IDC Independent Directors Council
Promoting Excellence in Fund Governance

MEMORANDUM

TO: ACCOUNTING/TREASURERS MEMBERS No. 14-15
SEC RULES MEMBERS No. 44-15
INVESTMENT COMPANY DIRECTORS No. 19-15
RE: SEC CHARGES AUDITOR WITH VIOLATING AUDITOR INDEPENDENCE RULES; CHARGES FUND TRUSTEE AND FUND ADMINISTRATOR FOR RELATED VIOLATIONS

In a settled enforcement action, the Securities and Exchange Commission charged a fund auditor with violating auditor independence rules when its consulting affiliate maintained a business relationship with a trustee serving on the boards and audit committees of three funds it audited. In the Matter of Deloitte & Touche LLP, ALPS Fund Services, Inc. and Andrew C. Boynton, Administrative Proceeding File No. 3-16672 (July 1, 2015), available at http://www.sec.gov/litigation/admin/2015/34-75343.pdf). The SEC also settled charges against the trustee for causing related reporting violations by the funds and the funds' administrator with causing the funds' violation of rule 38a-1 under the Investment Company Act of 1940 (1940 Act).

The auditor discovered the independence-impairing relationship five years after it had begun as a result of monitoring procedures the auditor implemented as part of its efforts to enhance independence quality controls. The auditor reported its findings to the funds' audit committee and then to the SEC's Office of the Chief Accountant. Two weeks later, the auditor's relationship with the funds ended.

The respondents consented to the order without admitting or denying the Commission's findings. The order is summarized below.

Commission Findings

On May 16, 2006, at a time when the trustee was serving on the boards and audit committees of three funds that were audit clients of the auditor, an affiliate of the auditor entered into a business relationship with the trustee. The relationship entailed the affiliate's purchase from the trustee and his business partners of intellectual property rights to a brainstorming business methodology and a simultaneous agreement for the trustee to serve as a consultant to the affiliate for a three-year period to train personnel in the use of the methodology.

Although the auditor's policies required an independence consultation prior to entering into a new business relationship with a consultant, an independence consultation was not performed before the

affiliate entered into the relationship with the trustee. The auditor did not discover that the independence consultation had not been performed until nearly five years after the relationship had been established.

For the duration of the trustee's business relationship with the auditor's affiliate, the trustee served on boards of three funds while the auditor served as the funds' outside auditor, which represented that it was independent in its audit reports for all three funds for fiscal years 2007 through 2011. With the auditor's knowledge and consent, those audit reports and information about the "independent" auditors were included in their clients' annual reports on Form N-CSR and proxy statements. In addition, the auditor expressly confirmed to the funds at the end of each affected fiscal year in written confirmations required by PCAOB Rule 3526 that it was "independent."

The fund administrator had contractually agreed to assist the funds in discharging their responsibilities under rule 38a-1. The fund administrator drafted, for approval and implementation by the funds' boards, the funds' compliance policies and procedures and provided employees to serve as the funds' chief compliance officer. The policies and procedures governing auditor independence were inadequate. Although the trustee and officer (T&O) questionnaires that the fund administrator circulated to T&Os asked them to identify their "principal occupation(s) and other positions" and, beginning in 2009, asked them to identify any "direct or material indirect business relationship" with the fund's auditor, business relationships with the auditor's affiliates were neither expressly covered by the questionnaires or by any other policy or procedure. The funds did not have sufficient written policies and procedures reasonably designed to prevent violations of the broader auditor independence requirements beyond prohibited business relationships between the auditor and T&Os. The funds also did not provide sufficient training to assist the funds' board members in the discharge of their responsibilities as to auditor independence.

The trustee's responses to the annual T&O questionnaire calling for identification of his "principal occupation(s) and other positions" did not identify the relationship with the auditor's affiliate. Relying on his understanding that the auditor was a separate legal entity from the affiliate, the trustee also did not identify the business relationship with the affiliate in response to the question as to whether he had any "direct or material indirect business relationship" with the auditor. Nor did the trustee's participation in any annual audit committee votes to retain the auditor occasion any disclosure by him of his business relationship with the affiliate. The trustee never inquired whether the auditor's and the affiliate's relationship to one another carried auditor independence or conflict-of-interest implications despite having worked directly with auditor personnel (not assigned to the funds' audits) on brainstorming methodology projects.

Violations and Sanctions

The auditor engaged in improper professional conduct pursuant to section 4C(a)(2) of the Securities Exchange Act of 1934 and rule 102(e)(1)(ii) of the Commission's Rules of Practice. The auditor violated

rule 2-02(b) of Regulation S-X each time it signed an audit report for the funds, where either the period covered by the audit or the period of the audit work (or both) overlapped with the business relationship, because they incorrectly stated that they were performed in accordance with generally accepted auditing standards, which require auditors to maintain independence—both in fact and in appearance—from their audit clients.

The trustee and the auditor each caused the funds' violations of sections 30(a) and 20(a) of the 1940 Act and rule 20a-1 thereunder each time non-independent audit reports were filed with or incorporated in the funds' annual reports or other information concerning the "independent" auditors was provided in proxy statements.

The fund administrator caused the funds to violate rule 38a-1 under the 1940 Act.

In determining to accept the settlement offer of the auditor, the Commission considered the steps taken by the auditor, both before and after the firm's detection of the independence-impairing relationship with the trustee, to enhance its independence quality control system. In determining to accept the settlement offer of the fund administrator, the Commission considered its remedial steps, which included commencing work with its clients' boards and their counsel to enhance auditor independence policies and procedures and to implement training concerning business-relationship independence prohibitions.

The auditor was censured and ordered to pay disgorgement of audit fees plus a $500,000 penalty.

The trustee was ordered to pay disgorgement plus a penalty of $25,000.

The fund administrator was ordered to pay a $45,000 penalty.

Each party agreed to cease and desist from future violations without admitting or denying the findings.

Annette Capretta
Deputy Managing Director

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