

AU Section 9332

Auditing Derivative Instruments, Hedging Activities, and Investments in Securities: Auditing Interpretations of Section 332

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 principals 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 section 332?

.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 those charged with governance

.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, *Reports on Audited Financial Statements*, paragraphs .22 to .26.

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