MEMO# 11324

October 20, 1999

DRAFT ICI COMMENT LETTER ON AUDITOR INDEPENDENCE

1 See Memorandum to Accounting/Treasurers Committee No. 30-99, SEC Rules Committee No. 71-99, dated September 23, 1999. [11324] October 20, 1999 TO: ACCOUNTING/TREASURERS COMMITTEE No. 35-99 SEC RULES COMMITTEE No. 80-99 RE: DRAFT ICI COMMENT LETTER ON AUDITOR INDEPENDENCE ____ Attached for your review is a draft comment letter on the Independence Standards Board's proposal on audits of mutual funds. The proposal is intended to provide standards by which the independence of the audit firm and its partners and employees from mutual fund complexes may be established.1 The proposal would require a specified set of persons in the audit firm to be independent of non-audit client "sister" funds when auditing a mutual fund. In particular, the accounting firm itself, and its retirement plans (other than self-directed defined contribution employee benefit plans), the audit engagement team, and its chain of command, and the partners and managerial employees in offices participating in a significant portion of the audit must be independent of non-audit client sister funds when auditing a mutual fund. In addition, the proposal would permit spouses of certain partners to invest in audit client funds through an employer sponsored benefit plan. Please call me at (202) 326-5851 by Wednesday, October 27th with any comments on the attached draft comment letter. Non-audit Client Sister Funds Currently, in order to maintain independence with respect to audit client funds, auditors must also be independent of all other funds within the same fund complex or advised by the same investment adviser. These restrictions apply to all partners in the firm, irrespective of whether they actually participate in the engagement. The proposal would permit partners and other employees not on the "engagement team" to invest in non-audit client sister funds. The draft comment letter supports this proposal as a reasonable relaxation of existing rules. Spouse Investment in Audit Client Funds Currently, spouses and dependents of partners are prohibited from investing audit client funds. The proposal would permit spouses of partners not on the engagement team, not in its chain of command, and not in an office participating in the engagement, to invest in audit-client funds through an employer sponsored benefit plan. The draft comment letter supports this provision and recommends additional circumstances in which spouses of partners should be permitted to invest in audit-client funds. First, spouses of partners should be permitted to make direct investments in audit-client funds (i.e., in addition to investments through employer sponsored benefit plans). Second, spouses of partners in the engagement office should be permitted to invest in audit-client funds through employer sponsored benefit plans, so long as the partner does not work on the engagement and is not part of the chain of command. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment