MEMO# 11543

January 11, 2000

ISB ISSUES FINAL STANDARD ON MUTUAL FUND AUDITS

[11543] January 11, 2000 TO: ACCOUNTING/TREASURERS MEMBERS No. 2-00 SEC RULES COMMITTEE No. 6-00 RE: ISB ISSUES FINAL STANDARD ON MUTUAL FUND AUDITS ____ The Independence Standards Board recently issued Independence Standard No. 2, Certain Independence Implications of Audits of Mutual Funds and Related Entities. The Standard establishes a framework whereby an audit firm, and its partners and employees, can establish and maintain independence from audit-client mutual funds. The Standard is effective with respect to audits of financial statements for periods beginning after June 15, 2000. However, ISB No. 2 indicates that, certain SEC and AICPA independence rules are more restrictive than the Standard, and compliance with those existing more restrictive rules continues to be necessary unless and until they are revised. ISB No. 2 is summarized below and is available at the ISB web site (www.cpaindependence.org). Sister Funds and Related Non-fund Entities In order to be considered independent of audit-client mutual funds, auditors must be independent of all sister funds and all related non-fund entities (e.g., the investment adviser, or broker- dealer in the mutual fund complex). Also, to be considered independent of a related non-fund entity, auditors must be independent of all funds in the complex. If the related non-fund entity is an investment adviser, this would include all funds it advises, even if they are outside the mutual fund complex. For this purpose “auditor” includes: i) the auditing firm itself, ii) its retirement plans (other than self-directed defined contribution employee benefit plans), iii) the audit engagement team, and iv) those in a position to influence the audit. The original proposal included all partners and managerial employees in offices participating in a significant portion of the audit within this group (even if they did not participate in the audit). In response to comments, partners and managerial employees located in the engagement office may invest in sister funds, so long as they are not in a position to influence the audit of the client fund. Spousal/Dependent Investment in Mutual Funds A spouse, cohabitant or dependent of a partner not on the audit engagement team, and not in a position to influence the audit, may invest in audit-client funds through an employer sponsored benefit plan. The original proposal precluded spouses of partners in the engagement office from investing in audit-client funds through employer sponsored benefit plans. In response to comments, spouses of partners in the engagement office may invest in audit-client funds through an employer sponsored benefit plan, so long as the partner is not in a position to influence the audit of the client fund. Gregory M. Smith Director – Operations/ Compliance & Fund Accounting