



# MUTUAL FUND DIRECTORS FORUM

*The FORUM for FUND INDEPENDENT DIRECTORS*

September 8, 2015

Mr. Brent J. Fields  
Secretary  
United States Securities and Exchange Commission  
100 F Street N.E.  
Washington, DC 20549

Re: Concept Release Regarding Possible Revisions to Audit Committee Disclosures, File No. S7-13-15

Dear Mr. Fields:

The Mutual Fund Directors Forum (“the Forum”)<sup>1</sup> welcomes the opportunity to comment on the recent concept release by the Securities and Exchange Commission (“Commission”) seeking public comment regarding audit committee reporting requirements.<sup>2</sup>

The Forum is an independent, non-profit organization for investment company independent directors and is dedicated to improving mutual fund governance by promoting the development of concerned and well-informed independent directors. Through education and other services, the Forum provides its members with opportunities to share ideas, experiences, and information concerning critical issues facing investment company independent directors, and also serves as an independent vehicle through which Forum members can express their views on matters of concern.

## I. Introduction

We appreciate the SEC’s interest in providing investors with information to assist them in evaluating the performance of audit committees. Additionally, we welcome the SEC’s decision to issue a concept release rather than proposed rules to allow a full inquiry into whether and how the disclosure regime needs to be changed to protect investors. The Release is, on its face, directed to operating companies, although it asks whether the disclosures should be made by “all issuers.”<sup>3</sup> While the Forum supports the concept of enhanced disclosure where it serves to assist investor decision making, the proposed disclosures will not advance that objective with respect to registered open-end and closed-end funds (“funds”). We are concerned that providing additional disclosures regarding a fund’s audit committee’s oversight of independent auditors as

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<sup>1</sup> The Forum’s current membership includes over 887 independent directors, representing 122 mutual fund groups. Each member group selects a representative to serve on the Forum’s Steering Committee. This comment letter has been reviewed by the Steering Committee and approved by the Forum’s Board of Directors, although it does not necessarily represent the views of all members in every respect.

<sup>2</sup> Concept Release: Possible Revisions to Audit Committee Disclosures, (July 1, 2015) Release No. 33-9862 [80 FR 38995 (July 8, 2015)] (“Release”).

<sup>3</sup> Release at 52.

discussed in the Release may actually impede the ability of that committee to protect shareholder interests.

Specifically, we have two primary concerns with the Release. The first is that disclosure of the topics and/or substance of communications between the audit committee and auditor has the potential to disrupt the relationship between a fund's independent auditors and audit committee, making the audit committee less effective to act on behalf of shareholders. Audit committee members should have the freedom to discuss a wide variety of topics, issues, and concerns, both potential and actual, without consideration of how and whether such matters might be disclosed to the public. Second, the additional disclosure suggested by the Release would not be beneficial to fund shareholders and would instead make current disclosure unnecessarily confusing. We therefore do not believe the proposal should be applied to funds.

## II. Requiring Disclosure of the Substance of Communications Will Reduce the Communication Between Audit Committee Members and Auditors, to the Detriment of Fund Shareholders

Under the 1940 Act, an independent board of directors oversees the management of each fund on behalf of its shareholders. The fund's independent auditor must be selected each year at an in-person meeting by a majority of the fund's independent directors. The Release primarily focuses on "the audit committee's responsibilities with respect to the appointment, compensation, retention, and oversight of the work of the registered public accounting firm."<sup>4</sup> As a practical matter, however, the involvement of fund independent directors with the audit team is significant and goes well beyond the topics addressed in the Release. The ability of fund audit committees to organize and act in a manner best suited to their particular shareholders' needs is therefore a critical component of the statutory scheme governing funds.

Fund audit committee meetings, and particularly executive sessions, provide directors and independent auditors with opportunities to explore openly a wide variety of topics, ranging from very large issues to those that are seemingly immaterial. While the audit committee members do provide oversight of the audit process, fund boards also discuss a range of other issues with their auditors. These conversations may include issues regarding the fund's risk control environment, accounting processes, valuation policies and procedures, the quality and sufficiency of resources devoted to accounting and compliance functions, comparisons to other clients, the morale of the fund accounting personnel, and so on. Discussions during executive sessions may include topics such as the relationship between the auditors and management, analysis of past problematic situations to help the audit committee better understand the events, and conversations about potential concerns to help the audit committee put particular issues in context. Frank and free discussion can help directors gain a deeper understanding of the funds they oversee and the management companies that serve those funds. Indeed, these somewhat impressionistic conversations with the auditor may be among the most important for the audit committee members.

These discussions are effective in part because the participants do not need to consider whether the topics will be disclosed in any public fashion and later analyzed and second-guessed by

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<sup>4</sup> Release at 30.

regulators, plaintiffs' attorneys, or others. Disclosure of the nature and substance of these communications, therefore, will incent the parties to organize discussions in a way to minimize the necessary disclosure.

As a result, the disclosure contemplated by the Release will likely chill the highly beneficial, free-flowing communication between auditors and directors that exists under the current disclosure regime. This is true whether the conversations involve the nature or substance of the required communications (Request for Comment 11, 12), or additional matters that the audit committee discusses with the auditor (Request for Comment 14, 19). The negative impact on the auditor/audit committee relationship would be particularly critical with regard to executive sessions with the auditor (Request for Comment 19) because it is in that setting the audit committee is able to explore both their concerns and also whether there may be any potential issues the audit team has identified of which the audit committee should be aware.

Reducing the quantity and quality of communications in audit committee meetings as a by-product of regulatory reform will harm fund investors. Indeed, such a result runs counter to the express goal of regulators, who have sought to encourage effective two-way communication between the auditor and the audit committee. As the SEC has long recognized, a healthy working relationship between a fund's audit committee and its independent auditors is critical to foster a good financial reporting environment.<sup>5</sup>

### III. The Contemplated Disclosures Will Not Benefit Fund Shareholders

We do not believe the disclosure contemplated in the Release should be applied to funds. Fund shareholders are primarily retail investors who need clear and concise information. Thus, much of the disclosure contemplated in the Release would needlessly complicate the key information now presented to shareholders.<sup>6</sup> As the critical topics relevant to fund audits are already disclosed to shareholders, we fail to see the benefit of providing additional information about the audit committee's deliberations and communications, nor are we aware that fund shareholders seek such information.

Many of the specific disclosures contemplated in the Release, aimed at enabling shareholders to evaluate whether to ratify the selection of an auditor, are simply inapposite in the fund context. The independent directors, not the shareholders, select the fund's auditor, and shareholder ratification of that decision is virtually never required.<sup>7</sup>

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<sup>5</sup> As the SEC has noted, "[b]y effectively carrying out its functions and responsibilities, the audit committee helps to ensure that management properly develops and adheres to a sound system of internal controls, that procedures are in place to objectively assess management's practices and internal controls, and that the outside auditors, through their own review, objectively assess the company's financial reporting practice." Release 33-8220, Standards Relating to Listed Company Audit Committees, effective date April 25, 2003.

<sup>6</sup> Such a result is contrary to the SEC's efforts to provide clear and concise disclosure to fund investors. See, e.g., the Summary Prospectus Rule, Release No. 33-8998, March 31, 2009.

<sup>7</sup> Rule 32a-4 under the 1940 Act exempts investment companies from obtaining shareholder approval of the selection of independent accountants if the fund has an audit committee composed entirely of independent directors and the audit committee has adopted a written charter.

### A. Funds Currently Disclose all Material Accounting Policies and Issues

Fund shareholders will not benefit from disclosures concerning topics discussed by the audit committee and auditor, because all key accounting policies are already fully disclosed. Substantially all of an investment company's assets are investments, with income from returns on those investments.

While operating companies may have complex operations, off-balance sheet items and other accounting issues less visible to investors, such issues do not arise in the fund context. Fund financial statement disclosures are comprehensive and already adequately identify areas of audit risk and complexity. Prospectuses and financial statements currently include extensive disclosure about valuation policies and procedures, for example, including a description of the inputs used in fair valuations. Required disclosures also identify all significant contractual relationships and related party transactions. As a result, fund shareholders now have information about the most challenging areas of the audit, and would recognize no additional benefit from disclosure of communications on those topics between the auditor and the audit committee.

### B. Disclosure of the Substance or Nature of Audit Committee Conversations With the Auditor Will Result in Confusing Disclosures to Fund Shareholders

As a result of the realities of how funds issue quarterly and annual reports to shareholders, the changes contemplated by the release would only serve to add additional complexity and cloud existing disclosure. Funds within the same investment company complex generally will share accounting and valuation functions and therefore will be included in a combined annual report. Any disclosure of matters such as the number of times an audit committee met in executive session (Request for Comment 19) or the nature and/or substance of communications with the auditor (Requests for Comment 8, 11, 12 and 14) would likely only involve some subset of the funds opined on, and thus these disclosures would have to occur on a fund-by-fund basis. Fund shareholders would have to wade through pages of disclosures seeking those that are applicable to their fund. With additional complexity comes additional cost for the fund. Unfortunately, it is the shareholders would bear the additional costs of creating these unnecessary and unhelpful disclosures.

### C. Disclosure of Auditor Tenure Is Unhelpful With Respect to Funds

The Release raises the issue of whether disclosing the auditor's tenure might be "a relevant consideration to the audit committee's determination of whether or not to engage or retain the auditor."<sup>8</sup> Whether or not that is true in the operating company context (and the Release concedes that neither short nor long auditor tenure is correlated with audit quality), it is not sufficiently significant for funds to justify highlighting it.

Investment company audits require specialized knowledge, particularly in the area of valuation of portfolio securities. There is a separate audit guide for investment companies, as well as

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<sup>8</sup> Release at 46.

unique regulatory requirements. As a result, fewer firms have developed expertise in auditing funds than operating companies.

The problem of relatively few audit firms with the appropriate level of expertise in this area is exacerbated by the fact that a conflict may prevent one of the few qualified audit firms from servicing a fund complex. For example, some of the otherwise qualified audit firms may have a financial business relationship with the fund complex, such as lines of credit with a bank affiliated with the adviser. Additionally, an audit firm may use the adviser to manage all or a portion of its retirement plan, which may render the firm not independent with respect to the audit of the fund.

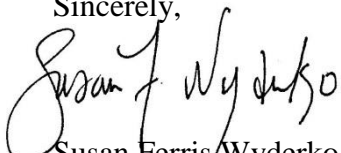
Other independence issues can arise when the fund complex, as part of normal business operations, develops new affiliations, merges, or in some other manner changes a portion of its business relationships. The availability of audit firms can be further constricted where the audit firm wishes to provide consulting services to the adviser or its affiliates, which can be more desirable to the audit firm than having the fund as an audit client. The limited universe of appropriately qualified audit firms can be particularly significant when the fund is part of a broadly diversified financial services firm.

These factors, combined with the relatively small size of the available pool of qualified, high quality audit firms that possess the requisite expertise to audit mutual funds, mean that considerations other than audit tenure are far more likely to have an impact on the selection of the auditor. Requiring disclosure of audit tenure would place wholly unwarranted attention on a factor that is, in general, not dispositive.

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We look forward to continuing to participate in this ongoing discussion, as independent directors have an important role to play in fostering healthy communications with fund shareholders. If you would like to discuss our comments further, please feel free to contact us at [REDACTED].

Sincerely,

  
Susan Ferris Wyderko  
President, CEO