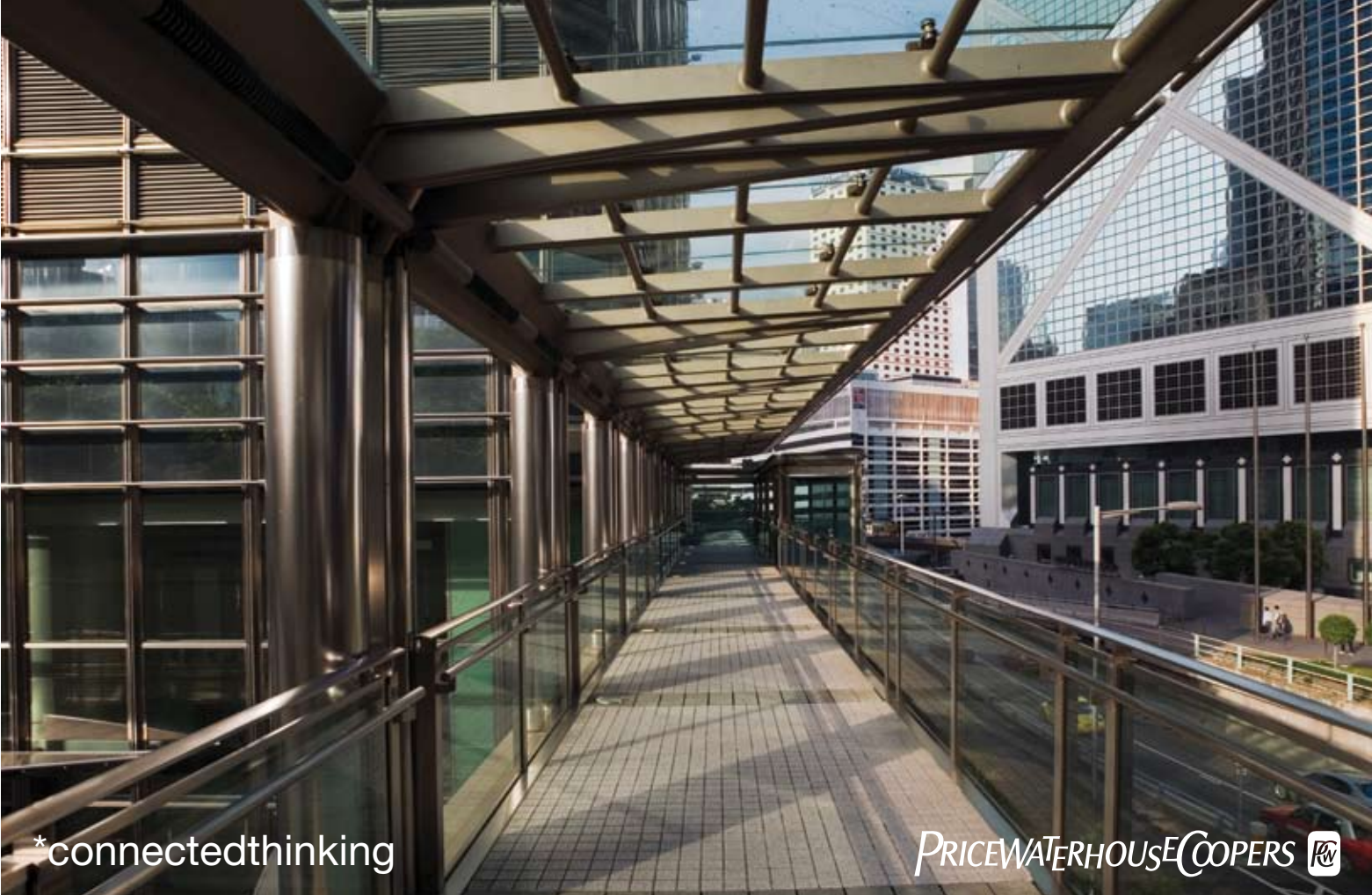


# Working guide\*

for an investment company's audit committee



Dear Clients and Friends,

We are pleased to present this newest edition of our publication, *Working guide for an investment company's audit committee*. For more than thirty years, as part of our commitment to the US investment management industry, we have been providing this reference tool for use by audit committees of registered open- and closed-end investment companies.

The guide provides members of those audit committees a source of possible topics and matters to discuss with, and questions to address to, fund management, service providers, and internal and independent auditors. We believe the guide's best uses are as a "memory jogger" and "thought provoker" to minimize the risk of any considerations or discussions being unintentionally overlooked during audit committee meetings and, conversely, to identify relevant and suitable subjects for discussion.

The guide presents considerations for audit committees in a number of areas with significance to open- and closed-end funds' financial statements and their internal control, as well as matters pertaining to their relationships and communications with management and internal and independent auditors. Its Appendix provides information about certain additional requirements and responsibilities of fund audit committees, management, and/or independent auditors contained in regulations, listing standards of national securities exchanges and associations, and auditing standards.

We hope you find the accompanying information useful as you discharge your responsibilities as a fund audit committee member. We encourage you to ask fund/trustee counsel and your PricewaterhouseCoopers representative any questions you may have about the information in this guide or ways to consider the material in circumstances specific to the fund or fund family for which you have oversight responsibilities.



Barry P. Benjamin  
Leader, US Investment Management  
and Real Estate Practice  
barry.p.benjamin@us.pwc.com  
410-659-3400

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## Introduction

PricewaterhouseCoopers last updated this publication to reflect the numerous and important changes in audit committee responsibilities arising from passage of the Sarbanes-Oxley Act of 2002 and the adoption, by the Securities and Exchange Commission (SEC), of rules pertaining to compliance programs of registered investment companies and investment advisers<sup>1</sup>.

Since that time, while the rate of issuance of new regulations and standards affecting the duties and responsibilities of fund audit committees has lessened considerably, the tasks of audit committees and their members remain significant in number and challenging in nature. Many audit committee members are spending an increasing amount of time gaining further understanding of and making inquiries about the operations of funds, particularly their investment strategies and holdings. Reviews and discussions of valuations (both their sources and reliability) and liquidity of structured investment vehicles and other newer securities are expanding during audit committee meetings. And these reviews and discussions are taking place as management begins their planning to adopt a new accounting standard which establishes a single conceptual framework for measuring fair values and, more significantly, for registered funds, imposes new disclosures about their fair value determinations.

A new accounting interpretation puts a fresh spotlight on income taxes, as well — even for registered investment companies which are commonly viewed as tax ‘pass-through’ entities. Fund managements are closely examining tax positions taken by each fund during open tax years and determining, using new accounting guidance, whether any prior tax benefits recorded in fund financial statements need to be ‘de-recognized’ (i.e., record a tax liability). Also, many funds are instituting new or enhancing existing procedures and controls to enable management to better identify new tax positions taken (and to assess the effects on prior accounting determinations for tax positions taken of any new information which has become available pertinent to such) and make determinations about their effects, if any, on the funds’ financial statements<sup>2</sup>. While few tax liabilities are expected to be recorded by registered funds as a result of this new interpretation, audit committees will want to understand processes followed by management to identify significant tax positions taken and, equally important, the reasonableness of their judgments made about the accounting for such positions.

Open-end funds are also focused on their new and additional requirements<sup>3</sup>, as part of their oversight of shareholder trading in omnibus accounts administered by financial intermediaries. These new requirements have their roots in the market timing and late trading arrangements exposed several years ago.

The SEC has also adopted rules modifying the definitions of *material weakness* and *significant deficiency* for use in reporting internal control deficiencies, including by fund management in certifications contained in periodic SEC filings. The Public Company Accounting Oversight Board



(PCAOB) made similar modifications to the definitions used by independent auditors when reporting on internal control over financial reporting. The changes to the definitions of these terms are intended to raise the importance of using judgment in determining the relative severity of a control deficiency and emphasize communication requirements among or between management, the audit committee and independent auditors on those control matters that are important enough to merit attention.

On a broader level, fund audit committees will want to stay close to the activities of the recently formed SEC Advisory Committee on Improvements to Financial Reporting. This Committee is charged with making recommendations aimed at reducing unnecessary complexities in financial reporting and increasing its usefulness to investors. The Committee is expected to complete its study and issue final recommendations by August 2008 (possibly providing some interim recommendations prior to that time). In another effort to make financial data more useful and understandable for investors, the SEC has adopted final rule amendments that enable mutual funds to submit risk/return summary information from their prospectuses — comprising a fund's investment objectives and strategies, risks, costs, and historical performance — using interactive data (powered by a computer software language, XBRL). Of course, apart from the technology dimension, SEC Chairman Christopher Cox continues to exhort all who work in the financial reporting supply chain to embed more transparency and 'plain English' in their public reporting and disclosures. Audit committees should understand management's assessment of the extent to which the fund's reporting is responsive to these objectives as well as the independent auditor's observations in this regard relative to the fund's financial statements and related disclosures.

Further, while any related impact is beyond the immediate horizon, the SEC has also issued a concept release. The release seeks information about the nature and extent of the public's interest in allowing U.S. issuers, including investment companies subject to the Investment Company Act of 1940, to prepare financial statements in accordance with International Financial Reporting Standards, as published by the International Accounting Standards Board. These international standards differ, in some respects, from U.S. standards currently used; for example, for investment companies, among several other notable differences, international standards do not require a schedule of investments or financial highlights.

And, finally, while the rate of issuance of new regulations adopted has slowed over the recent past, the collective focus of at least several parties — regulators, shareholders, and the media — on fund operations remains strong and intense. Undoubtedly, many will expect a continued appropriate focus by fund audit committees as well.

## Section 1. Financial Reporting, Internal Control and Fraud Risk

Sections 1 through 5 of the guide present matters fund audit committees may wish to consider, when applicable and significant to funds for which they have oversight responsibilities, in determining the nature and extent of their inquiries, reviews, and discussions to be undertaken. Certain of the matters, depending upon the manner in which the fund's board of directors/trustees has structured its board committees, if any, and corresponding responsibilities, may be considered (in whole or in part) by the full board or by other fund board committees, including a contracts committee, service and operations committee, compliance committee, pricing/valuation committee, and/or trading/brokerage committee.

### Financial Reporting

Consider these matters:

- Determine processes to be used to review fund financial statements and accompanying footnote disclosures (together, "financial statements"), and which of the following activities to incorporate within the review:
  - Understanding procedures followed by management to ensure that financial statements comply with generally accepted accounting principles in the United States and applicable SEC requirements, including any differences in procedures followed for semiannual and annual reports to shareholders;
  - Reviewing master footnote library used in preparing financial statements;
  - Reviewing continued appropriateness of accounting policies and disclosure practices and their consistency with industry norms, and any changes made thereto;
  - Understanding significant adjustments made to financial statements by management as part of the period-end accounting process;
  - Reviewing other information accompanying financial statements in shareholder reports (such as Management's Discussion of Fund Performance);
  - Reviewing (i) all financial statements; (ii) representative financial statements at a group level (for example, by major investment objective such as domestic equity, international equity, municipal bond, etc.); and/or (iii) other selected financial statements for annual and/or semiannual periods; and
  - Discussing financial statements with management and independent auditors, including obtaining their comments and observations on the timeliness in preparing, and the quality of, draft financial statements.

- Inquire about whether any required or desired disclosures pertaining to any new circumstances have been made, such as:
  - Unusual or nonrecurring significant transactions;
  - Events that may have significant impact on the fund’s future operations or its financial statements (for example, pending litigation; recently issued or pending administrative rulings; pending or completed mergers of funds; acquisitions of fund affiliates; and matters arising which raise uncertainty about the ongoing operations of service providers); and
  - Volatility in markets, caused by credit, currency, or other factors.
- Understand impact to fund of circumstances with current significant interest to investors or regulators and adequacy of related disclosures, such as:
  - Investments in complex securities (like derivatives and other structured investment vehicles) and corresponding valuation, accounting, and reporting practices;
  - Investment strategies employing short sales;
  - Securities lending activities;
  - Other fund leverage (borrowings);
  - Transactions between the fund and (i) officers/directors; or (ii) other affiliates/related parties.
  - Accounting determinations made in respect of tax positions taken or expected to be taken; and
  - Fee arrangements with service and subservice providers.
- Consider other matters:
  - Management’s philosophy and practices regarding the disclosure of information (financial and nonfinancial) in periodic reports filed with the SEC beyond that required by generally accepted accounting principles or regulation;
  - Financial reporting matters for which independent auditors obtained ‘special’ representations in management’s written representation letter, and any matters for which independent auditors had difficulty in obtaining management’s written representations;
  - Accounting and disclosure issues determined not to be material in the current period but which may be material in the future;
  - New pronouncements by standard-setters (FASB, SEC, AICPA) expected to require changes in accounting policies or disclosures and their anticipated effect(s), including considerations made of early adoption of such pronouncements;



- Consistency of disclosures contained in Management’s Discussion of Fund Performance (MDFP) and other nonfinancial information sections of shareholder reports with the financial statements and the audit committee’s understanding of the fund and its operations;
- Quality of MDFP disclosures, particularly the extent to which they address the fund’s specific portfolio strategies and security selection during the period;
- Comments of SEC and other regulators about the fund’s accounting and disclosure practices and management’s responses thereto (including copies of any written responses), as well as comments of fund shareholders or other parties, such as the business media;
- Any nonstandard or qualified disclosures contained in certifications of periodic financial reports provided by management (Sarbanes-Oxley Act of 2002, Sections 302 and 906); and
- Management’s considerations made in choosing or not choosing to provide the fund’s risk/return summary information from its prospectus using interactive data (XBRL) in filings with the SEC.

### **Internal Control over Financial Reporting**

Consider these matters:

- Overall “tone at the top” established by management with regard to financial reporting practices and internal control over financial reporting, including compliance with laws and regulations having a material effect on financial statements (see also next section entitled “Internal Control over Compliance with Laws and Regulations”).
- Identification and management of risks that could give rise to material misstatements in financial reporting, including by fraud and error.
- Assessment by internal and independent auditors of the extent to which management and service providers understand and how well they discharge their internal control responsibilities.
- Process senior executive and financial management uses to establish a basis for their certifications regarding the fund’s disclosure controls and procedures and internal control over financial reporting contained in periodic SEC filings (Sarbanes-Oxley Act of 2002, Section 302), taking note of any disclosures made therein of:
  - control deficiencies constituting significant deficiencies or material weaknesses in internal control over financial reporting; and
  - significant changes in internal control over financial reporting which occurred during the specified period covered by the report that have materially affected, or are reasonably likely to materially affect, the fund’s internal control over financial reporting.

- Relevancy of control deficiency or deficiencies identified in respect of one fund to other funds in the fund family.
- Adequacy of fund accounting and reporting personnel (level of resources and competencies) and any management plans for changes in this area.
- Findings contained in independent auditor’s letter on internal control over financial reporting for inclusion in Form N-SAR.
- Internal and independent auditor’s observations concerning:
  - Internal control over financial reporting, including management’s procedures for monitoring service providers’ controls;
  - Management’s and service providers’ ability to maintain adequate internal control over financial reporting during periods of higher growth and activity or increase in the number of funds or complexity of their investments;
  - Communication protocols used between or among fund accounting and fund reporting functions and other service providers;
  - Errors in NAV/per share, their causes, and any corrective actions taken as a result;
  - Areas where alternative or extended audit procedures were required because of inadequate records or controls; and
  - Sufficiency and timeliness of improvements to internal control over financial reporting made as a result of recommendations provided in current or prior audits.
- Results of other audit-related services (e.g., review of Form N-14 merger prospectus/proxy statement and related pro forma information) provided by independent auditors during the year.
- Results of any SEC inspections and other regulatory inquiries.

### **Internal Control over Compliance with Laws and Regulations**

Consider these matters:

- Laws and regulations<sup>4</sup>, noncompliance with which could have a material effect on financial statements:
  - Scope of work performed or oversight or advice provided in such areas by management, the fund’s chief compliance officer, other compliance staff, internal and external counsel, and internal and independent auditors.
- Significant elements of the annual review of the fund’s compliance program administered by its chief compliance officer, including (i) those elements pertaining to service providers; (ii) the nature and extent of forensic testing performed; and (iii) findings and any corrective actions taken or necessary to take.

- Significant changes in compliance policies and procedures.
- Findings contained in any third-party reports provided by service providers regarding the adequacy of their controls directed at achieving compliance with laws and regulations (e.g., attestation reports issued by independent auditors and reports issued in connection with a specific rule requirement such as securities counts under SEC Rule 17f-2).
- Status of any legal matters that could have a material effect on the financial statements.
- Administration of the fund's and adviser's code of ethics programs, including violations or other reportable matters (such as exceptions/waivers granted to senior management), and related disclosures provided in certain SEC filings.
- Procedures used to identify potential conflicts of interest and ways in which such circumstances are managed and disclosed.
- Compliance by investment adviser/fund administrator with terms of investment advisory/administration contracts, including adherence to fund expense limitations.
- Unusual or nonrecurring transactions between or among the fund, affiliates, and/or other related parties, including nature and extent of related disclosures.
- Compliance with relevant:
  - advertising regulations;
  - loan agreements or senior debt or preferred stock issues, including compliance with any rating agency requirements for debt or preferred stock;
  - the USA PATRIOT Act and related anti-money laundering regulations and rules; and
  - corporate governance listing standards pertaining to compliance matters<sup>5</sup>.
- Relevancy of control deficiency or deficiencies identified in respect of one fund to other funds in the fund family.
- Illegal acts identified or alleged through any source (e.g., "whistle-blower," chief compliance officer, internal or independent auditors) to ensure: (i) appropriate research or investigation is undertaken, including whether an independent investigation by the audit committee or board is necessary; and (ii) an appropriate disposition of the matter(s) is achieved.
- Comments and observations provided by fund management, the fund's chief compliance officer, and the internal and independent auditors concerning the sufficiency of compliance resources, the performance of compliance activities, and the fund's internal control over compliance with laws and regulations.
- Results of any SEC inspections and other regulatory inquiries.

## Fraud Risk

Consider these matters:

- Policies and procedures established by management, including the “control culture,” to deter and detect instances of fraud involving fraudulent financial reporting or misappropriation of assets.
- Risks that could result in a material misstatement of the financial statements due to fraud, identified by management or internal or independent auditors, and how those risks are addressed in audit processes.
- Susceptibility of controls being overridden by management.
- Features of incentive compensation programs and their possible influence on management/employee behaviors.
- Policies and procedures to handle “whistle-blower” and other complaints, including anonymous submissions, and guide special investigations, taking note of:
  - Support for open communications by employees of concerns;
  - Reports in industry, financial or other press questioning or critical of the fund’s financial reporting practices and/or internal control;
  - Communications by independent auditors of any attempt to “fraudulently influence, coerce, manipulate or mislead” them for the purpose of rendering the audit report misleading;
  - Communications from counsel of a material violation of securities law or breach of fiduciary duty by the fund or an agent thereof; and
  - Fraud identified or alleged through any source (e.g., “whistle-blower,” chief compliance officer, internal or independent auditors) to ensure:
    - (i) appropriate research or investigation is undertaken, including whether an independent investigation by the audit committee or board is necessary; and (ii) an appropriate disposition of the matter(s) is achieved.
- Independent auditor views of adequacy of management’s and, as appropriate, the board’s response to becoming aware of potential or actual illegal acts (pursuant to independent auditor’s responsibilities under Section 10A of Securities Exchange Act of 1934).



## Section 2. Service providers

### General (all service providers)

Consider these matters:

- Contractual provisions (including parties' responsibilities) for nature and extent of services to be performed.
- Internal control, including adequacy of segregation of duties and approach taken to risk management, compliance activities and ethics.
- Organization structure, including adequacy of resources — managerial, staff, and capital/financial.
- Potential conflicts of interest bearing upon arrangements with the fund and manner in which managed and, when required or otherwise appropriate in the circumstances, disclosed.
- Extent of employee turnover and/or plans for significant personnel additions/reductions.
- Use of offshore affiliates or third parties to perform activities.
- Use of subservice providers, including affiliates, to perform activities.
- Adequacy of overall business continuity plans (including information technology), and results of testing for recoverability of systems and operations.
- Adequacy of record retention and retrieval practices, including compliance with laws and regulations.
- Procedures to identify legal and regulatory changes relevant to the fund's operations.
- Procedures to check the fee computations or charges for consistency with contract provisions.
- Fund management's assessment of quality of services provided.
- Periodic assessment of need to request proposal to provide services from other service providers.
- Effect of pending mergers, divestitures, going-private transactions, or other changes in financing or ownership on service provider's ability to maintain or enhance service quality.
- Findings contained in any independent auditor's SAS70 or attestation report on service provider's internal controls directed at financial reporting or compliance with laws and regulations.
- Differences, if any, in oversight measures required or desired to be applied in instances when the service provider is affiliated vs. unaffiliated with the adviser.

## Investment Adviser

See also Section 3 for additional considerations pertaining to portfolio valuation.

- Criteria for selecting broker-dealers for securities transactions; and ongoing analysis and evaluation of such broker-dealers.
- Procedures to research the nature and terms of investments in derivatives and other structured investment vehicles (including asset-backed securities such as collateralized debt obligations (CDOs) and “conduits”), prior to their purchase, to ensure a full understanding of the securities’ features by investment, accounting, tax, reporting, and compliance personnel — and the adequacy of accounting systems and valuation sources for such securities.
- Procedures to monitor compliance of portfolio and securities transactions with laws, regulations, and prospectus restrictions, and to identify “style drift.”
- Procedures for monitoring adequacy of collateral for repurchase agreements and the creditworthiness of counterparties.
- Procedures for monitoring sufficiency and appropriate segregation of collateral pledged to counterparties, including maintenance of “segregated accounts” when required.
- Nature and extent of portfolio transactions with affiliates/related parties.
- Comparison of actual portfolio turnover with disclosures of expected turnover.
- Disclosure (qualitative and/or quantitative) of information about portfolio trading costs and effect on shareholder return.
- Risks arising from potential conflicts of interests, such as:
  - Number and types of accounts (e.g., other registered investment companies and unregistered collective funds, separate accounts and hedge funds) managed by the fund’s portfolio manager;
  - Allocation of investment opportunities (e.g., initial public offerings) among the fund and other investment accounts with similar investment objectives;
  - Allocation of cost of a block of securities purchased for multiple investment accounts;
  - Portfolio manager compensation models, including incentive structures; and
  - Use of “cross-trading” between investment accounts.

- Procedures established by investment adviser and subadvisers for providing portfolio information outside the normal public filing processes, either on a periodic or real-time basis, incorporating fund's restrictions on selective disclosure of portfolio information (for example, limits on parties to whom information is disclosed and execution of confidentiality agreements by recipients).
- Procedures for reviewing "best execution" and "soft dollar" brokerage arrangements, and related disclosures in investment materials.
- Procedures to prevent a broker-dealer's sales of fund shares from influencing the decision to use the broker-dealer for portfolio transactions.
- Procedures to assess and measure overall portfolio risk and return (e.g., "value at risk," "stress testing," or other statistical measures) relative to appropriate benchmarks.
- Procedures to identify and participate in voluntary and mandatory corporate actions (e.g., rights offerings, tender and exchange offers) and class action settlements relating to portfolio holdings.
- Coordination and monitoring of subadviser activities.
- Maintenance of lines of credit or similar financing facilities to meet normal and customary shareholder redemptions, when desirable.
- Mitigation measures (investment and financing options) available for scenarios involving acceleration of shareholder redemptions during periods of unexpected and acute market/portfolio decline.

### **Custodian**

*Aspects of the following pertaining to foreign custody may also address or be addressed by, in part, provisions of SEC Rule 17f-5.*

- Procedures to safeguard the fund's portfolio securities and results of periodic counts of securities (or reconciliations between fund and central depository/Federal Reserve Bank Book Entry System records) by the custodian, management, and/or independent auditors.
- Controls over securities maintained in central depositories and the Federal Reserve Bank Book Entry system.
- Assessments of internal control at the custodian and domestic and foreign subcustodians by fund management.
- Procedures used to manage risks of subcustody in emerging markets, including performance of subcustodians.
- Insurance coverage to protect against lost and stolen securities.
- Procedures used to (i) clear securities transactions, including the affirmation process, and follow-up on failed transactions; (ii) ensure timely receipt and

recording of dividends, interest, and corporate actions, including follow-up of past due items, particularly relating to foreign securities; and (iii) segregate assets to cover commitments arising from options/futures and delayed delivery or when-issued securities transactions.

- Procedures to monitor the appropriateness (nature and terms) and maintenance of any minimum cash balances required, including accounting and disclosure practices.
- Review of nature and frequency of fund overdrafts and costs incurred.
- Performance of securities lending agent, including volume of lending activity and procedures to monitor (i) adequacy of collateral and reliability of related valuations; (ii) timely return of loaned securities/failed deliveries; and (iii) adequacy (fairness to fund) and timely receipt of substitute income payments on securities loaned.

### **Fund Administrator/Accounting Agent<sup>6</sup>**

- Procedures to ensure timely, complete, and accurate filings of fund information with government agencies or regulators (such as prospectuses, statements of additional information, annual and semiannual shareholder reports, tax returns and Forms N-CSR and N-Q).
- Procedures to ensure all required fund-related information is provided timely to shareholders (such as annual and semiannual reports and year-end tax forms).
- Procedures to adjust fund records (and shareholder records through the transfer agent) for any NAV errors in accordance with fund policy.
- Procedures to report daily NAV/share amounts to third-party information reporting services.
- Accounting, tax, operations, and reporting considerations related to recently merged or soon-to-be merged funds:
  - Status and quality of respective funds' accounting, custody and shareholder records at time of combination (e.g., existence of out-of-balance conditions or uncleared reconciling items and known required adjustments);
  - Capabilities of administrator, custodian, transfer agent and other service providers proposed to assume responsibilities for "acquired" funds;
  - Differences in accounting and tax policies between the 'merging' funds, and effect of their harmonization on determination of net asset values and distributions to shareholders; and
  - Determining the "survivor fund" for accounting, tax and performance reporting purposes.



## **Transfer and Dividend Disbursing Agent**

- Procedures, undertaken in conjunction with those of the distributor and/or other parties to support determinations regarding levying contingent deferred sales charges (CDSC) and complying with prospectus and/or contractual provisions.
- Handling and monitoring inquiries from shareholders, including shareholder complaints.
- Findings contained in independent auditor's report on controls at the registered transfer agent filed with the SEC pursuant to SEC Rule 17Ad-13.
- Procedures for reconciling outstanding capital shares between fund accounting and transfer agent records, and processing dividend and capital gain reinvestments.
- Reporting to shareholders taxable and tax-exempt dividends, capital gains, return of capital, and foreign tax credits.
- Procedures for withholding income tax for dividends paid to certain shareholders (e.g., persons subject to back-up withholding).
- Procedures for reporting to shareholders the sources of fund distributions (i.e., "Section 19" notices).
- Nature of shareholder accounting services provided by mutual fund supermarkets or other intermediaries, including the manner in which the fund, adviser, or affiliates pay for such services.
- Practices, in conjunction with those used by the distributor and/or other parties, to deter, detect and remediate potential market timing or late trading activity (including practices to monitor activity in intermediary omnibus accounts and assess intermediaries' procedures in this regard), and communication protocols regarding any grants of waivers of policy in this area.
- Procedures, in conjunction with those used by the distributor and/or other parties, to ensure shareholders invest in suitable classes of shares and are provided available and properly computed sales discounts, including management's assessment of adequacy of procedures performed by fund agents or intermediaries in this regard.
- Procedures to prevent unauthorized access to shareholder information.
- Policies and practices regarding privacy and sharing of shareholder information, including compliance with SEC Regulation S-P.
- Procedures over escheatment of shareholder account balances to government agencies or authorities.

## **Distributor**

- Identification and resolution of any ambiguities in contracts with distributors, dealers/selling agents, transfer agents, and/or intermediaries over responsibilities for compliance with prospectus terms for fund share sales, including suitability of share class, providing eligible sales discounts (breakpoints), effecting share conversions, as well as monitoring for market timing and late trading activities (and procedures undertaken to achieve such).
- Compliance with terms of distribution plans under SEC Rule 12b-1 and NASD regulations, including nature and amounts of fees and expenses paid pursuant to such.
- Procedures to monitor the timely reporting of fund share sales to fund accounting, and to follow up collection of receivables for shares sold and pursue losses incurred on canceled or erroneous transactions.
- Procedures to monitor proper registration of shares with the SEC and state securities authorities (“Blue Sky” registration) and avoid inadvertent sales of unregistered shares.
- Procedures to comply with foreign registration requirements for sale of shares abroad.

## **Information Technology (IT) (all service providers)**

- Organization, supervision, and staffing of the IT department(s).
- Management’s assessment of adequacy of resources allocated to technology (including personnel).
- Controls over implementation of new, and changes to current, systems and applications, including corresponding changes in operations.
- Procedures to ensure computer operations are working as intended, and significant hardware or software problems are timely identified and remediated.
- Controls over physical and logical access to systems and applications, including by user organizations.
- Procedures and controls over website access and modification:
  - Understanding reputation risk of links to other sites appearing on fund’s website, and implications of allowing other sites to link to the fund’s website;
  - Updating information appearing on website, including removing stale or outdated information;

- Maintaining security of site (including preventing “hacker” access — either directly to site or to broader computer systems through breach of firewalls—) and diversion of legitimate users to counterfeit site); and
- Monitoring external “chat room” discussion of funds and restricting or prohibiting fund employees from participating in such discussions.
- Procedures and controls over e-commerce and internet transactions:
  - Understanding security over transactions and data, including potential for unauthorized access to shareholder information, verification of identity of parties executing transactions, and level of assurance that transactions cannot be repudiated once executed;
  - Establishing confidentiality of information — protection of shareholder data and information about the fund’s activities;
  - Achieving continuous operating reliability of systems and services; and
  - Complying with legal and regulatory provisions, including when (i) providing electronic deliveries of prospectuses, reports and/or account statements; (ii) using “E-SIGN” for electronic signatures; (iii) determining where transactions occur for tax and regulatory purposes; and (iv) offering shares across multiple jurisdictions.

## Section 3. Other Areas

### Portfolio Valuation

Consider these matters:

- Status of implementation plans for SFAS No. 157, *Fair Value Measurements*, which establishes a common definition of and single framework for measuring, among other assets and liabilities, the fair value of securities and, most significantly for registered funds, imposes new disclosure requirements<sup>7</sup>.
- Nature and frequency of management reviews of overall portfolio valuation policies and practices, including fair value determinations made by management.
- Nature of any role assumed by portfolio managers in fair value determinations.
- Valuation practices used by pricing services, results of management reviews of the performance of the pricing services, and findings contained in third-party reports on their operations or controls.
- Circumstances in which management override of valuations received from third-party sources may be permitted, and accompanying communication or reporting protocols.
- Procedures to (i) monitor and adjust valuations for “significant events” (for example, when closing prices in foreign markets no longer represent current values, including use of external “fair valuation” services for securities traded in foreign markets); and (ii) compare all fair value determinations with subsequent market openings or next available market values.
- Valuation policies and practices for difficult-to-price securities (such as thinly traded holdings).
- Extent to which:
  - ‘matrix’ pricing is used;
  - securities valuations are obtainable from only a single pricing source or counterparty (e.g., selling broker/dealer) and management’s efforts to identify additional pricing sources;
  - pricing sources or counterparties use and rely on information provided by the fund or adviser to estimate fair values;
  - a fund or fund complex holds most or all of an issuer’s different issues of securities, understanding related effects on valuation and liquidity; and
  - valuation models are used for derivatives, asset-backed securities and other complex securities and degree to which such model-based valuations are (or can be) compared to market transactions.



- Consistency among prospectus and financial statement disclosures and actual methods used regarding valuation practices.
- Nature and frequency of management review of integrity of prices used in daily net asset value determination (e.g., research of significant day-to-day changes and identification of stale prices).
- Valuation and financial statement disclosure considerations arising from restrictions on repatriation of assets from foreign countries.
- Procedures to initially assess and regularly monitor liquidity of portfolio securities.
- Procedures used by money market funds for assessing minimal credit risk and monitoring amortized cost to market value, as required by SEC Rule 2a-7.
- Impact of markets' volatility on existing pricing policies and procedures.
- Impact of any new regulatory or standard-setter guidance on valuation policies and procedures.
- Independent auditor's comments and observations regarding valuation policies and procedures.

#### **Tax Matters**

- Procedures established to:
  - Implement the provisions of FASB Interpretation No.48, *Accounting for Uncertainty in Income Taxes*<sup>8</sup>.
  - Maintain qualification of the fund as a regulated investment company (RIC) under the applicable provisions of the Internal Revenue Code ("the Code");
  - Assure that all required federal and state tax filings and notices to shareholders are made timely;
  - Make distributions and/or federal income tax payments sufficient to meet the minimum distribution requirements of the Code and avoid the imposition of excise tax; and
  - Identify and report certain dividend designations that allow favorable tax treatment of dividends received by shareholders (e.g., qualified dividend income, long-term capital gains, and qualified net interest income).
- Management's assessments and conclusions of the effect of fund tax positions taken or expected to be taken, including positions taken with respect to RIC qualification tests and the recognition of income and/or deductions (including the dividends-paid deduction) where alternative positions exist and the effect on tax status qualification or required distributions could be significant.

- Procedures to monitor for tax law changes which may have a significant effect on tax status, operations, or investment strategy of the fund.
- Status of any ongoing examinations or assessments by taxing authorities.
- Filing and status of any requests for private letter rulings (PLRs).
- Special procedures established for international funds with respect to:
  - Payment of foreign taxes (e.g., capital gains taxes, securities transaction taxes, dividend/interest withholding), preparation of necessary foreign tax returns, and filing of applicable reclaim requests;
  - Procedures to monitor application for, and collection and recovery of, reclaimable foreign taxes; and
  - Identification and treatment of equity securities subject to U. S. tax requirements for “passive foreign investment companies” (PFICs).

## Section 4. Auditors

Consider these matters:

### **Internal Auditors**

- Role of adviser/administrator internal audit department as it relates to fund matters, including understanding the nature of its relationship with or reporting responsibility to the fund audit committee and the extent of its operational independence.
- Organization, supervision, training and staffing of the internal audit department, including extent of resources allocated for reviewing fund operations.
- Plan of work for internal auditors as it pertains to fund operations and degree of coordination between internal and independent auditors to ensure collective coverage is appropriate in the circumstances.
- Oversight of or participation in activities relating to selection of new or reappointment of current service provider(s).
- Oversight of or participation in activities relating to conversions of fund accounting, custody, or shareholder accounting systems or operations to new information systems or service providers.
- Oversight of or participation in activities relating to due diligence procedures performed for mergers of funds, including operations, tax, reporting, compliance and internal control matters.
- Internal audit department's compliance with standards for the professional practice of internal auditing.
- Performance of the internal audit department as it pertains to work performed relating to the fund.

### **Independent Auditors**

#### Appointment and Compensation

- Independent auditor's affirmation of its reporting responsibility to audit committee, as representatives of the shareholders.
- Discussion of significant matters included in the independent auditor's engagement letter.
- Independent auditor's standing, including applicable registration, with the Public Company Accounting Oversight Board (PCAOB), Securities and Exchange Commission, state boards of public accountancy, the AICPA, and other relevant bodies.

- Consideration of independent auditor's industry expertise, engagement team's experiences and capabilities, and prior performance.
- Results of internal and peer reviews and other inspections of the independent auditor undertaken by PCAOB<sup>9</sup>. Existence of significant litigation matters or disciplinary action(s) instituted by SEC or other governmental or professional authorities and any steps taken to address such matters.
- Audit firm practices for compensating and rewarding audit partners.
- Reasonableness of fees paid in relation to planned scope of work for audit, attest and review services.

### Scope of Audit

- Overview of audit strategy, including principal audit objectives and timetables.
- Extent to which audit scope may be affected by changes in accounting principles, regulatory requirements, or fund operations (e.g., new or recently acquired funds; new investment strategies; new service providers or systems; or new management), or to address issues arising in prior audits.
- Extent of planned reliance on examination reports issued pursuant to:
  - (i) Statement on Auditing Standards No. 70, *Service Organizations*, for controls in place at service providers pertaining to financial reporting; and
  - (ii) AICPA Attestation Standards for service providers' controls in respect of compliance objectives (laws and regulations), including auditors' evaluation of the nature and scope of such testing performed and integration with its other audit tests performed.
- Plans to extend or reduce scope of testing in specific areas relative to prior periods, including plans to improve the efficiency of the audit.
- Business risks or other circumstances identified as increasing the risk of a material misstatement of the financial statements and the manner in which audit scope and approach addresses such.
- Independent auditor's consideration of materiality (quantitative and qualitative) for purposes of establishing audit scope and approach and proposing adjustments to financial statements.
- Testing of internal controls (including identifying areas of the fund's operations in which internal controls are not relied upon by the independent auditor for purposes of its audit or not tested because of system weaknesses or other considerations).
- Systems utilized in processing information supporting financial statements, and extent of auditor review of related controls.

- Audit considerations made in respect of provisions of the Investment Company Act of 1940 and other relevant laws and regulations which could have a direct and material effect on financial statements.
- Identification and review of related party transactions and adequacy of disclosures.
- Nature and extent of information appearing in shareholder report outside of financial statements and auditor's consideration, if any, of such information during the audit.
- Extent to which significant changes were made to the audit plan during the course of the audit, and reasons for such.
- Assurance that independent auditor received full cooperation from all parties relevant to the audit and no restrictions were placed on its work.
- Assurance that no attempts were known to have been made by any parties to restrict, limit, or similarly influence the scope of the audit.

#### Quality of Audit

- Professional and fund industry experience and specialization of senior members of engagement team.
- Involvement of concurring ("quality review") partner and other firm technical specialists in review of important accounting, reporting, and auditing judgments.
- Specialists and special services available within the independent auditor's firm, enabling the auditors to more effectively perform the audit and provide other assistance when necessary.
- Quality control procedures employed by independent auditor's firm.

#### Auditor Independence

- Compliance with fund policy and regulatory requirements related to hiring independent auditor's staff, including those who previously worked or currently work on the audit, and management's controls and procedures to assure compliance.
- Procedures established to monitor adherence with SEC requirements for rotation of "lead," "concurring" ("quality review"), and "audit" partners.
- Provision in fund policies and procedures that audit and nonaudit services be brought before the audit committee for preapproval, as required.

## Section 5. Internal Governance and Reporting

Consider these matters:

- Review any written audit committee charter, updating when necessary.
- Sufficiency of length of audit committee meetings and level of discussion to accomplish the committee's objectives.
- Use of portion of audit committee meeting for members to meet solely among themselves for discussion of topics of specific interest to one or more members.
- Means used to review the effectiveness of the audit committee, including effectiveness of chair in leading the committee, driving the agenda, and building working relationships with other committee members.
- Understandings among audit committee, management, fund's chief compliance officer, internal auditors and independent auditors to provide constructive feedback on each other's performance, and identify improvements that can be made to enhance each party's effectiveness.
- Means used to keep current with fund industry, regulatory and auditing/accounting/tax developments affecting responsibilities of audit committee members (continuing education).
- Sufficiency of audit committee's relationships and meetings (general and private session) and other interactions with management, fund's chief compliance officer, and internal and independent auditors.
- Mutual understandings among the audit committee, fund's chief compliance officer, and internal and external auditors of expected communications about matters requiring special or immediate attention.
- Sufficiency of meeting agendas and advance materials (contents, clarity, and timeliness of distribution) to enable audit committee members to prepare for meetings appropriately.
- Adequacy of process to prepare, circulate, discuss, and finalize minutes of audit committee meetings.
- Nature, extent and frequency of audit committee reporting of its activities and findings to the full board, including matters pertaining to:
  - Quality and integrity of the financial statements;
  - Current design and operation of internal controls, including controls established to deter and detect fraud;
  - Compliance with legal and regulatory requirements that have a material effect on the financial statements;
  - Performance and independence of the independent auditors; and
  - Performance of internal auditors as it pertains to fund operations.
- Review/approve any written report/disclosure made in public filings of audit committee activities.



## Appendix

### Information pertaining to certain additional requirements and responsibilities of audit committees, management, and/or independent auditors

#### Introduction

Authorities, duties and responsibilities of registered funds' audit committees, management, and independent auditors for matters pertaining to fund governance are enumerated in, among other sources, the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) and SEC rules issued thereunder, listing standards for issuers (including those of The New York Stock Exchange (NYSE), The American Stock Exchange (Amex), or The NASDAQ Stock Market (NASDAQ); collectively, referred to hereafter as "listing standards" ), and audit standards and related rules of the Public Company Accounting Oversight Board (PCAOB)<sup>10</sup>. Some provisions of these laws, rules, and standards have applicability to all registered funds; other provisions are applicable only to some registered funds (for example, NYSE listing standards are applicable only to registered funds whose shares are traded on the NYSE). Audit committees, management, and independent auditors need to be mindful of all fund governance considerations relevant to the specific fund circumstances at hand.

Listing standards referred to above prohibit the listing of securities of any issuers, including closed-end funds and exchange-traded funds structured as open-end funds (open-end ETFs), which have not met the requirements for their audit committee enumerated in Sarbanes-Oxley Section 301, Public Company Audit Committees, pertaining to its composition, authorities and responsibilities<sup>11</sup>. Many believe these and other provisions of listing standards imposed upon fund audit committees represent "leading practices" for open-end fund audit committees as well.

Further, under Sarbanes-Oxley and related SEC rulemaking, registered funds are required to disclose whether their audit committee has at least one member qualifying, in their board's determination, as an "audit committee financial expert" and, if so, whether he/she is independent of management and provide the identity of that person. Funds must provide a reason when no financial expert serves on the audit committee.

This Appendix highlights some of the more commonly applied provisions of these laws, rules and standards for use as a reference guide by registered fund audit committees; however, audit committees are advised that the listing may not include all requirements or considerations relevant to their funds' circumstances<sup>12</sup>.

The Appendix is composed of four sections, each of which is aligned with a corresponding section appearing in this guide:

- Financial reporting
- Internal control over financial reporting
- Fraud risk
- Independent auditors

Unless otherwise indicated therein, use of the term ‘auditor’ or ‘auditors’ in the Appendix means ‘independent auditor(s)’.

## **Financial Reporting**

### *Required Actions:*

- SEC rules require the auditor to report specified matters to the audit committee prior to the filing of its auditor’s report on financial statements with the SEC (or, for funds, annually with an update to such within 90 days prior to any filing of its auditor’s report on financial statements reflecting any changes to the previously reported information):
  - All critical accounting policies and practices to be used;
  - All alternative treatments within generally accepted accounting principles for policies and practices related to material items that were discussed with management, including the ramifications of using such alternative disclosures and treatments and the auditor’s preferred treatment;
  - Copies of material written communications between the auditor and management, such as any management letter and schedule of unadjusted differences (i.e., audit adjustments proposed but not reported in the financial statements due to management’s conclusion that their effect was not material) and management’s representation letter; and
  - A list of nonaudit services provided to any entity in the investment company complex for which audit committee preapproval was not required.
- Auditing standards require the auditor to inform the audit committee or, in some cases, otherwise be satisfied that the audit committee has been informed about<sup>13</sup>:
  - Auditor’s responsibility for conducting the audit in accordance with standards of the PCAOB;
  - Auditor’s responsibility for other information in documents containing audited financial statements, any procedures performed, and the results;
  - Significant accounting policies initially selected or changes in such or their application, including methods to account for significant unusual transactions and the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus;
  - Auditor’s judgments about the quality, not just the acceptability, of accounting principles applied in the financial reporting, including, but not limited to, observations about consistency of the accounting policies and their application, and clarity and completeness of financial statements and related disclosures;

- Process used by management in formulating particularly sensitive accounting estimates and about the basis for the auditor’s conclusions regarding the reasonableness of those estimates;
  - Adjustments arising from the audit, whether or not made, that could have a significant effect on the fund’s financial statements; and uncorrected misstatements determined by management to be immaterial to the fund’s financial statements;
  - Any disagreements between the auditors and management, whether or not satisfactorily resolved, about matters that could be significant to the financial statements or the auditor’s report;
  - Any consultations management had with other accountants about auditing and accounting matters about which the fund auditor is aware, and the auditor’s views about significant matters covered in such consultations;
  - Any serious difficulties encountered by the auditor in dealing with management related to the performance of the audit;
  - Any fraud involving senior management about which the auditor is aware; and any other fraud about which the auditor is aware (whether caused by senior management or other employees) that causes a material misstatement of the financial statements. (Note: the auditor and audit committee also should reach an understanding regarding the extent of expected communications about misappropriations perpetrated by lower-level employees); and
  - Any illegal acts about which the auditor is aware (unless clearly inconsequential or the nature of which is not within the reporting protocols or guidelines agreed upon by the auditor and audit committee).
- NYSE listing standards require audit committees review and discuss the audited/unaudited financial statements with management and the auditor, including reviewing the specific disclosures in Management’s Discussion of Fund Performance when presented.

### **Internal Control over Financial Reporting**

#### *Required Actions:*

- Under SEC rules, management is required to indicate in certifications contained in specified and periodic filings with the SEC whether it has disclosed to the fund’s audit committee and auditors:
  - All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the fund’s ability to record, process, summarize, and report financial information; and

- Any fraud, whether or not material, that involves management or other employees who have a significant role in the fund’s internal control over financial reporting.
- Auditing standards require auditors to provide written communication to audit committees (and management), prior to the issuance of the auditor’s report on the fund’s financial statements, of all significant deficiencies and material weaknesses in the fund’s internal control over financial reporting.
- NYSE listing standards require audit committees discuss policies with respect to the fund’s risk assessment and risk management.

## **Fraud Risk**

### *Required Actions:*

- Auditing standards require the auditor to inquire directly of the audit committee (or at least its chair) about its views of the risks of fraud and whether the committee has any knowledge of any fraud or suspected fraud affecting the fund, including fraud pertaining to the fund’s financial reporting. The auditor is expected to obtain an understanding of how the audit committee exercises any oversight of the fund’s assessment of the risks of fraud and the programs and controls the fund has established to mitigate these risks.
- SEC rules require that senior executive and financial management affirm, as part of certifications contained in periodic filings with the SEC, that they have disclosed to the fund’s audit committee and auditors any fraud, whether or not material, that involves management or other employees who have a significant role in the fund’s internal control over financial reporting.

## **Independent Auditors**

### **Appointment and Compensation**

#### *Required Actions:*

- Audit committee is responsible (with reference to the board’s statutory responsibilities under the Investment Company Act of 1940 to ratify the selection of the fund’s independent auditor) for the appointment, compensation and oversight of the work of the auditor, including resolution of disagreements between management and the auditor regarding financial reporting.
- Auditing standards require the auditor to inform the audit committee of any major issues discussed with management prior to the auditor’s retention or reappointment including, among other matters, any discussions regarding the application of accounting principles and auditing standards.
- NYSE listing standards require that, annually, audit committees review a report provided by the auditor describing: (i) its internal quality control procedures; (ii) any material issues raised by the most recent internal quality control review or peer review, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, in

respect of any of its audits (and any steps taken to deal with such issues); and (iii) all relationships between it and the fund.

### Auditor Independence

#### *Required Actions:*

- Funds are required to disclose in certain filings with the SEC their audit committee's preapproval policies and procedures and also specified fee information of the auditor.
- Audit committees are required to preapprove (i) audit and nonaudit services provided by the auditor to the fund; and (ii) nonaudit services provided by the auditor to the investment adviser and any other entity within the 'investment company complex' providing ongoing services to the fund, if such services relate directly to the fund's operations or financial reporting<sup>14</sup>.
- Auditors are required to disclose to the audit committee other nonaudit services, which are not subject to preapproval, provided to the investment adviser and any other entity within the 'investment company complex.'
- Auditors are required to provide audit committees written communication as to the scope and fee structure of permissible tax services and discuss with the audit committee potential effects of such services on its independence.
- Auditors are required to provide audit committees written communication (and have discussion with the audit committee about such) in connection with the audit committee's preapproval of permissible nonaudit services related to internal control over financial reporting.
- Audit committee is required to disclose whether it considers nonaudit services, not subject to preapproval, provided to the investment adviser and any other entity within the 'investment company complex' that performs ongoing services for the fund, compatible with maintaining the auditor's independence.
- Auditors are required to provide to audit committees, at least annually, a letter (ISB No. 1, *Independence Discussions with Audit Committees*) pertaining to independence matters that:
  - Discloses all relationships between the auditor and its related entities and the fund and its related entities that, in the auditor's professional judgment, may reasonably be thought to bear on independence<sup>15</sup>; and
  - Confirms that, in the auditor's professional judgment, it is independent of the fund within the meaning of the federal securities acts administered by the SEC and requirements of the PCAOB.

ISB No. 1 also requires that the auditor discuss its independence with the audit committee.

## Internal Governance and Reporting

### *Required Actions:*

- SEC rules require, at least annually, the fund board's evaluation of the performance of its audit committee, including its consideration of the effectiveness of the fund board's committee structure<sup>1</sup>.
- NYSE listing standards require the undertaking of an annual performance evaluation of the audit committee.
- Written audit committee charter required to be in place by listing standards of NYSE, Amex, and NASDAQ.
- NYSE listing standards require audit committees to meet, periodically and separately, with management, internal auditors, and independent auditors.
- Funds are required, in certain circumstances, to provide disclosures about their audit committees and their audit committee activities in certain SEC filings (such as Form N-CSR and proxy statements).



For additional information and resources on audit committee structure and responsibilities, the following resources are available:

*Audit Committee Effectiveness: What Works Best, 3rd edition* (June 2005), authored by PricewaterhouseCoopers LLP and published by the Institute of Internal Auditors Research Foundation, provides insights into leading practices relating to organization (composition, meetings, charters, and evaluation), responsibilities, and relationships with management and external and internal auditors.

*Auditor Independence After Sarbanes-Oxley: A Guide to Auditor Services for Fund Audit Committees*, co-authored by PricewaterhouseCoopers LLP and Dechert LLP, provides a comprehensive discussion of the process for investment company audit committee preapproval of audit and nonaudit services required under the Sarbanes-Oxley Act of 2002, and includes illustrative preapproval policies and procedures.

*Current Developments for Mutual Fund Audit Committees*, published quarterly by PricewaterhouseCoopers LLP, provides summaries and observations on accounting, tax, financial reporting, regulatory, and other related developments affecting funds and their audit committees, and also includes a listing of recent publications of interest to mutual fund audit committees.

*Current Developments for Directors*, published annually by PricewaterhouseCoopers LLP, provides information, insights, and practical guidance on key issues facing directors including those on corporate governance, regulatory, and financial reporting developments.

All of these publications can be obtained from your PricewaterhouseCoopers representative.

<sup>1</sup>The general or summary information presented in this report was developed as of September 2007, and PricewaterhouseCoopers accepts no responsibility for reporting any changes in laws, regulations, or standards referred to herein, or any changes in the interpretation of or guidance for applying the provisions of such, which may occur after that date.

<sup>2</sup>Any tax liabilities recorded will affect, correspondingly, computations of daily net asset values for registered funds (as SEC rules follow GAAP in this regard).

<sup>3</sup>Open-end funds subject to SEC Rule 22c-2, *Mutual Fund Redemption Fees*.

<sup>4</sup>In addition to federal securities laws and related SEC regulations and rules (and any exemptive relief orders or no-action letters issued), term is meant to include, among others, any laws, regulations, rules or provisions of the Financial Industry Regulatory Authority (FINRA), the Internal Revenue Code, the Internal Revenue Service, states or their regulatory agencies, the U.S. Department of Labor, foreign jurisdictions, and national securities exchanges and national securities associations which are relevant to the fund's operations or activities.

<sup>5</sup>For requirements relating to funds whose shares trade on The New York Stock Exchange (NYSE), audit committees should: (i) understand the nature of any qualifications contained in the fund CEO's annual certification of the fund's compliance with NYSE corporate governance listing standards; and (ii) assist in the board's oversight of the fund's compliance with legal and regulatory requirements.

<sup>6</sup>Aspects of procedures and activities described herein may be undertaken by, or in conjunction with, other service providers depending upon the fund's contractual arrangements with its service providers and/or structure of its operations.

<sup>7</sup>SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and including periods within those fiscal years.

<sup>8</sup>FIN 48 is effective for fiscal years beginning after December 15, 2006. However, in response to matters raised by the fund industry about this new Interpretation, SEC staff issued interpretive letters in December 2006 and June 2007 which effectively allow registered funds additional time to implement FIN 48, and otherwise provide additional guidance for registered funds in applying the provisions of FIN 48.

<sup>9</sup>In the event the PCAOB's inspection of the independent auditors includes a review of one or more fund audits, the PCAOB examiners may wish to interview the audit committee chair to discuss matters such as:

- Nature and frequency of discussions between the independent auditor and audit committee;
- Audit committee expectations and evaluation of the independent auditor;
- Nature and quality of independent auditor communications;
- Communications about audit adjustments; and
- Audit committee philosophy about approval of nonaudit services.

<sup>10</sup>This guide does not address any provisions of individual state statutes directed at responsibilities of fund audit committees.

<sup>11</sup>Audit committees of issuers whose shares are listed on national securities exchanges and national securities associations must:

1. Be comprised only of members of the board of directors of the issuer.
2. Have authority to engage independent counsel and other advisers as necessary.
3. Be responsible (with reference to the board's statutory responsibilities under the Investment Company Act of 1940 to ratify the selection of the fund's auditor) for the appointment, compensation and oversight of the work of the auditor.
4. Establish procedures for handling complaints regarding accounting, internal accounting controls, or auditing matters, as well as confidential, anonymous submissions by employees of the issuer of concerns regarding questionable accounting or auditing matters.

Listing standards impose additional requirements and responsibilities on audit committees of funds whose shares are traded on the exchange in several of the areas set forth above in this footnote; such as, the minimum number of members that need to comprise the audit committee and their required qualifications or experiences. Further, listing standards require funds to provide appropriate funding, as determined by their audit committee, for: (i) the independent auditor for issuing an audit report or performing other audit, review, or attest services; (ii) any other advisers employed by the audit committee; and (iii) administrative expenses of the audit committee necessary or appropriate in carrying out its duties.

<sup>12</sup> See additional information about the limitations of the contents of this guide presented on the back cover of this publication.

<sup>13</sup> International standards on auditing include additional matters ordinarily communicated including: (i) potential effect(s) on the financial statements of any significant risks and exposures; (ii) material uncertainties related to events and conditions that may cast doubt on the ability of the entity to continue as a going concern; and (iii) expected modifications to the auditor's report.

<sup>14</sup> SEC rules relating to listed issuers' audit committees require audit committees to preapprove all audit, review and attest services, whether provided by the principal auditor or other firms.

<sup>15</sup> In a pamphlet entitled, *Audit Committees and Auditor Independence*, issued in 2007, the SEC Office of the Chief Accountant indicates that audit committees should consider discussing the following matters with the auditor regarding its independence disclosures: (i) processes the auditor uses to ensure complete disclosure of all relationships with the registrant and its affiliates; (ii) relationships the auditor may have with officers, board members and significant shareholders; and (iii) relationships not included in the communication because they were deemed immaterial.

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The report is not intended to be – and should not be used as – a “one-stop” source of all information required by a registered investment company’s (fund) audit committee and its members or as a ‘checklist’ to be completed by such parties. Readers are cautioned that the information is summary in nature and is not intended to represent a complete list of requirements imposed upon audit committees of funds registered with the U.S. Securities and Exchange Commission by laws, regulations, rules, or professional standards. Further, the information presented in this report is not intended to convey all matters of interest or possible interest to fund audit committees and their members or all matters of significance or possible significance to the oversight of a fund’s activities by its audit committee. Conversely, not all of the considerations presented herein will be relevant to each fund audit committee as the structure and nature of the operations of funds varies substantially across the investment management industry. Also, in some circumstances, other committees of a fund’s board of directors/trustees or the board, itself, may have oversight responsibility for some of the areas, matters, and considerations presented herein.

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