



1401 H Street, NW, Suite 1200  
Washington, DC 20005-2148  
Phone 202/326-8300  
Fax 202/326-5828  
www.idc.org

September 8, 2015

Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: Possible Revisions to Audit Committee Disclosures; File No. S7-13-15

Dear Mr. Fields:

The Independent Directors Council<sup>1</sup> appreciates the opportunity to submit comments on the Securities and Exchange Commission's concept release regarding audit committee reporting requirements.<sup>2</sup> The Concept Release seeks public input as to whether there would be benefit from requiring audit committees to provide additional audit committee report disclosure. Specifically, the Concept Release asks whether additional disclosure about an audit committee's oversight of the independent auditor would assist investors in making investment decisions, or better inform proxy voting decisions regarding ratification of the auditor and the election of directors who are members of the audit committee.

As a preliminary matter, we note that the Concept Release applies to closed-end funds, and does not apply to open end funds. Item 22(b)(16) under Schedule 14A requires closed-end fund proxy statements pertaining to the election of directors to disclose information about the audit committee

---

<sup>1</sup> IDC serves the U.S.-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds, and unit investment trusts. Members of ICI manage total assets of \$18.2 trillion and serve more than 90 million shareholders, and there are approximately 1,900 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

<sup>2</sup> See *Possible Revisions to Audit Committee Disclosures*, Release Nos. 33-9982; 34-75344 (July 1, 2015) (the "Concept Release"), available at <http://www.sec.gov/rules/concept/2015/33-9862.pdf>.

and its oversight of the audit of the financial statements. Open-end funds do not hold annual shareholder meetings and their audit committees are not required to provide these disclosures. In addition, while the Concept Release technically does apply to closed-end funds, the Concept Release, and all of the discussion contained in it, is geared to audit committees of public operating companies. The Concept Release fails to make a case for why audit committees of closed-end funds should make additional disclosures.

For the reasons discussed below, we do not believe that additional disclosure would benefit closed-end fund shareholders.<sup>3</sup> IDC is, and has consistently been, fully supportive of disclosure that helps investors make informed investment decisions.<sup>4</sup> The disclosure contemplated by the Concept Release, however, is not material information that would help closed-end fund investors in making investment or proxy voting decisions. Moreover, we are concerned that the suggested disclosure could in fact chill audit committee discussions and adversely impact audit committee practices, with little or no benefit to investors. In addition, the disclosure described in the Concept Release would not make sense for open-end funds.

### **Closed-End Fund Investors Would Not Benefit From the Proposed Disclosure**

In the Concept Release, the Commission points to various sources to support the proposition that investors are interested in receiving more disclosure relating to audit committees. Notably, the Commission does not cite, nor are we aware of, any calls from closed-end fund investors for more disclosure about the work of closed-end fund audit committees. Current disclosures required by closed-end funds in their proxy statements and their statements of additional information already provide information about audit committees.<sup>5</sup>

In addition, we believe that the disclosure, if proposed and adopted, would amount to “information overload.” The information is simply not relevant for closed-end fund investors making investment or proxy voting decisions. As both the SEC and the PCAOB have recognized, funds are

---

<sup>3</sup> Currently, the audit committee report for a closed-end fund must, among other things, state whether the audit committee has: a) reviewed and discussed the audited financial statements with management; b) discussed with the independent auditor the matters required to be discussed by audit standards set forth by the Public Company Accounting Oversight Board (“PCAOB”); c) received the written disclosures and letter from the auditor required by PCAOB standards pertaining to the auditor’s independence; and d) recommended that the audited financial statements be included in the shareholder report filed with the SEC.

<sup>4</sup> See e.g., Letter from Dorothy A. Berry, IDC Governing Council Chair, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (September 15, 2009) (supporting the SEC’s governance disclosure proposal).

<sup>5</sup> For example, Item 18.5 of Form N-2 and Item 22 of Schedule 14A both require that the fund identify its board’s standing committees, provide a concise statement of the functions of the committee, identify the members of the committee, and disclose the number of meetings held during the fund’s last fiscal year.

unique and differ in significant ways from operating companies.<sup>6</sup> In recognition of these differences, for instance, funds are generally not required to seek shareholder ratification of the board's selection of the independent auditor.<sup>7</sup> In adopting this exemption, the SEC reasoned that the shareholder ratification had become largely perfunctory, and that ongoing oversight provided by an independent audit committee can provide greater protection to shareholders than shareholder ratification of a fund's independent auditors.<sup>8</sup> This long-standing and well-advised exemption renders moot the intention that enhanced audit committee disclosure would help closed-end fund shareholders cast an informed vote about the fund's independent auditor.

In addition, SEC registered investment company financial statements, and therefore audits of those financial statements, are inherently less complex than those of operating companies. Unlike operating companies, investment company activities are limited to raising capital from investors and investing in a portfolio of securities with the objective of earning a return. As a result, fund assets consist entirely of investment securities. Funds typically have no intangibles, inventories, loan loss provisions, pension obligations, or income tax expense. Further, funds have far fewer choices in the application of accounting policies. Because an investment company's assets consist entirely of investment securities, the principal objectives in an investment company audit are to provide reasonable assurance that the fund has ownership and accounting control over its investments and that they are valued properly. This lack of complexity dramatically decreases the likelihood that problems may arise during the audit or that a fund's financial statements would need to be restated. It also decreases any perceived need for additional disclosure regarding the audit committee's oversight of the independent auditor. We therefore believe that the disclosure contemplated by the Concept Release would not be appropriate for closed-end funds and, more importantly, would not benefit closed-end fund investors.

---

<sup>6</sup> See e.g., SEC Rule 2-07 of Regulation S-X, 17 C.F.R. § 210.2-07 (setting forth different requirements for the timing of communications between an auditor and an investment company audit committee than for those of an audit committee of other issuers); PCAOB Auditing Standard 16 (setting forth different requirements for the timing of communications between an auditor and an investment company audit committee than for those of an audit committee of other issuers).

<sup>7</sup> Under rule 32a-4 of the Investment Company Act of 1940, both closed-end and open-end funds are exempt from having to seek shareholder approval of the independent public accountant, if (i) the fund establishes an audit committee composed solely of independent directors that oversees the fund's accounting and auditing processes, (ii) the fund's board of directors adopts an audit committee charter setting forth the committee's structure, duties, powers, and methods of operation, or sets out similar provisions in the fund's charter or bylaws, and (iii) the fund maintains a copy of the audit committee charter.

<sup>8</sup> Securities and Exchange Commission, Role of Independent Directors of Investment Companies, Rel. Nos. 33-7932; 34-43786; IC-24816 (January 2, 2001).

### **The Proposed Disclosure Could Chill Audit Committee Discussion and Adversely Impact Committee Practices**

The current disclosure framework appropriately balances interest in providing transparency into the work of boards with the need for audit committees to be able to engage in robust discussions and have confidence that their deliberations will remain confidential. Making public the disclosures outlined in the Concept Release could chill this discussion. In addition, audit committee meetings would likely be managed with the goal of satisfying the disclosure requirements, rather than having meetings that organically allow an audit committee to hold free-flowing discussions of substantive issues. A lack of robust and free-flowing discussion, we believe, would ultimately decrease the quality of board oversight of the audit process.

The disclosure suggested by the Concept Release also would likely adversely impact audit committee practices. In an effort to satisfy regulatory expectations and avoid proxy statement liability, audit committees may feel compelled to take a “checklist” approach to the committee’s work, which would not enable an audit committee to devote as much time, attention, and focus as it would otherwise be able to for matters of particular relevance. Checklists also lead to boilerplate disclosures, which would run counter to the usefulness of the disclosures that the Commission is seeking.

### **The Disclosure Would Not Make Sense for Open-End Funds**

The Concept Release asks, if the Commission were to proceed with requiring some or all of the disclosures contemplated by the Concept Release, whether the disclosures should be made by “all issuers.”<sup>9</sup> As noted above, the Commission wisely determined that open-end investment companies are not subject to the audit committee report requirement. Absent any compelling justification to change this, we see no reason why the disclosures contained in the reports or the disclosures contemplated in the Concept Release should apply to open-end investment companies. In addition to the comments above, which apply equally to open-end funds, the discussion below underscores why the disclosure does not make sense for open-end funds.

First, open-end funds are typically organized in states that do not require annual shareholder meetings. While shareholder meetings are called from time to time for specific purposes (e.g., to approve changes to fundamental investment policies, to approve changes to investment advisory contracts, or to elect directors when the proportion of independent directors is less than the required minimum) they are infrequent. Combined with the exemption from shareholder ratification of the board’s selection of the independent auditor, the intent of the contemplated disclosure—to better inform open-end fund shareholder proxy voting decisions—would not be achieved.

---

<sup>9</sup> Concept Release, *supra* note 2, at 52.

Mr. Brent J. Fields  
September 8, 2015  
Page 5 of 5

Second, if it were to apply, the result would be a dramatic increase in the frequency of audit committee meetings at a significant cost to shareholders, as well as in direct contravention to rule 2-07(a) of Regulation S-X, which allows investment company audit committees to meet quarterly, rather than prior to the filing of each audit report. This is because fund complexes typically offer several different funds, each organized as a separate legal entity, with fiscal year ends staggered throughout the year. In many cases one board oversees all of the funds in the complex. The audit committee of a particular fund board could have oversight responsibility for dozens of funds and would have to meet throughout the year to review financial statements and recommend that they be included in the shareholder report before it is filed with the SEC.<sup>10</sup> This could result in monthly meetings, whereas our research shows a typical fund audit committee currently meets on average four times each year.

\* \* \*

If you have any questions about our comments, please contact me at [REDACTED].

Sincerely,



Amy B.R. Lancellotta  
Managing Director  
Independent Directors Council

cc: The Honorable Mary Jo White  
The Honorable Luis A. Aguilar  
The Honorable Daniel M. Gallagher  
The Honorable Kara M. Stein  
The Honorable Michael S. Piwowar

Matthew Giordano, Chief Accountant  
Division of Investment Management

---

<sup>10</sup> While audit committees for closed-end funds are already required to meet in connection with each fund's fiscal year end, open-end funds, which account for the vast majority of investment companies in the marketplace today, have no such requirement.