

MEMO# 16473

August 26, 2003

SEC ISSUES FREQUENTLY ASKED QUESTIONS ON APPLICATION OF AUDITOR INDEPENDENCE RULES

[16473] August 26, 2003 TO: ACCOUNTING/TREASURERS MEMBERS No. 36-03 CLOSED-END INVESTMENT COMPANY MEMBERS No. 69-03 COMPLIANCE ADVISORY COMMITTEE No. 65-03 SEC RULES MEMBERS No. 111-03 RE: SEC ISSUES FREQUENTLY ASKED QUESTIONS ON APPLICATION OF AUDITOR INDEPENDENCE RULES The SEC's Office of the Chief Accountant recently provided responses to 35 frequently asked questions (FAQs) regarding the application of the Commission's rules on auditor independence.¹ Earlier this year the Commission adopted rules designed to strengthen auditor independence as mandated by the Sarbanes-Oxley Act.² The staff's responses to the FAQs are intended to assist registrants and their audit committees, audit firms, and other market participants in the understanding of and compliance with the new regulations. The document addresses questions related to several aspects of the independence rules: • partner rotation and transition; • other audit partner and partner rotation matters; • nonaudit services; • audit committee pre-approval; • audit committee communications; • fee disclosures; • cooling off periods; and • broker-dealers and investment advisers. One of the FAQs related to audit committee pre-approval addresses pre-approval policies and procedures. In particular, can the audit committee use monetary limits as the basis for establishing its pre-approval policies and procedures? The staff's response notes that the 1 The staff's responses to the frequently asked questions can be found on the Commission's website at: <http://www.sec.gov/info/accountants/ocafaqaudind080703.htm>. 2 See ICI Memo No. 15603 (January 31, 2003). 2 Commission's rules include three requirements that must be followed in the audit committee's use of pre-approval through policies and procedures. First, the policies and procedures must be detailed as to the particular services to be provided. Second, the audit committee must be informed about each service. Third, the policies and procedures cannot result in the delegation of the committee's authority to management. Pre-approval policies and procedures must comply with each of these three requirements and accordingly, monetary limits cannot be the only basis for the pre-approval policies and procedures. Monetary limits alone would not constitute policies that are detailed as to the particular services and would not ensure that the audit committee would be informed as to each service. The document includes one FAQ related to investment advisers – do the partner rotation and compensation requirements apply to investment advisers that are not issuers? The staff's response indicates that the term “audit partner” is intended to apply to an issuer as defined by the Sarbanes-Oxley Act. Therefore, for investment advisers which are not issuers, the auditors would not be subject to the rotation requirements or the compensation requirements. However, since the prohibition on nonaudit services applies to

“audit clients,” the prohibition on nonaudit services would apply to auditors of non-issuer investment advisers. Gregory M. Smith Director - Operations/Compliance & Fund Accounting

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