

SEC SANCTIONS AUDITOR, ADMINISTRATOR, AND TRUSTEE IN CONNECTION WITH AUDITOR-TRUSTEE RELATIONSHIP

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On July 1, 2015, the SEC issued a consent order (“Order”) instituting administrative and cease-and-desist proceedings against the former auditor (“Auditor”) of three closed-end funds (“Funds”), an administrator of the Funds that provided compliance services (“Administrator”), and a former member of the Funds’ boards of trustees (“Trustee”).¹

While serving as a non-interested member of the boards of the three Funds, as well as on each Fund’s audit committee, the Trustee entered into an ongoing material business relationship with an affiliate of the Auditor (“Auditor’s Affiliate”), which impaired the Auditor’s independence. The Trustee did not disclose the business relationship to the Funds, and the business relationship also went undetected by the Auditor for several years. During this time, the Administrator assisted the Funds in implementing a regulatory compliance program that, among other things, required board members to disclose potential conflicts of interest in an annual questionnaire, including any direct or indirect business relationships with the Auditor. Relationships with the Auditor’s affiliates were not expressly covered by the questionnaire nor by any other policy or procedure adopted by the Funds.

1. The Auditor.

Although the corporate parent of the Auditor and the Auditor’s Affiliate had policies requiring an “independence consultation” prior to entering into a new business relationship, that consultation never occurred prior to the initial business transaction with the Trustee nor during the consulting engagement that followed. During this period, the Auditor permitted its audit reports to be included in the Funds’ annual reports and proxy statements without disclosure of its affiliate’s relationship with the Trustee or the Auditor’s impaired independence. The Auditor did not discover the relationship until it made enhancements to its independence quality controls several years later, at which point the Auditor reported the issue to the Funds’ audit committees, to the Administrator, and to the SEC.

The SEC sanctioned the Auditor for (a) engaging in improper professional conduct, (b) violating Rule 2-02(b) of Regulation S-X, and (c) causing the Funds to violate ICA Sections 20(a) and 30(a) and ICA Rule 20a-1, by failing to disclose the Trustee’s relationship with the Auditor’s Affiliate and by permitting its audit reports to be used in the Funds’ annual reports and proxy statements. Without admitting or denying the SEC’s findings, the Auditor agreed to pay disgorgement, pre-judgment interest, and a civil penalty totaling approximately \$1.1 million.

2. The Administrator.

The Administrator had contractually agreed to assist the Funds in discharging their responsibilities under Rule 38a-1, which requires “written policies and procedures reasonably designed to prevent violation of the Federal Securities Laws by the Fund.” The Administrator provided a chief compliance officer to each of the Funds and provided compliance policies and procedures, which were approved by the Funds’ boards. Pursuant to those procedures, board members annually completed questionnaires in which they were required to identify potential conflicts of interest. The questionnaires asked board members to disclose, among other things, any “direct or material indirect relationship” with the Auditor. The questionnaire did not expressly ask about relationships with affiliates of the Auditor, nor did any other of the Funds’ policies and procedures directly address business relationships with affiliates of the Auditor.

According to the Order, the Funds’ policies and procedures regarding auditor independence were inadequate, and the Funds provided insufficient training to board members “in the discharge of their responsibilities as to auditor independence.” The SEC

¹ *In the Matter of Deloitte & Touche LLP, ALPS Fund Services, Inc. and Andrew C. Boynton*, Adm. Proc. File No. 3-16672 (July 1, 2015). A copy of the Order is available at <http://www.sec.gov/litigation/admin/2015/34-75343.pdf>.

sanctioned the Administrator for causing the Funds to violate ICA Rule 38a-1. Without admitting or denying the findings, the Administrator agreed to pay a civil penalty of \$45,000.

3. The Trustee.

The business relationship between the Auditor's Affiliate and the Trustee involved the purchase from the Trustee and his business partners of intellectual property rights to a business methodology, as well as a simultaneous agreement that the Trustee would serve as a consultant to the Auditor's Affiliate for a three-year period. In his consulting role, the Trustee participated in trainings and workshops involving employees of the Auditor's Affiliate and, on at least one occasion, employees of the Auditor. The Auditor's Affiliate paid the Trustee amounts that totaled more than 10% of the Trustee's income and more than 10% of the Trustee's net worth.

The Trustee completed the Funds' independence questionnaires annually. In response to the questionnaires' request for his "principal occupation(s) and other positions," the Trustee did not identify his relationship with the Auditor's Affiliate. Based, according to the Order, on his understanding that the Auditor's Affiliate was a separate legal entity from the Auditor, the Trustee also did not disclose his relationship with the Auditor's Affiliate in response to the questionnaires' request for disclosure about any "direct or material indirect business relationship" with the Auditor. The Trustee never inquired whether his relationship with the Auditor's Affiliate raised any auditor independence or conflict of interest issues.

The SEC sanctioned the Trustee for causing the Funds to violate ICA Sections 20(a) and 30(a) and ICA Rule 20a-1 by failing to disclose his relationship with the Auditor's Affiliate and thereby permitting the Auditor's audit reports to appear in the Funds' annual reports and proxy statements without disclosure of the Auditor's impaired independence. Without admitting or denying the findings, the Trustee agreed to pay disgorgement, prejudgment interest, and a civil penalty totaling approximately \$60,000.

4. The Funds.

Although the Order does not sanction or penalize the Funds, the Order found: (a) that the actions and omissions of the Auditors and the Trustee caused the Funds to violate ICA Sections 20(a) and 30(a) and ICA Rule 20a-1 by including the Auditors' audit reports in the Funds' annual reports and proxy statements without disclosure of the Auditor's impaired independence, and (b) that the actions and omissions of the Administrator caused the Funds to violate ICA Rule 38a-1 by having inadequate policies and procedures governing auditor independence.