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Reports on audited financial statements of investment companies: amendment to AICPA audit and accounting guide, Audits of investment companies

American Institute of Certified Public Accountants. Investment Companies Committee

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**Statement of
Position**

89-2

**Reports on
Audited Financial Statements
of Investment Companies**

January 1989

**Amendment to
AICPA Audit and Accounting Guide
*Audits of Investment Companies***

Prepared by the Investment Companies Committee

**American Institute of
Certified Public Accountants**

AICPA

NOTE

This statement of position presents the recommendations of the AICPA Investment Companies Committee regarding the application of generally accepted auditing standards to reports on audited financial statements of investment companies. It represents the considered opinion of the committee on the best auditing practice in the industry and has been reviewed by members of the AICPA Auditing Standards Board for consistency with existing auditing standards. AICPA members may have to justify departures from the recommendations in this statement if their work is challenged.

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Reports on Audited Financial Statements of Investment Companies

Introduction

1. In 1987, the audit and accounting guide *Audits of Investment Companies* was issued. Chapter 9 of that guide illustrates reports on audited financial statements. In April 1988, the AICPA's Auditing Standards Board issued Statement on Auditing Standards (SAS) No. 58, *Reports on Audited Financial Statements*, which changes the auditor's standard report on financial statements. This statement of position amends *Audits of Investment Companies* in response to the changes required by SAS No. 58; it replaces paragraphs 9.3 through 9.9 of the guide with new paragraphs 9.3 through 9.9.

9.3. The following form of auditor's report may be used to express an unqualified opinion on the financial statements:

Independent Auditor's Report

To the Shareholders and
Board of Directors
XYZ Investment Company:

We have audited the accompanying statement of assets and liabilities of XYZ Investment Company, including the schedule of portfolio investments, as of December 31, 19X4, and the related statements of operations and cash flows¹ for the year then ended, the statement of changes in net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended. These financial statements and per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and per share data and ratios based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial

¹ On November 30, 1988, the Financial Accounting Standards Board (FASB) issued an exposure draft of a proposed statement titled *Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows From Certain Securities Held for Resale*. That proposed statement would amend FASB Statement No. 95, *Statement of Cash Flows*, to exempt certain investment companies that meet specified criteria from the requirement to provide a statement of cash flows.

statements and per share data and ratios are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of December 31, 19X4, by correspondence with the custodian and brokers. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of XYZ Investment Company as of December 31, 19X4, the results of its operations and its cash flows² for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with generally accepted accounting principles.

Independent Auditor

Anytown, USA
January 21, 19X5

9.4. The reference to “and brokers” in the fourth sentence of the scope paragraph is not normally required if the investment company’s financial statements do not show an amount payable for securities purchased. Also, if securities were “verified by examination,” the report should be modified to state that.

9.5. The accountant’s report for a fund referred to as a “series fund” needs to be modified because of the uniqueness of the financial statements that have evolved to present its financial position, results of operations, and cash flows. The financial position, results of operations, and cash flows of the portfolios or other entities constituting the series are frequently presented in separate columns. The financial statements of the series may also be presented as if the series were a separate entity. In both cases, the scope of the audit should be sufficient to enable the auditor to report on the individual financial statements of the various entities constituting the series fund.

² See note 1.

9.6. The following illustration is for a multicolumnar presentation of the portfolios constituting the series:

Independent Auditor's Report

To the Shareholders and
Board of Directors
XYZ Series Investment Company:

We have audited the accompanying statements of assets and liabilities, including the schedules of investments, of XYZ Series Investment Company (comprising, respectively, the Foreign, Domestic Common Stock, Long-Term Bond, and Convertible Preferred Portfolios) as of December 31, 19X4, and the related statements of operations and cash flows³ for the year then ended, the statements of changes in net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended. These financial statements and per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and per share data and ratios based on our audits.

[Same second paragraph as in the report illustrated in paragraph 9.3.]

In our opinion, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of each of the respective portfolios constituting the XYZ Series Investment Company as of December 31, 19X4, the results of their operations and their cash flows⁴ for the year then ended, the changes in their net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with generally accepted accounting principles.

Independent Auditor

Anytown, USA
January 21, 19X5

³ See note 1.

⁴ See note 1.

9.7. The following illustration is for a presentation of one of the portfolios or entities constituting the series:

Independent Auditor's Report

To the Shareholders and
Board of Directors
XYZ Series Investment Company:

We have audited the accompanying statement of assets and liabilities, including the schedule of portfolio investments, of the Convertible Preferred Portfolio (one of the portfolios constituting the XYZ Series Investment Company) as of December 31, 19X4, and the related statements of operations and cash flows⁵ for the year then ended, the statements of changes in net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended. These financial statements and per share data and ratios are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and per share data and ratios based on our audits.

[Same second paragraph as in the report illustrated in paragraph 9.3.]

In our opinion, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of the Convertible Preferred Portfolio of the XYZ Series Investment Company as of December 31, 19X4, and the results of its operations and cash flows⁶ for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with generally accepted accounting principles.

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Anytown, USA
January 21, 19X5

The auditor's reports illustrated in this paragraph and in paragraph 9.6 are not intended to be all-encompassing or necessarily illustrative of all situations that may be encountered in practice.

⁵ See note 1.

⁶ See note 1.

9.8. The auditor's report should include an explanatory paragraph when the financial statements contain securities whose values were estimated by the board of directors in the absence of readily ascertainable market values, and the range of possible values of those securities is significant. That report, as illustrated below, should be used only if the auditor concludes that, after examining the underlying documentation supporting the board's good-faith estimate of value, the valuation principles are acceptable, are being consistently applied, are reasonably supported by the documentation, and the range of possible values is significant. If the range of possible values is not significant, a report such as that illustrated in paragraph 9.3 may be issued.

Independent Auditor's Report

To the Shareholders and
Board of Directors
XYZ Investment Company:

[Same first, second, and third paragraphs as in the report illustrated in paragraph 9.3.]

As explained in Note 2, the financial statements include securities valued at \$_____ (_____ % of net assets), whose values have been estimated by the Board of Directors in the absence of readily ascertainable market values. We have reviewed the procedures used by the Board of Directors in arriving at its estimate of value of such securities and have inspected underlying documentation, and, in the circumstances, we believe the procedures are reasonable and the documentation appropriate. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the securities existed, and the differences could be material.

Independent Auditor

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9.9. If the auditor concludes that the valuation procedures are inadequate or unreasonable, or that the underlying documentation does not support the valuation, the auditor should express a qualified opinion as follows:

Independent Auditor's Report

To the Shareholders and
Board of Directors
XYZ Investment Company:

[Same first and second paragraphs as in the report illustrated in paragraph 9.3.]

As explained in Note 2, the financial statements include securities valued at \$_____ (_____ % of net assets), whose values have been estimated by the Board of Directors in the absence of readily ascertainable market values. We have reviewed the procedures used by the Board of Directors in arriving at its estimate of value of such securities and have inspected underlying documentation. In our opinion, those procedures are not reasonable, and the documentation is not appropriate to determine the value of the securities in conformity with generally accepted accounting principles. The effect on the financial statements of not applying adequate valuation procedures is not readily determinable.

In our opinion, except for the effects on the financial statements and selected per share data and ratios of the valuation of investment securities determined by the Board of Directors, as described in the preceding paragraph, the financial statements and selected per share data and ratios referred to above present fairly, in all material respects, the financial position of XYZ Investment Company as of December 31, 19X4, the results of its operations and its cash flows⁷ for the year then ended, the changes in its net assets for each of the two years in the period then ended, and the selected per share data and ratios for each of the five years in the period then ended, in conformity with generally accepted accounting principles.

Independent Auditor

Anytown, USA
January 21, 19X5

Effective Date

2. This statement is effective at the time of its issuance.

⁷ See note 1.

Investment Companies Committee
(1988-89)

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