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U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Grant Thornton LLP  
175 W Jackson Boulevard, 20th Floor  
Chicago, IL 60604-2687  
T 312.856.0200  
F 312.565.4719  
[www.GrantThornton.com](http://www.GrantThornton.com)

Via e-mail: [Ethics-ExposureDraft@aicpa-cima.com](mailto:Ethics-ExposureDraft@aicpa-cima.com)

Re: File Number S7-10-18: Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships; Release Nos. 33-10491, 34-83157; IC-33091: IA-4904

Dear Office of the Secretary:

Grant Thornton LLP (“Grant Thornton”) appreciates the opportunity to comment on the Securities and Exchange Commission’s (“Commission” or “SEC”) Proposed Rule, *Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationship* (“Proposed Rule” or “proposal”), 83 Fed. Reg. 20753 (May 8, 3018).

Grant Thornton agrees with the Commission’s proposal to amend Rule 2-01(c)(1)(ii)(A) of Regulation S-X (the “Loan Provision”) as certain aspects of the Loan Provision are not working as intended. Grant Thornton believes these proposed revisions would increase the effectiveness of the Loan Provision without jeopardizing auditor objectivity and impartiality in the performance of an audit.

While Grant Thornton supports the revisions set forth in the Proposed Amendments, we have provided the following comments for the SEC’s consideration.

#### General Comments

Grant Thornton suggests that SEC consider providing illustrative example scenarios and frequently asked questions to assist in the application of modifications.

#### Request for Specific Comments

Below are Grant Thornton’s specific comments – as requested in the Release.

#### 1. Focus the Analysis Solely on Beneficial Ownership

Grant Thornton supports the Commission’s proposal to remove the reference to “record” owners from the Loan Provision. We agree with the Commission that the record owners would

lack the ability to exert influence over the issuer audit client. Grant Thornton agrees that the removal of analyzing record owners eliminates a compliance challenge as record owners are not identifiable in publicly available information and issuer audit clients are often unaware of all record owners. We believe that beneficial owners should be defined if this continues to be referenced in the Loan Provision. It should be clarified that beneficial ownerships would include those that have economic interest in the issuer audit client, however, the lack of an economic interest in the issuer audit client would result in the inability for a beneficial owner to have significant influence over the issuer audit client. By including a significant influence test, the Commission could consider removing beneficial ownership from the Loan Provision, therefore, may want to consider converging on a common “affiliate of audit client” definition used by the profession in application of other SEC independence rules.

Grant Thornton does not believe the removal of the requirement to analyze record owners would raise concern about the independence of auditors as it is not likely that investors would view record owners as having the ability to control or influence the issuer audit client. We believe that any self-interest threats to independence created by a lending relationship between a covered person or an accounting firm would be insignificant. While Grant Thornton supports the removal of record ownership from the Loan Provision, we still believe other modifications to the Loan Provision would be appropriate, as discussed below.

## 2. “Significant Influence” Test

Grant Thornton supports the Commission’s proposal to replace the 10 percent bright-line test with a significant influence test and agrees with the reasons shared by the Commission for this modification. We believe that solely focusing on 10 percent or greater ownership may result in evaluating relationships with an entity that would not have the ability to exert influence over an issuer audit client. Furthermore, it is quite challenging for auditors and issuer audit clients to identify relationships where the ownership is less than 20% percent since significant influence is generally not exerted, therefore, the entity was not being tracked or monitored from an affiliate perspective.

Grant Thornton agrees with the proposed reference to ASC’s 323 provisions for “significant influence” as accounting firms and issuer audit clients are familiar with this requirement and the application would be consistent with other evaluations of affiliate relationships. Grant Thornton believes that replacing the 10 percent bright-line test with a “significant influence” test along with the other proposed amendments, address the compliance challenges that are identified in the Commission’s Release based on the familiarity that the profession with this test. While Grant Thornton recognizes that the application of “significant influence” for financial reporting purposes and the evaluation of auditor independence may not necessarily be congruent, we believe that ASC 323 provides an appropriate framework for analyzing “significant influence” in the context. The Commission may want to also provide a materiality consideration in the framework to converge on a consistent application of the definition of an “affiliate of an audit client”. While Grant Thornton agrees that accounting firms and issuer audit clients are familiar with the concept of significant influence, we believe that additional guidance provided by the Commission would assist in clarifying the entities that providing lending relationships to accounting firms and/or covered persons should be the focus of the “significant influence” test and not lending relationships with entities that are under common control with or controlled by

the beneficial owner. The Commission should consider including guidance to identify responsibilities of issuer audit clients in identifying entities with significant influence.

Grant Thornton believes that the “significant influence” test will address the compliance challenges generated by the current the Loan Provision for fund audit clients. Additional guidance will also be beneficial when evaluating entities that may have significant influence in the investment fund context as ASC 323 is not routinely applied in the investment fund context. Grant Thornton believes that codification of the “significant influence” test will promote consistent application by accounting firms and issuer audit clients.

Grant Thornton agrees with the consideration of the rebuttable presumption of 20 percent as noted in ASC 323 and does not feel that it is necessary to set a different threshold for the Loan Provision. The proposed amendments may result in different entities being evaluated as significant influence could exist through governance oversight (or other qualitative factors) that may not have previously been identified through percentage of ownership.

Grant Thornton does not believe that alternatives to the “significant influence” test are needed, and supports the “significant influence” test with the other proposed modifications to the Loan Provision. While an entity may have influence over an issuer audit client, a lending relationship with an entity with influence that is not deemed as significant over an issuer audit client would not be viewed as having a significant threat accounting firm’s independence.

The Commission has highlighted certain entities that may be viewed as having significant influence over the issuer audit client. When evaluating whether an investment advisor has significant influence, Grant Thornton believes that the nature of the services provided by the investment advisers should be considered. The factors identified in the Proposed Rule are appropriate to be considered in the analysis performed by accounting firms and issuer audit clients. The governance structure and governing documents, as well as the services provided by the investment advisers, will need to be considered. While participation rights are identified in the proposed amendments, evaluating participation rights as a factor along would likely not indicate significant influence.

### 3. “Known Through Reasonable Inquiry”

Grant Thornton is in agreement with the “known through reasonable inquiry” addition and clarification in the proposed amendments. We believe this proposed amendment establishes criteria for an accounting firm to work with their issuer audit client to identify entities that would also be considered beneficial owners through the ownership of the issuer audit client’s equity securities or to identify entities that have significant influence. If the entity was not identified by the issuer audit client, it would not be reasonable to conclude that a lending relationship that exists between an accounting firm or covered person with the entity could impair the accounting firm’s independence. Grant Thornton agrees that using the “known through reasonable inquiry” standard would assist in addressing compliance challenges associated with the application of the Loan Provision.

Grant Thornton believes that the Commission may want to consider identifying additional parameters that accounting firms would consider when determining procedures for performing a

reasonable inquiry with an issuer audit client. In addition to the “known through reasonable inquiry” standard, Grant Thornton believes it would be reasonable to conclude that an accounting firm could also review publicly available information to determine ownership information of their issuer audit client that would need to be considered if an accounting firm and/or covered person was considering a lending relationship with an entity.

Grant Thornton believes both the significant influence test and the reasonable inquiry standard would be appropriate to include as amendments to the Loan Provision as these modifications clarify the process that should be completed by accounting firms. This also provides a framework for accounting firms and issuer audit clients for evaluating lending relationships that could impact the accounting firm’s objectivity and impartiality.

#### 4. Exclude from “Audit Client” Other Funds Considered an “Affiliate of the Audit Client”

Grant Thornton agrees with the Commission’s proposal to exclude funds that otherwise would be considered an affiliate of the issuer audit client from the definition of the SEC’s definition “affiliate of an audit client” for purposes of the Loan Provision. We believe a lending relationship with entities held in funds that are not audited by the firm would not represent a significant independence threat as long as the lending relationship is extended within ordinary course of business terms. However, we believe the Commission should consider providing clarification that the same principles applied to funds could also be applied outside of the fund complex, to other issuer audit client affiliates (not audited by the accounting firm). Grant Thornton also believes that it would be appropriate to exclude other funds of an “investment company complex” (other than the fund under audit). Grant Thornton believes that lending relationships with entities that are within the “investment company complex” but, not subject to audit would not pose a significant threat to auditor independence. We believe the Commission should provide clarification that downstream affiliates of excluded fund affiliates would also be outside of the scope of the Loan Provision. The Commission should also consider modifying the exclusion for purposes of the Loan Provision to also include downstream and commonly-controlled affiliates of any issuer audit client and not limiting to the fund audit clients since the threat would not be significant to auditor independence.

#### 5. Other comments relating to the Loan Provision or other provisions in Rule 2-01

##### Materiality

Grant Thornton believes that it may not be necessary to consider materiality when evaluating the significance of the lender’s investment in the issuer audit client’s equity securities. It may also be challenging in determining materiality to the lender. However, if the clarifications suggested (above) are not incorporated into the final rule, a materiality qualifier for the lender’s investment in the issuer audit client would be helpful. The proposed amendment to the Loan Provision would result in any entity that the issuer audit client has significant influence over being considered an “affiliate” regardless of consideration of materiality. A lending relationship with an entity that the issuer audit client has significant influence over that is not material to the issuer audit client would not impact an auditor’s objectivity and impartiality. The addition of a materiality qualifier may assist in reducing compliance costs for accounting firms and issuer audit

clients, therefore, allowing the evaluation to focus on lending relationships that may bear on auditor independence.

#### **Accounting Firms' "Covered Persons" and Immediate Family Members**

Grant Thornton does not believe that an amendment is needed to the "covered person" definition. The Commission could consider modifying partner, principal or shareholder references to focus on individuals that have the potential for providing services to the issuer audit client such as audit partners and partners, principals or shareholders that provide services to the issuer audit client as it relates to the Loan Provision.

Grant Thornton believes the current inclusions in the office definition are sufficient. We also believe the inclusion of immediate family members is appropriate in the definition as partners, principals and shareholders have influence over their immediate family members' lending relationships.

#### **Expansion of Exception for certain lending relationships**

Grant Thornton believes that the Commission could consider expanding the exception to student loans, partner capital account loans, and credit cards as long as the loan is made by the financial institution under its normal lending procedures, terms and requirements. The Commission may want to consider including a materiality factor and a grandfathering consideration to minimize the independence threat that could occur if a covered person or their immediate family member entered into a lending relationship with an issuer audit client. A grandfathering consideration would include determining that a lending relationship existed prior to the an individual being considered a covered person and the loans were kept current as well in as in compliance with all terms and the terms were not modified in any manner from the original agreement.

#### **Evaluation of Compliance**

Grant Thornton does not believe that it is necessary to include specific dates as a requirement for evaluating compliance. We believe it would be appropriate for an accounting firm to evaluate compliance based on facts and circumstances, and document conclusions reached based on their firm's policies. An accounting firm may consider it appropriate to evaluate compliance prior to the commencement of an engagement period, prior to annual independence communications, and when a material change in governance has occurred based on reasonable inquiry and publicly available information. Grant Thornton agrees with the process described in the proposed modifications for monitoring auditor independence as it relates to the Loan Provision.

#### **Secondary Market Purchases of Debt**

Grant Thornton believes that lending relationships that are purchased in a secondary market of debt should be excluded from the Loan Provision as accounting firms and covered persons are unable to control these transactions or influence the secondary market purchase. We believe it would be appropriate to establish a grandfathering process for lending relationships that are sold in a secondary market if not excluded in the final rule.

### Other Changes to the Commission's Auditor Independence Rules

Grant Thornton appreciates the opportunity to provide comments for the Commission to consider related to changes to the auditor independence rules. Similar to the proposed amendments to the Loan Provision, we believe the existing business environment could benefit from the re-evaluation of certain auditor independence rules. We would encourage the Commission to consider the following auditor independence rules to confirm that the rules are operating as originally intended while continuing to maintain independence in fact and appearance.

**Affiliate Rule\_**– Grant Thornton believes the Commission could consider reviewing the Affiliate Rule as the modern business environment allows for frequent changes in ownership positions to facilitate capital formation. The Commission's definition of "affiliate of the audit client" may result in an entity meeting the affiliate criteria that may not reasonably be viewed to pose an independence threat to the issuer audit client. The Commission could consider modifying the concept of "control" to allow for the focus of accounting firm's evaluation of relationships that may bear on independence to be directed at the issuer audit client and its downward affiliates. We would support the Commission in considering modifications to the "up-and-over" provision due to the frequency and existing compliance challenge to timely monitor changes in ownership. We believe the Commission should consider modifications to the affiliate criteria evaluations established by other regulators, such as the AICPA and IESBA. In addition, when the AICPA adopted its current affiliate definition, the AICPA also adopted exceptions to permit prohibited services to certain affiliates that were not audited by the accounting firm (such as brother-sister affiliates) if certain criteria (or requirements) were met since such services did not create a significant independence threat or impair the accounting firm's objectivity or integrity to perform the audit. The Commission may want to consider this when reviewing the Affiliate Rule or other independence rules.

**Transition Rule\_**– Grant Thornton believes the Commission could consider providing a transition or grace period when a company pursues an initial public offering ("IPO") to promote timely capital formation. Providing a period of transition will allow a private company to maintain audit quality with minimal business interruption by continuing to work with their auditor who may have an independence matter as the accounting firm had been following a different regulator's independence requirements. The lack of a transition period may create barriers for companies seeking to go public as two to three-year period of financial statements are required to be included in the IPO filing.

A transition period would also be beneficial if an ownership change occurs that results in a new affiliate with an existing nonaudit service, financial relationship or business relationship that may not been permitted under the independence requirements. We believe a reasonable investor would not deem the existence of these prohibited services at the time of the ownership change as a matter that would impair auditor independence as the accounting firm would not be aware of the future affiliate relationship at the time the prohibited relationship was initiated under the previous ownership structure. We encourage the Commission to consider a potential modification to the independence rules to address the impact of transition matters.

**Business Relationship Rule** – Similar to the review that was performed by the Commission on the Loan Provision, Grant Thornton believes the Commission could consider completing a review of Regulation S-X Rule 2-01(c)(3), commonly referred to as the Business Relationship Rule. As currently designed, certain business relationships are restricted with substantial stockholders that have decision-making capacity over the audited entity. We would recommend that the Commission consider replacing “substantial stockholder” with the “significant influence” test as described in the proposed modifications to the Loan Provision. We also encourage the Commission to consider the technological advancements that have occurred since the Business Relationship Rule became effective.

**Expanded Safe Harbor Rule**– The Commission’s rules have allowed accounting firms to apply a “safe harbor” where the independence of a covered person in an accounting firm is inadvertently impaired, provided that the violation is addressed timely and the accounting firm maintains an adequate quality control system. While this “safe harbor” approach addresses instances of non-compliance related to financial relationships, there is not a similar approach applied to other types of non-compliance with the independence rules if the instance of noncompliance is inadvertent or de minimis. We recommend that the Commission consider whether it would be appropriate to apply a similar framework to other instances of non-compliance with the independence rules (e.g., nonaudit services, etc.). The Commission may want to also consider the guidance that has been developed by other regulators (e.g., AICPA or IESBA) to consider a similar approach to evaluating instances of non-compliance (or breaches) that may not result in an independence threat.

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We would be pleased to discuss our letter with you. If you have any questions, please contact Anna Dourdourekas, National Partner in Charge, Ethical Standards, at [Anna.Dourdourekas@us.gt.com](mailto:Anna.Dourdourekas@us.gt.com) or (630) 873-2633.

Very truly yours,



Grant Thornton LLP