

AU Section 9328

Auditing Fair Value Measurements and Disclosures

1. Auditing Interests in Trusts Held by a Third-Party Trustee and Reported at Fair Value

.01 *Question*—Entities may have interests in trusts held by a third-party trustee. For example, a not-for-profit organization (NPO) may have an interest in a trust established by a donor for the benefit of the NPO. Further, that interest may be required to be reported at fair value because it is a beneficial interest pursuant to paragraph 15 of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 136, *Transfers of Assets to a Not for Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*. Further, the fair value of that beneficial interest may be estimated, at least in part, because a readily determinable fair value does not exist. For example, the NPO may have an unconditional right to receive all or a portion of the specified cash flows from a charitable trust that has investments in limited partnership interests or other private equity securities for which a readily determinable fair value does not exist. In such circumstances, the auditor typically would satisfy the existence assertion through confirmation, examination of legal documents, or other means. In confirming the existence, the auditor may request the trustee to indicate or to confirm the trust's fair value, including the fair value of investments held in the trust. In some circumstances, the trustee will not provide management or the auditor detailed information about the basis and method for measuring those investments, nor will they provide information about the specific investments held by the trust. For example, in some circumstances the trustee may inform

management or the auditor that investments are held by the trust as follows:

- In aggregate, such as “\$XXX of total investments”
- In aggregate, such as “\$XXX of total investments in private equity securities, \$YYY of total investments in interests in limited partnerships, and \$ZZZ of total investments in debt securities”
- On an investment-by-investment basis, such as “AA shares of common stock of private company A, with a fair value of \$AAA; BB shares of preferred stock of private company B, with a fair value of \$BBB; CC units of limited partnership interest CCC, with a fair value of \$CCC; and real estate property DDD, with a fair value of \$DDDD”

In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments held by a trust, does receiving a confirmation from the trustee, either in aggregate or on an investment-by-investment basis, constitute adequate audit evidence with respect to the existence assertion and auditing fair value measurements in accordance with Section 328, *Auditing Fair Value Measurements and Disclosures*?

.02 Interpretation—In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments held by a trust, simply receiving a confirmation from the trustee, either in aggregate or on an investment-by-investment basis, does not in and of itself constitute adequate audit evidence with respect to the requirements for auditing the

fair value of the interest in the trust under Section 328. In addition, receiving confirmation from the trustee for investments in aggregate (illustrated by the first two bullets above) does not constitute adequate audit evidence with respect to the existence assertion. Receiving confirmation from the trustee on an investment-by-investment basis (illustrated by the third bullet above), however, typically would constitute adequate audit evidence with respect to the existence assertion. Also, as noted in Section 328, paragraph .04, in discussing management's responsibility for making fair value measurements:

Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with GAAP.

.03 In addition, Section 328 discusses the auditor's responsibility dealing with:

- Understanding the entity's process for determining fair value measurements and disclosures and the relevant controls, and assessing risk
- Evaluating conformity of fair value measurements and disclosures with GAAP
- Engaging a specialist, where necessary
- Testing the entity's fair value measurements and disclosures
- Disclosures about fair values

- Evaluating the results of audit procedures
- Management representations
- Communication with audit committees

.04 In circumstances in which the auditor is unable to audit the existence or measurement of interests in trusts at the financial statement date, the auditor should consider whether that scope limitation requires the auditor to either qualify his or her opinion or to disclaim an opinion, as discussed in Section 508, paragraphs .22 to .26.

AU Section 9332

Auditing Derivative Instruments, Hedging Activities, and Investments in Securities

1. Auditing Investments in Securities Where a Readily Determinable Fair Value Does Not Exist

.01 Question—Entities may make investments in securities, required by generally accepted accounting principles to be accounted for at fair value, where a readily determinable fair value for those securities does not exist. For example, an entity may have an investment in a hedge fund that it reports at fair value, but for which a readily determinable fair value does not exist. Further, the hedge fund may own interests in investments in limited partnership interests or other private equity securities for which a readily determinable fair value does not exist. As part of an auditor's procedures in accordance with Section 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, he or she typically would satisfy the existence assertion through either confirmation with the hedge fund, examination of legal documents, or other means as discussed in Section 332. In confirming the existence, the auditor may request the hedge fund to indicate or to confirm the fair value of the entity's investment in the hedge fund, including the fair value of investments held by the hedge fund. In some circumstances, the hedge fund will not provide management or the auditor detailed information about the basis and method for measuring the entity's investment in the hedge fund, nor will they provide information about the specific investments held by the hedge fund. For

example, in some circumstances the hedge fund may inform management or the auditor that investments are held by the hedge fund as follows:

- In aggregate, such as “\$XXX of total investments”
- In aggregate, such as “\$XXX of total investments in private equity securities, \$YYY of total investments in interests in limited partnerships, and \$ZZZ of total investments in debt securities”
- On an investment-by-investment basis, such as “AA shares of common stock of private company A, with a fair value of \$AAA; BB shares of preferred stock of private company B, with a fair value of \$BBB; CC units of limited partnership interest CCC, with a fair value of \$CCC; and real estate property DDD, with a fair value of \$DDDD”

In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments in securities, does receiving a confirmation from a third party, either in aggregate or on a security-by-security basis, constitute adequate audit evidence with respect to the existence and valuation assertions in SAS No. 92?

.02 Interpretation—In circumstances in which the auditor determines that the nature and extent of auditing procedures should include verifying the existence and testing the measurement of investments in securities, simply receiving a confirmation from a third party, either in aggregate or on a security-by-security basis, does not in and of itself constitute adequate audit evidence with respect to the valuation assertion in Section 332. In

addition, receiving confirmation from a third party for investments in aggregate (illustrated by the first two bullets above) does not constitute adequate audit evidence with respect to the existence assertion under Section 332. Receiving confirmation from a third party on a security-by-security basis (illustrated by the third bullet above), however, typically would constitute adequate audit evidence with respect to the existence assertion under Section 332. Also, as noted in Section 328, *Auditing Fair Value Measurements and Disclosures*, paragraph .04, in discussing management's responsibility for making fair value measurements:

Management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with GAAP.

.03 In addition, Section 328 discusses the auditor's responsibility dealing with:

- Understanding the entity's process for determining fair value measurements and disclosures and the relevant controls, and assessing risk
- Evaluating conformity of fair value measurements and disclosures with GAAP
- Engaging a specialist, where necessary
- Testing the entity's fair value measurements and disclosures
- Disclosures about fair values

- Evaluating the results of audit procedures
- Management representations
- Communication with audit committees

.04 In circumstances in which the auditor is unable to audit the existence or measurement of interests in investments in securities at the financial statement date, the auditor should consider whether that scope limitation requires the auditor to either qualify his or her opinion or to disclaim an opinion, as discussed in Section 508, paragraphs .22 to .26.