MEMO# 25660

November 22, 2011

Draft ICI Comment Letter On Mandatory Audit Firm Rotation - Comments Requested By December 7

[25660]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 19-11 RE: DRAFT ICI COMMENT LETTER ON MANDATORY AUDIT FIRM ROTATION - COMMENTS REQUESTED BY DECEMBER 7

As you know, the PCAOB recently issued a concept release requesting comment on ways that auditor independence, objectivity, and professional skepticism could be enhanced. [1] The primary focus of the release is mandatory audit firm rotation (i.e., requiring public companies, including funds, to change their audit firm after a prescribed time period). Attached for your review is a draft comment letter to the PCAOB.

The draft comment letter strongly opposes mandatory audit firm rotation. The letter indicates that the Board has not conclusively tied the "audit failures" described in the concept release to a lack of objectivity or professional skepticism. The draft letter questions whether any of the audit failures described in the release relate to SEC registered investment companies. The letter then goes on to describe existing mechanisms intended to enable the auditor to resist management pressure and ensure that the audit is performed in compliance with professional standards. These mechanisms include, for example: oversight by the audit committee; concurring partner review; rotation of the lead and concurring partner after five years; mandatory audit firm quality control systems; and, the Board's inspection and enforcement programs. The draft letter also describes the disruption to management and the audit committee, the decrease in audit quality during the first year of engagement, and the increase in audit cost that would result from mandatory audit firm rotation.

The draft comment letter also describes industry-specific factors that may limit audit committee choice in selecting an audit firm under mandatory rotation. For example, the letter describes how mutual funds are offered through 401(k) retirement plans, including plans sponsored by the audit firms. The letter expresses concern that a particular audit firm may not be willing to audit a fund that is offered through its 401(k) plan, because of the independence issues it would raise. The letter goes on to describe the term "investment company complex" as defined in the SEC's auditor independence rules and indicates that the extensive reach of the defined term may further limit the audit committee's choice in the selection of auditors.

The draft letter indicates that the significant reforms implemented since 2002 combined with the Board's inspection and enforcement programs have significantly improved public company audits. The letter indicates that if the Board can demonstrate the need to further enhance independence, objectivity and professional skepticism, that it do so through its standard setting, inspection and enforcement programs. If the Board decides to pursue mandatory audit firm rotation, the letter recommends that it permit investment company complexes to either rotate audit firms or have two separate audit firms, each firm auditing a separate group of funds. The letter argues that having two separate audit firms may enhance skepticism and objectivity, without the disruption and cost associated with mandatory audit firm rotation.

Please provide any comments on the draft letter to me (202/326-5851 or smith@ici.org) no later than the close of business on Wednesday, December 7.

Gregory M. Smith
Director - Operations/Compliance & Fund Accounting

Attachment

endnotes

[1] *See* Institute Memorandum (25473) dated September 9, 2011.