MAKING SENSE OF AUDITOR INDEPENDENCE ISSUES

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Auditor independence has always been a regulatory compliance priority. Failure to comply with independence requirements has potentially serious legal and business consequences, including the risk that an audit engagement be terminated and past financial statements reaudited.

Registered investment companies ("funds") are subject to the same auditor independence requirements as other public companies. However, rules applicable to funds are broader and more complicated. A number of actions by the SEC and its staff over the last several months have focused on the complex way the independence rules apply to funds and their auditors. The actions also offer a reminder to fund boards and audit committees of the importance of reviewing independence matters with fund auditors.

As widely reported, the auditor independence rules were the subject of a no-action letter granted by the Securities and Exchange Commission ("SEC") staff to Fidelity Management & Research Company ("Fidelity") (the "Fidelity Letter") in June 2016.[1] The Fidelity Letter temporarily addresses some of the issues that have arisen under Rule 2-01(c)(1)(ii)(A) of Regulation S-X, otherwise known as the "Loan Rule." The Loan Rule states that an audit firm is not independent if one of its lenders owns more than ten percent of the voting securities of a fund audit client.

Although it provides important relief for funds, the Fidelity Letter left open a number of questions. Following conversations with the SEC staff, the Investment Company Institute issued a "Frequently Asked Questions" ("ICI FAQ") memorandum in September 2016 to clarify certain of these issues. Also in September 2016, the SEC settled two enforcement actions regarding personal relationships that potentially compromise auditor independence.

To read the full alert, click here.

Notes

[1] Fidelity Management & Research Company, SEC No-Action Letter (June 20, 2016).

