

MEMO# 14364

January 16, 2002

SEC CENSURES AUDITOR FOR INDEPENDENCE VIOLATION

[14364] January 16, 2002 TO: ACCOUNTING/TREASURERS COMMITTEE No. 4-02 SEC RULES COMMITTEE No. 5-02 RE: SEC CENSURES AUDITOR FOR INDEPENDENCE VIOLATION The SEC recently censured KPMG LLP for engaging in improper professional conduct because it purported to serve as an independent accounting firm for an audit client at the same time it had made substantial financial investments in the client.¹ The SEC found that from May through December 2000, KPMG held a substantial investment in a money market mutual fund. According to the SEC's order, KPMG opened the money market account with an initial deposit of \$25 million and at one point the account balance constituted 15% of the fund's net assets. The SEC found that KPMG audited the financial statements of the money market fund at a time when the firm's independence was impaired, and that the fund included KPMG's audit report in various filings it made with the SEC. The SEC's order indicates that KPMG's investment in the money market fund was discovered by an employee of the fund complex. The employee, recognizing KPMG as the fund's auditor, notified fund management, which in turn notified the KPMG audit team. No member of the KPMG audit team had any prior knowledge that KPMG had an investment in the fund. KPMG immediately liquidated its investment in the fund and resigned from the audit engagement. The fund retained another accounting firm to reaudit the financial statements. KPMG reimbursed the fund for the cost of the reaudit and related expenses. According to the SEC, KPMG's independence violation occurred primarily because the firm lacked adequate policies or procedures to prevent or detect such violations, and because the steps which KPMG personnel usually took before initiating investments of the firm's surplus cash were not taken in this instance. The SEC concluded that KPMG's lack of adequate policies and procedures constituted an extreme departure from the standards of ordinary care, and resulted in a violation of the Commission's auditor independence rules and Generally Accepted Auditing Standards. ¹ See SEC Release No. IC-25360 (January 14, 2002). A copy of the SEC's order is attached. ² The SEC censured KPMG and ordered it to undertake certain remedies designed to prevent and detect future independence violations caused by financial relationships with, and investments in, the firm's audit clients. KPMG consented to the entry of the SEC's order without admitting or denying the facts, findings, or conclusions in the order. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment Attachment (in .pdf format)

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