Director of Professional Standards