

**MEMO# 11516**

January 4, 2000

## **ICI COMMENT LETTER ON ISB AUDIT FIRM STRUCTURE PROPOSAL**

1 See Memorandum to Accounting/Treasurers Committee No. 41-99, SEC Rules Committee No. 90-99, dated November 2, 1999. [11516] January 4, 2000 TO: ACCOUNTING/TREASURERS COMMITTEE No. 1-00 SEC RULES COMMITTEE No. 2-00 RE: ICI COMMENT LETTER ON ISB AUDIT FIRM STRUCTURE PROPOSAL

As we previously informed you, the Independence Standards Board issued a Discussion Memorandum on the changing nature of audit firm structure and the related threats to auditor independence.<sup>1</sup> One of the evolving firm structures discussed in the DM is public ownership of an interest in the non-audit practice of a public accounting firm. This structure may give rise to a situation where an investment company purchases shares in a publicly held corporation that is a subsidiary of, or affiliated with, its auditor. The DM indicates that such purchases constitute a potential threat to auditor independence and may necessitate replacement of the audit firm. Further, the DM questions whether purchases by a corporation, its officers and directors, of a mutual fund, that in turn invests in an affiliate or subsidiary of the corporation's auditor, constitute a threat to auditor independence. The attached comment letter argues that immaterial investments by an audit firm client in a subsidiary/affiliate of its auditor do not constitute a threat to the auditor's independence. Further, if the ISB decides to proceed with a "zero-tolerance" approach as described in the DM, immaterial, inadvertent or isolated violations do not justify replacement of the auditor or necessitate re-issuance of the audit opinion. Finally, the letter indicates that whatever standard the ISB determines to adopt (e.g., zero-tolerance or one that includes an exception for immaterial investments), it should not be extended to investment by audit clients, and their officers and directors, in mutual funds that invest in securities issued by audit firm subsidiaries and affiliates. The indirect shareholder status ensures that the audit-client will have no opportunity to influence audit firm. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment