

March 16, 2020

U.S. Securities and Exchange Commission 100 F Street, NE Washington, DC 20549-1090

Via e-mail: rule-comments@sec.gov

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Re: File Number S7-26-19: Amendments to Rule 2-01, Qualifications of Accountants; Release Nos. 33-10738; 34-87864; FR-86; IA-5422; IC-33737.

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, *Amendments to Rule 2 01, Qualification of Accountants* ("Proposed Amendments" or "Proposal").

Grant Thornton agrees with the Commission's Proposal to amend the comprehensive framework of rules governing auditor independence, Rule 2-01 of Regulation S-X (the "Qualification of Accountants"), to modernize certain aspects of the auditor independence framework in light of current market conditions and industry practices. The modifications set forth in the Proposed Amendment will continue to promote and enhance investor protection, and meet the objectives of the SEC's general standard of auditor independence in Rule 2-01(b) that an accountant will not be recognized as independent "if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement," and that it is appropriate to consider "all relevant circumstances" in assessing independence (refer to 17 C.F.R. § 210.2-01(b)).

Grant Thornton also believes the proposed revisions would more effectively structure the independence rules and analysis so that relationships and services that would not pose threats to an auditor's objectivity and impartiality would not trigger non-substantive rule breaches or potentially time consuming audit committee review of non-substantive matters. Furthermore, the proposed revisions will allow the audit committee, auditor and Commission to better focus on those relationships, services and other potential independence threats that could jeopardize auditor objectivity and impartiality in the performance of an audit.

The amendments and further clarifications in the Proposal will continue to meet the key objectives on maintaining auditor independence and investor protection. 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 hypothetical scenarios based on the Commission's experience over the past decade through consultations, illustrative diagrams and frequently asked questions to assist auditors in the application of the Proposed Amendments. When developing such guidance, the Commission should also reiterate that audit firms and registrants, including their audit committees, have a shared responsibility for monitoring independence.

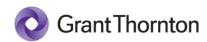
Request for Specific Comments

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

1. Proposed Amendments for the Common Control and the Affiliate of the Audit Client

Grant Thornton supports the Commission's proposal to amend Rule 2-01(f)(4)(i) to include a materiality qualifier with respect to operating companies where there is common control with the sister entity and the entity under audit and to focus the independence analysis on sister entities that are material to the controlling entity under proposed Rule 2-01(f)(4)(i)(B).

For sister entities under common control with the audit client, the Proposed Amendment adds a materiality qualifier for the sister entity to be an affiliate only if it is material to the entity that controls it. Grant Thornton agrees with the Commission that an auditor's services or relationships with immaterial sister entities generally do not pose a threat to the auditor's objectivity. All sister entities under common control are currently considered affiliates. Therefore, by adding the materiality qualifier Grant Thornton agrees it will reduce the number of sister entities requiring monitoring for independence purposes. In addition, auditors are familiar with materiality evaluations currently applied in the existing affiliate of an audit client definition in Rule 2-01(f)(4)(ii) and (iii) and in applying the American Institute of Certified Public Accountants ("AICPA") affiliate definition. However, due to the challenges encountered in applying the materiality concept, we suggest the Commission provide guidance on how auditors can determine materiality in situations where the portfolio company audit client does not have a relationship with the private equity group, and total assets under management, total revenue, total assets or net income, for example, are not available in the public domain for either the controlling entity or the portfolio companies. For example, are there qualitative factors that the auditor and the audit client should consider when certain quantitative data or information is not available in the public domain? Therefore, what is the expectation of the Commission as to "best efforts" to obtain such information if not readily accessible to the auditor or audit client? If the expectation is to assume materiality in all cases it will not reduce the burden of monitoring an auditor has to perform. Based on the above, we request that the Commission consider issuing guidance in alignment with the AICPA's guidance included in 1.224.010.03, Client Affiliates. Additionally, due to the dynamic nature of some private equity groups and the volume of acquisitions and exited investments, we recommend that the SEC consider explaining in the final rule how often monitoring is expected if lists can only be obtained annually from private equity groups, for example would at least annually be considered reasonable.

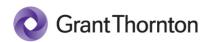


The proposed revisions do not fulfill an auditor's independence evaluation, based on our interpretation, of immaterial sister entities that do not meet the affiliate criteria. It appears that the general standard in Rule 2-01(b) must still be considered to ensure independence in both fact and appearance to entities not deemed affiliates under the Proposed Amendments of the control prong due to lack of materiality. We believe an overarching consideration is sufficient to mitigate the risk of any potential independence appearance issues. However, Grant Thornton believes it would be helpful if the Commission clarified in a scenario, examples of the type of relevant facts and circumstances auditors and audit clients should consider when further independence evaluation related to a nonaudit service or other relationship with entities not deemed affiliates is required. Specifically, those the Commission would consider to be prohibited and result in a corresponding threat to an auditor's objectivity and impartiality. Therefore, including the types of relationships and services, individually or in the aggregate, to address the aggregation of multiple sister entities which the Commission would expect to be known by the auditor and the audit client due to the nature, extent and relative importance or other aspects of the service or relationship in the final rule, will assist auditors with any additional independence evaluation that may be necessary.

The Proposed Amendment to Rule 2-01(f)(4)(i) also provides clarification to the rule's application when the audit firm is the auditor of a portfolio company as a type of operating company. Generally, the portfolio companies (operating type companies) are unrelated other than being controlled by the same entity in the private equity group or Investment Company Complex (ICC). Therefore, it is appropriate to identify affiliates of the audit client (an operating company) under Rule 2-01(f)(4)(i) rather than Rule 2-01(f)14, since the entity under audit is a portfolio company and does not fall within the definition of ICC in the proposed Rule 2-01(f)(14). We support the proposed revisions to foster consistent application of the rules.

Although Grant Thornton is supportive of the proposed revisions, it is unclear as to why the affiliate definition discussed above be more restrictive than the AICPA and International Ethics Standards Board of Accountants ("IESBA"). What is the rationale of not applying the AICPA definition whereby the sister entity would be deemed an affiliate when both the sister entity and the entity under audit are material to the common control entity (e.g., private equity firm) which would be in alignment with both the AICPA and IESBA standards. We believe such an approach would bring uniformity with the common control prong of the SEC affiliate definition along with the existing IESBA and AICPA standards for which auditors and network firms are already familiar with. We suggest that the SEC consider explaining its rationale in the final rule.

There are significant challenges that registrants and auditors face when applying the SEC affiliate definition in the private equity space. For example, independence issues currently can arise where an audit firm provides nonaudit services to an immaterial sister entity that is not an entity under audit, and that sister entity is under common control (through a private equity firm relationship) with the entity under audit — even though neither the sister entity nor the entity under audit controls or exerts any influence over the other, and there is different management and boards (e.g., board of directors, audit committees). As observed in the Proposal, audit firms providing services to or having relationships with sister entities not material to the controlling entity do not typically present issues with respect to the auditors' objectivity or impartiality. We also share this view and support the proposed revisions to increase accounting firm selections available to



companies and competitiveness for audit and nonaudit services. Furthermore, we also believe that the materiality qualifier being proposed will better serve investors by reducing compliance costs while maintaining protections that are designed to promote auditor objectivity and impartiality.

Grant Thornton believes the Commission's aim to modernize certain aspects of the auditor independence rules, including the current affiliate definition, will help facilitate capital formation while continuing to maintain independence without hampering investor protection. The Commission's current 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 audit client. Grant Thornton believes the Commission's consideration around modifying the concept of "control" allows for the focus of an audit firm's evaluation of relationships that may bear on independence to be directed at the audit client and its downward affiliates. We support the Commission's 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 could further consider modifications to the affiliate criteria evaluations established by other regulators, such as the AICPA and IESBA, for consistency in application. 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 audit firm (for example, brother-sister affiliates) if certain criteria (or requirements) were met since such services did not create a significant independence threat or impair the audit firm's objectivity or impartiality to perform the audit. The Commission may want to further consider this in the final rule when addressing the SEC's affiliate definition, in other SEC independence rules or in future rule making.

2. Proposed Amendment to the Investment Company Complex

Grant Thornton supports the Commission's proposals to amend paragraph (f)(14) of the ICC definition of Rule 2-01 to include a materiality qualifier in the common control provision and to distinguish how the definition applies when an auditor is auditing a portfolio company, an investment company or an investments adviser or sponsor. Including clarification for consistent application if an auditor audits both, therefore, both of the proposed Rules 2-01(f)(4)(i) and (f)(14) would be applied to identify the entities that are affiliates of the audit client and where the auditor would need to monitor for prohibited relationships and services.

We support the proposed revisions to the ICC definition in Rule 2-01(f)(14)(i)(A) which provides clarification to the rule's application to focus on the entity under audit for the analysis of identifying entities that are part of the ICC organizational structure. However, the materiality qualifier as discussed above, in the proposed revisions relating to identifying sister affiliates, does present challenges in monitoring the increases and decreases in fund investments as they are constantly fluctuating and changes to materiality may be frequent.

Although Grant Thornton agrees with the proposed revision to align the common control prong of the proposed ICC definition (proposed Rule 2-01(f)(14)(i)(D)(l)) with the proposed common control prong for operating companies to only include sister investment companies, adviser, and sponsors that are material to the controlling entity, while the general standard under Rule 2-01(b) will still apply. It would be helpful if the Commission could consider explaining the rationale in



the final rule as to why the unregistered funds under audit are being included, for example, is the inclusion because the entity under audit has a registered investment adviser. Currently, for the unregistered funds, if the audit is not performed in lieu of the custody examination or filed with the SEC to satisfy filing requirements, the SEC independence rules are not applicable for the independence analysis.

Grant Thornton agrees with adding a reference for clarification to proposed paragraph (f)(14)(i)(C) to support the parent and subsidiary concept to ensure downstream and upstream entities of the entity under audit are considered in the analysis for common control.

Grant Thornton does not believe the Commission should consider aggregating sister entities in the materiality assessment rather than the assessment being performed on an individual basis for the following reasons: 1) the entities are deemed to be separate legal entities 2) the entities do not have the same management and boards (e.g., board of directors, audit committees or those charged with governance) 3) materiality is different when evaluating each sister entity on an individual basis versus when evaluating at an aggregate level; and 4) professional judgement may be applied, therefore, different qualitative factors may be considered for sister entities such as board positions.

3. Proposed Amendment to Audit and Professional Engagement Period

Initial Public Offerings ("IPO")

Grant Thornton supports the Commission's Proposal to amend Rule 2-01(f)(5)(iii) so that the one year look back provision (audit and professional engagement period) for all "first-time" issuers filing or required to file a registration statement or report with the Commission for the most recently completed fiscal year provided the foreign private issuer ("FPI") has been in full compliance with the home country independence standards in all prior periods covered by any registration statement or report filed with the Commission, thereby treating all such filers that is either a "domestic" issuer or FPI similarly for purposes of assessing compliance with the independence requirements under Rule 2-01.

Under the current auditor independence rules when a domestic company is seeking to go public there are typically two to three years of audited financial statements (look-back period) requiring SEC independence which are included in the issuer's registration statement filed with the SEC. Therefore, not allowing a domestic company the same transition period provision as provided for FPI when transitioning from the private audit client independence rules to the SEC/PCAOB independence rules for public audit clients. The lack of a transition period creates barriers for domestic companies seeking to go public.

Applying the same independence rules that FPI are subject to in connection with IPOs will address the significant challenges that can arise in evaluating independence under the more restrictive SEC/PCAOB independence rules during the two to three year period prior to an IPO, in some cases, resulting in a change in auditor, delaying the IPO or decision to go public. This adds considerable expense and time around evaluating relationships and nonaudit services



provided in all years presented in a registration statement under SEC and PCAOB independence rules.

Furthermore, it is quite challenging for auditors of private audit clients going through IPOs when there is control by a private equity firm to identify all of the other controlled portfolio companies, evaluate from an independence perspective, monitor and track services and relationships.

Grant Thornton believes that the Commission could consider providing clarification with respect to the withdrawal of a registration statement filed with the SEC and then re-registration, and would the company still be considered a first time filer. In addition, we believe clarity is needed on how to apply the proposed changes to reverse mergers or Special Purpose Acquisition Companies (SPAC), if such transaction is being considered by an audit client that is currently not an issuer.

Grant Thornton believes that providing a transition or grace period when a company pursues an IPO promotes timely capital formation. Further, 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 audit firm had been following a different regulator's independence requirements.

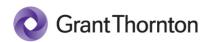
4. Proposal to Amend Independence Rules with Respect to Debtor-Creditor Relationships

Grant Thornton is in agreement with the three limited revisions (see below) to the debtor-creditor provisions recognizing that not all creditor or debtor relationships threaten an auditor's objectivity and impartiality. We are supportive as permissible debtor-creditor relationships in Rule 2-01(c)(1)(ii)(A).

The Proposal would include the following exclusions (or revisions) from independence impairing lending relationships: 1. student loans related to a covered person's educational expenses if the loan was obtained under normal lending procedures, terms and requirements before he or she became a covered person in the firm as defined under Rule 2-01(f)(11); 2. clarification of the reference to a "mortgage loan" a covered person may have more than one on a primary residence and 3. the credit card rule to refer to "consumer loans" such as cell phone plans and retail installment loans (similar finance arrangements).

SEC independence rules currently prohibits certain lending relationships between a covered person in the firm including immediate family members and an audit client, its affiliates and other associated persons or entities. The proposal expands the exception list for certain types of loans based on similar concepts already applied under SEC rules related to pre-existing home mortgages for primary residence when certain criteria are met and de minimis credit card debt.

Grant Thornton suggests the Commission consider expanding the proposed exception for student loans to encompass student loans obtained by the covered person's immediate family members (similar to financial interest rules), even if considered material to the covered person, if



obtained in ordinary lending terms we do not believe the financial obligation would present a threat to the covered person's objectivity and impartiality. If the Commissions decides not to expand to immediate family members it would be helpful to provide an example of how such student loan borrowings could impact an auditor's objectivity and impartiality and a suggested threshold amount to consider significance. Further, the exclusion is limited to student loans obtained for covered person's educational expenses which ordinarily would include room, board, books other educational expenses including "tuition". It would be helpful for the Commission to clarify what types of expenses are considered educational expenses.

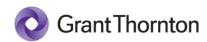
5. Proposed Amendments for Inadvertent Violations for Mergers and Acquisitions

Grant Thornton is in agreement with the proposing amendments to address challenges with inadvertent independence violations only arising as a result of a client's merger or acquisition (M&A) transactions, to include a transition framework modeled after Rule 2-01(d) Quality Controls, to monitor M&A activity, requiring the auditor to comply with the applicable independence standards in the period the services or relationship originated and correcting the independence violation as promptly as possible. This aligns mostly with the AICPA's *Breach of Independence Interpretation* (1.298.010) except the AICPA does not negate an independence impairment if determined significant and also addresses communication with those charged with governance. Under the SEC's proposed rule, independence would not be impaired under the transition provision provided the requirements in the SEC rule are met.

Under the Commission's proposed revisions it appears the inadvertent independence matter would not be viewed as a violation of the SEC's independence requirements under the transition provision provided the SEC rules were satisfied in the transition framework. This is consistent with the approach taken under IESBA, where an issue that arises in the connection with M&A transaction complies with the framework it is not treated as a violation of its code. Although Grant Thornton supports the proposed amendment due to audit firm familiarity in applying AICPA and IESBA, we believe guidance should be provided on how to address such matters with the audit committee or those charged with governance, including documentation of the substance of the discussion if not included in the PCAOB 3526 letter as a technical independence violation.

Further, the Proposal indicates the expectation to correct the violation, in most instances should be corrected before the effective date of the merger or acquisition. However, the Proposal, does recognize the challenges auditors face in obtaining this information prior to the transaction closing date, in practice such transaction are more likely to be identified at or after the close date, as such Grant Thornton believes the final rule should specifically clarify the framework would also apply to circumstances where the service or relationship is identified at or after the close of the transaction. Even with all best efforts taken, reasonable systems and controls in place, information is not in public domain, Grant Thornton believes the de minimis safe harbor rule can be applied and should not result in an independence violation.

Grant Thornton believes the final rule should include the corrective action time frame to address the violation in a timely manner of no later than six months after the effective date of the close of the transaction as reasonable to transition the prohibited services to an acceptable third party



services provider. This framework aligns with IESBA guidance including the time frame for corrective action to be taken when an inadvertent independence violation occurs only because of M&A activity.

A transition period is beneficial if an ownership change occurs that results in a new affiliate with an existing nonaudit service, financial relationship and/or business relationship that may have not been permitted under the SEC's independence requirements. We believe a reasonable investor would not deem the existence of these prohibited services (or relationships) at the time of the ownership change as a matter that would impair auditor independence as the audit firm would not be aware of the future affiliate relationship at the time the prohibited service (or relationship) was initiated under the previous ownership structure.

Grant Thornton supports the revisions as auditors are already familiar with applying a "safe harbor" where the independence of a covered person in an audit firm is inadvertently impaired, provided that the violation is addressed timely and the audit firm maintains an adequate quality control system. While this "safe harbor" approach addresses instances of non-compliance related to financial relationships, a similar approach is being applied here to other types of non-compliance with the independence rules (nonaudit services, etc.) as long as the instance of noncompliance is inadvertent or de minimis. The proposed changes are also mostly in alignment with guidance developed by other regulators (e.g., AICPA or IESBA) in evaluating instances of non-compliance (or breaches) that may not result in an independence threat.

6. Proposal to Amend the Reference to "Substantial Stockholder" in the Business Relationship Rule

Grant Thornton agrees with the Commission's proposal to replace "substantial stockholders" with beneficial owners (known though reasonable inquiry) of the audit client's equity securities who have significant influence over the audit client to be consistent with the recently revised loan provision amendments.

The SEC's business relationship rules (Regulation S-X Rule 2-01(c)(3)) prohibit any direct or material indirect business relationship with an audit client, including its affiliates and person's associated with the audit client in a decision making capacity including officers, directors and substantial stockholders.

The proposed revisions also provides clarity around the entity under audit excluding its affiliates and whether the beneficial owner has the ability to exert significant influence over the audited entity with respect to the independence analysis of a business relationship with the beneficial owner that could reasonable be viewed to impact the objectivity and impartiality of the audit firm. Grant Thornton supports this guidance to clarify the focus of the rule when evaluating independence and helping clients understand the application. In addition, in the final rule, we recommend the Commission specify the exclusions from the scope of the rule as it did in the loan provision amendments.

Grant Thornton requests the Commission provide examples of the types of business relationships that would be considered problematic as a result of their consultations given audit



firms evolution of what they are in the business of providing, and this can be accomplished through frequently asked questions or in revisions to the SEC's business relationship rules.

7. Proposed Amendments for Miscellaneous Updates

Grant Thornton supports the Commission's proposed revisions to make the miscellaneous updates.

8. Other considerations

Grant Thornton requests the Commission consider clarifying all rules when reference is made to the audit client or the entity under audit where the Commission means to focus the independence analysis on only on the entity under audit or the audit client and its affiliates. Currently, an audit client as defined by the SEC also includes its affiliates. Such clarification will assist auditors in better understanding which rules apply to the entity under audit and its affiliates, and comply with the SEC's independence requirements.

The PCAOB has adopted certain interim ethics and independence standards. We note that the PCAOB's interim independence standards include a general prohibition on loans with covered persons and a list of exceptions. If the debtor-creditor provisions set forth in the SEC's Proposal are adopted, the list of exceptions in the PCAOB interim independence standards may be viewed as "more restrictive" in comparison to the list of exceptions set forth in the SEC's amended debtor-creditor provisions. Therefore, we suggest that the Commission consider having a discussion with the PCAOB on whether it would be appropriate for the PCAOB to update its interim independence standards due to the amendments being proposed in the Proposal.

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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 or (630) 873-2633.

Very truly yours,

Grant Thornton LLP

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