Grant Thornton

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via Email to rule-comments@sec.gov

Grant Thornton LLP
171 N Clark Street, Suite 200
Chicago, IL 60601

T 312.856.0200
F 312.565.4719
www.GrantThornton.com

July 21, 2016

Re: File Number S7-06-16
Concept Release on Business and Financial Disclosure Required by Regulation S-K

Dear Office of the Secretary,

Grant Thornton LLP appreciates the opportunity to comment on the Securities and Exchange Commission ("SEC" or "Commission") April 13, 2016 Concept Release *Business and Financial Disclosure Required by Regulation S-K* ("Concept Release"). As we stated in our comment letter[1] regarding the Commission's September 25, 2015 *Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant*, we broadly support the Commission's efforts to enhance the effectiveness of public company disclosures and to modernize the content of registration statements and periodic reports. We applaud the Commission's efforts in this regard and are providing our firm's perspective gained primarily from serving public companies as independent accountants, including interaction with the SEC staff in this capacity. We encourage the Commission to continue its outreach to investors, registrants and other stakeholders as part of its Disclosure Effectiveness Initiative. We believe an understanding of all viewpoints is critical to furthering the modernization of Regulation S-K disclosures while ensuring investors have the essential information needed to make investment decisions.

Executive summary

In preparing our comments, we considered the goal of the SEC's Disclosure Effectiveness Initiative to make disclosure more effective and useful for investors and other stakeholders. In light of this overarching objective and our perspective as independent accountants, the main themes of our comments are:

- A principles-based disclosure framework, with clearly established objectives, could reduce from registrants' filings boilerplate information and/or other information that may not be relevant for users. Further, such a framework may provide a natural mechanism for tailorable disclosures without prescriptive scaling for registrants of differing size.

[1] https://www.sec.gov/comments/s7-20-15/s72015-40.pdf

- While we do encourage the streamlining of information included in documents filed with the SEC and are supportive of the use of hyperlinks and cross-referencing, there are some challenges to consider with respect to auditor association.
- The Concept Release notes, and we have observed, areas in Regulation S-K that warrant updating to minimize overlap with U.S. GAAP requirements.

Principles-based disclosure framework

As noted in the Concept Release, some portions of Regulation S-K are principles-based, allowing registrants to determine applicability and relevance and to make an assessment of materiality in order to tailor the content of their disclosures. However, several S-K "Items" contain a list of criteria which many registrants use as a checklist, regardless of materiality or relevance. While bright-line tests do have their merits in terms of certainty with respect to compliance, we have observed that prescriptive requirements may foster a checklist approach or compliance mind-set regarding periodic filings, particularly with respect to business-related disclosures in S-K Items 101 and 102, and certain portions of Item 303, *Management's discussion and analysis of financial condition and results of operations* ("MD&A").

Because registrant disclosures and investor informational needs likely vary based on the circumstances of each company, we strongly support an initiative to provide disclosure objectives for each S-K Item or Subpart, to potentially reduce immaterial and boilerplate disclosures in registrants' filings. The disclosure objectives would set forth the key focus for preparers so that they may assess if they have provided sufficient and necessary disclosure. Depending on the particular discussion area, the disclosure objectives may include some quantitative metrics, but also allow a registrant to consider a complete mix of information to make a judgment regarding what is material to company stakeholders. We believe this is consistent with the direction of other standard-setters, such as the Financial Accounting Standards Board ("FASB") and International Accounting Standards Board.

Should the Commission implement more principles-based concepts and objectives into Regulation S-K, it might consider if doing so could reduce the need for prescriptive scaled disclosures for various categories of registrants. While we fully support the ability of smaller companies to tailor their disclosures commensurate with their size, the proliferation of categories of registrants and accommodations[2] available to each can increase complexity in reporting as registrants and their advisors navigate the various filing scenarios.

Description of business

One area of focus to highlight our point with respect to the prescriptive criteria and rules-based disclosure is S-K Item 101, *Description of business*. S-K Item 101 results in disclosure containing a wealth of information about a company. However, despite much of that information being static from year to year, registrants must regularly include a significant amount of disclosure to comply with the requirements of the Item. There is, of course, information that changes from year to year, but we believe there is core information contained in a registrant's annual report on Form 10-K that may not belong in an annual reporting document. We support the concept

[2] See table summarizing scaled disclosure accommodations on pages 271-273 of the Concept Release.

of segregating "static" information (such as description of the business, the industry in which it operates, principal products and/or services, intellectual property and regulatory matters) into a separate informational document, filed on EDGAR and subject to SEC oversight. This "company profile document" could then be updated when and if changes are required, with appropriate notification made to the SEC when changes have occurred (such as on Form 8-K). We do recognize there could be some challenges to having a company profile document. Namely, how does the information become a part of periodic or registration statement filings? Further, there could be operational challenges with respect to auditor association, as discussed in more detail below, when information is not clearly included in a neatly packaged filing. Despite these challenges, we believe relegation of static information from periodic filings to another location would allow a user of the periodic filing to focus on the material changes and activities of the company.

S-K Item 101 also contains prescriptive lists of items that must be discussed, regardless of the industry in which the registrant operates or the composition of its operations. For example, all companies must disclose backlog[3]; however, backlog is not relevant to all industries. Similarly, all companies must disclose the number of persons employed by the registrant[4], but companies may be structured in such a way that pure count of employees may not be meaningful. Rather, what may be meaningful is outsourcing or shared-staff arrangements or the composition of the employed workforce (hourly vs. salaried; temporary vs. permanent).

Registrants should only be required to provide disclosure that is meaningful to its business and needed to communicate with its investors. Use of a principles-based framework with clearly articulated disclosure objectives, accompanied by any related guidance deemed necessary by the Commission or its staff, could assist in increasing the quality of disclosure in a given filing and better position a reader to understand the material changes in a registrant's business.

MD&A

MD&A has historically exemplified a principles-based disclosure framework within Regulation S-K. We support the Commission in efforts to maintain this flexibility to the extent practicable, as rigidity in MD&A may inadvertently divert management away from the key drivers of a company's historical financial performance, liquidity, and prospects for the future. Further, as introduced earlier, we encourage the SEC to lay out the disclosure objectives within each S-K Item or Subpart, including within MD&A. However, we agree with the points in the Concept Release that while the current framework is principles-based, substantial SEC staff guidance has been required to assist companies in improving the quality of their MD&A disclosures[5]. While such guidance may be voluminous, we have found it to be helpful to preparers in determining the adequacy of MD&A disclosures. We do believe, though, that such guidance should be codified into one location, to aid preparers in locating and applying current guidance.

Enhanced employment of a principles-based disclosure framework for MD&A may also allow a company to focus on the most relevant information in its discussion of historical operations in

[3] S-K Item 101(c)(1)(viii)
[4] S-K Item 101(c)(1)(xiii)
[5] See Content and Focus of MD&A (Item 303 - Generally) on pages 97–105 of the Concept Release.

the case of a significant change in its business. Consider an example: a registrant that has a reporting predecessor (predecessor entity has a change in basis):

> Under current SEC staff guidance[6], a company must discuss results of operations for the historical information presented, which, with a change in basis, may not comparable. Further, in many cases the discussion of historical performance may not be informative. The company is permitted to include a supplemental MD&A discussion based on pro forma financial information (prepared in accordance with Regulation S-X, Article 11, *Pro Forma Financial Information*, or other formats, such as the footnote pro forma information specified by ASC 805, *Business Combinations*). Many registrants assert that the pro forma discussion is the more meaningful disclosure, yet they are required by regulation to also include the non-comparable historical discussion.

We encourage the Commission to consider permitting flexibility to provide the most meaningful discussion in situations such as this, provided that disclosure is clear as to the framework used to prepare the underlying numbers.

Method of presentation, including auditor association

Given the volume of information contained in registrants' SEC filings, another area on which the Commission is seeking comment is with respect to presentation and delivery of important information. The Concept Release addresses the topics of cross-referencing and hyperlinking, including to information contained on a company's website, and requested feedback whether these methods are potential avenues for decreasing the volume of disclosure while increasing investors' ability to access and use that important information. We are offering our view on auditor association with information in a document that is presented alongside audited financial statements, which may be informative to any future steps in this area. We are supportive of the use of cross-referencing and hyperlinking, but believe there are implementation challenges that may exist related to professional standards and legal implications for auditors (responsibility), as well as legal implications for registrants (potential loss of safe harbor protections), should the Commission proceed.

PCAOB AS 2710 (formerly PCAOB AU 550), *Other Information in Documents Containing Audited Financial Statements*, addresses the auditor's responsibility with respect to other information in documents containing audited financial statements and the related auditor's report. Additionally, PCAOB AS 4101 (formerly PCAOB AU 711), *Responsibilities Regarding Filings under Federal Securities Statutes*, further provides requirements with respect to the auditor's procedures and responsibilities in connection with a Securities Act registration statement. With respect to other information, PCAOB AS 2710.04 states the following:

> "The auditor's responsibility with respect to information in a document does not extend beyond the financial information identified in his report, and the auditor has no

[6] See the Division of Corporation Finance (CorpFin) Financial Reporting Manual, Sections 9220.6–9220.9.

> obligation to perform any procedures to corroborate other information contained in a document. However, he should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements."

The standard further provides for the auditor's action should their reading of the document uncover a disclosure in the other information materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. The PCAOB proposed in 2013 potential amendments to PCAOB AS 2710[7]. The PCAOB staff is currently evaluating feedback received on the 2013 proposal, with no timeline set forth in the PCAOB's 2016 standard-setting agenda[8] regarding further activity with respect to an amendment to the other information standard. The PCAOB's 2013 proposal focused on the auditor's responsibility for other information included (or incorporated by reference) in the company's annual report on Form 10-K and, as proposed, could result in a potential increase in auditor responsibility and related performance requirements with respect to the other information.

Due to the responsibilities of auditors outlined in PCAOB AS 2710 and contemplated PCAOB rulemaking with respect to other information, it is important to know what this "other information" is in any given filing that includes audited financial statements and the related auditor's report. The introduction of external hyperlinks, which are not common in today's filings, could make it difficult to define what constitutes "the document" referred to in PCAOB AS 2710.04. Additionally, an external hyperlink could pose problems with respect to an auditor's ability to fulfil its responsibilities under both AS 2710 and AS 4101 if the externally hyperlinked information changes over time (such as information that may be housed on a company's website: how is it clear what is included in "the document"; how are changes in the external materials monitored over time?). Although the PCAOB's 2013 other information standard proposal does state, consistent with the current standard, that it is not intended that information on a company's website be considered "other information," a change in SEC rules (for example, permitting incorporation by reference of website material into an Exchange Act or Securities Act filing) may modify what is considered "filed." Therefore, we encourage the SEC to revisit with the PCAOB the timing around standard-setting in this regard, as SEC rules permitting external hyperlinking could widen the expectation gap with respect to auditor responsibility for other information.

With respect to cross-referencing, it is currently common for companies to cross-reference within their SEC filings to other sections in that same filing. SEC rules generally allow such use of cross-referencing; however, it is rare to see cross-references within the audited financial statement footnotes to other portions in the Form 10-K because of the need to be clear on what disclosures are covered by the auditor's report. We believe it is imperative that the SEC, the PCAOB, and the auditing profession work together on developing solutions to provide users more transparency into the auditor's responsibilities for such information, which may lead

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[7] PCAOB Rulemaking Docket No. 034: *Proposed Auditing Standards on the Auditor's Report and the Auditor's Responsibilities Regarding Other Information and Related Amendments*
https://pcaobus.org/Rulemaking/Pages/Docket034.aspx

[8] https://pcaobus.org/Standards/Documents/2016Q2-standard-setting-agenda.pdf

to demands from users for greater involvement by the auditor. Such solutions could facilitate more flexibility to cross-reference helpful information outside the financial statements within the audited financial statement footnotes.

Other audit and attest services

The Concept Release requested feedback on whether certain areas in Regulation S-K should be subject to additional auditor involvement, particularly with respect to S-K Item 301, *Selected financial data*, and MD&A. Auditors do have association with this "other information" when presented in a document containing audited financial statements and the related auditor's report. However, the Concept Release questions if additional auditor procedures should be required. We believe investors are best positioned to address this question, but we do point out that audit or attest standards do currently exist related to both selected financial data (PCAOB AS 3315, *Reporting on Condensed Financial Statements and Selected Financial Data*) and MD&A (PCAOB AT Section 701, *Management's Discussion and Analysis*). These standards have existed for decades, yet it is rare that an audit or attest engagement is requested under these standards. With respect to selected financial data, demand may not exist for an audit because the information, at least for the periods for which financial statements are included in the filing, is derived from financial statements that have been subject to audit. With respect to MD&A, an auditor can perform procedures focused on the compliance aspects of the discussions focusing on quantitative matters, but to provide a more subjective evaluation whether MD&A is fairly presented would require a fairly significant effort. Further, given the short timeframe in which the auditor must complete the financial statement audit and, when applicable, an integrated audit, especially for a large accelerated filer, having sufficient time to perform MD&A attest services prior to release of an annual report could be challenging. While we support the notion that such involvement could enhance the quality of such information to the benefit of investors, we believe the cost/benefit of requiring additional auditor procedures would need to be evaluated. Given the above discussion and potential blurring of lines between the financial statements and other financial information, we encourage the SEC to pursue this evaluation.

Other accounting-related matters

U.S. GAAP overlap

The Concept Release noted and we have observed disclosure requirements of Regulation S-K that overlap with U.S. GAAP. While we are not presenting an all-inclusive list of such duplication, we will highlight, in our view, the more significant areas for SEC consideration.

Segments

S-K Item 101 requires disclosure that is duplicative of and/or similar to the U.S. GAAP requirements in ASC 280, *Segments*, and requirements in other U.S. GAAP. Some notable areas include:

- S-K Item 101(b) and U.S. GAAP both require reporting revenues from external customers and a measure of profit or loss and total assets for each reportable segment.
- S-K Item 101(b)(1) and ASC 280-10-50-34 contain the same disclosure requirements when a company's segment reporting changes.

- S-K Item 101(c)(1)(i) and U.S. GAAP require reporting of revenue from each product and service separately and allow for grouping of similar products and similar services in this reporting. S-K Item 101 additionally requires that revenue be reported separately for each segment based on principal products and principal services of a segment.
- U.S. GAAP requires that all customers constituting 10% of revenue be disclosed without specific mention of the name of the customer, while S-K Item 101(c)(vii) requires disclosure of the name of the customer and the relationship to the company for sales to a customer over 10% of total revenue, if loss of that customer would have a material adverse impact on the company. Although these customer disclosures can be the same between U.S. GAAP and SEC regulations, there is more judgment in the SEC disclosure (material adverse impact versus the bright line 10% disclosure requirement of U.S. GAAP).
- S-K Item 101(c)(1)(xi) and ASC 730, *Research and Development,* both require disclosure of amounts incurred for research and development activities for each period reported. S-K Item 101(c)(1)(xi) does not specifically require disclosure of research and development expense related to computer software product to be sold, leased or otherwise marketed, as required by U.S. GAAP. However, this could be included as part of the general research and development disclosure requirement in S-K Item 101. The SEC disclosure requirement specifically includes research and development on "customer" sponsored research and development activities, which U.S. GAAP does not require.
- U.S. GAAP geographic disclosure requirements are generally the same as the geographic disclosure requirements in S-K Item 101(d), with both requiring disclosures of revenues from customers and long-lived assets based on a registrant's country of domicile, all foreign countries in total, and any individual foreign countries, if material. S-K Item 101(d) disclosure requirements do, however, allow for a cross-reference to the geographic disclosure included in the notes to the financial statements.

Alignment of these disclosures would streamline the reporting process and provide more succinct information for investors.

Critical accounting estimates

Within MD&A, there are two main areas of overlap we wish to explore: first is critical accounting estimates[9]. While we recognize from the Commission's 2002 Proposed Rule, *Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies*, and other SEC staff interpretive guidance on this topic[10], that the objective of critical accounting estimates disclosure in MD&A is different than the U.S. GAAP requirement to disclose significant accounting policies in the notes to the financial statements, many registrants have difficulty differentiating these concepts in Form 10-K. This is an area where we believe codification of the disclosure objectives would be helpful for preparers to use in drafting their critical accounting estimates disclosure. Companies should be encouraged to refer to their financial statements for discussion of significant accounting policies, and highlight within

[9] As defined in *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, Part V.
[10] https://www.sec.gov/rules/interp/33-8350.htm

MD&A only the critical estimates and inputs to such process that could, if different, have a material impact on the results of the company. The Commission may also want to consider the likely future interplay between the PCAOB's proposed discussion of Critical Audit Matters[11] within the auditor's report and the SEC's MD&A disclosure requirements for critical accounting estimates. While the two concepts have different meanings, there may be some confusion amongst stakeholders as to the relationship between the two.

Tabular disclosure of contractual obligations

Another MD&A area of overlap is S-K Item 303(a)(5),*Tabular disclosure of contractual obligations*, which contains prescriptive requirements for registrants to detail contractual commitments that require future cash outlay. The information in this table is largely the same as disclosed in a registrant's financial statements. However, it does not give insight as to the company's ability to pay those obligations as they become due. That concept is addressed within the liquidity discussion of MD&A. We question the utility of the required contractual obligations table in MD&A. If it is retained, setting forth objectives specifically for the disclosure of contractual obligations pursuant to Regulation S-K may be particularly beneficial for preparers.

Quantitative and qualitative disclosures about market risk

Currently, quantitative information about market risks (S-K Item 305, *Quantitative and qualitative disclosures about market risk*) shall be provided using one of three disclosure alternatives. XBRL has come into use since S-K Item 305 became effective and stakeholders are taking advantage of the ability to access quantitative information for a variety of uses. With the expanded use of XBRL, we believe tabular information under disclosure alternative A of S-K Item 305 provides the greatest potential benefit to users, particularly if those disclosures are disaggregated in a manner that is consistent with financial statement disclosures. For this reason, we believe that all registrants should be required to provide quantitative information about market risks in the tabular format set forth in alternative A. Registrants should be permitted, though, to supplement the tabular presentation with quantitative information under either alternative B or alternative C of S-K Item 305. Additionally, since S-K Item 305 became effective, disclosure requirements under U.S. GAAP are much more extensive. We encourage the Commission to work with the FASB to align the disaggregation criteria for the quantitative market risk disclosures under S-K Item 305 with disaggregation criteria for disclosure requirements of relevant topics within the FASB Codification such as ASC 310, *Receivables*; ASC 320, *Debt Securities*; ASC 470, *Debt*; and ASC 815, *Derivatives and Hedging*.

Selected financial data

S-K Item 301 requires a registrant (that is not a smaller reporting company (SRC) or emerging growth company (EGC)) to disclose certain financial metrics derived from its audited financial statements, covering the last five fiscal years and any additional periods that may be necessary to keep the disclosure from being misleading. SRCs are not required to comply with S-K Item 301, and additionally, EGCs are permitted to exclude selected financial data for any period prior to the earliest audited period included in its equity IPO registration statement. In the case

[11] PCAOB Release No. 2016-003, *Proposed Auditing Standard—The Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, https://pcaobus.org/Rulemaking/Docket034/Release-2016-003-ARM.pdf

of an EGC, this means that two years of information may be presented in its IPO registration statement, and the disclosure will build up to five years through the filing of subsequent annual periods in Form 10-Ks.

Generally, selected financial data is a summary of information already reported to investors. However, challenges are introduced when there are retrospective changes to a registrant's historical financial statements, which can occur after adoption of a new or revised accounting standard, or reported discontinued operation. Given these challenges in retrospective change situations, we have observed accommodations provided to registrants permitting them to not revise the figures presented in the earliest two years (years 4 and 5), and instead disclose the lack of comparability to the latest three years. A recent accommodation[12] has been provided for adoption of the new revenue recognition standard[13]. While this is not the only example of an accommodation given in this area, it is notable given the potential pervasive impact of the new revenue recognition standard on reported results for all registrants. If all years in the disclosure are not comparable, one might question the value of the disclosure, as it may not adequately illustrate trends in the historical data. If years 4 and 5 are not required to be presented at all, the information in selected financial data would be duplicative to information contained elsewhere in the same document (that is, within the audited financial statements). Absent a requirement to provide narrative discussion of trends, the current requirement under S-K Item 301 seems less useful in an electronic era where historical financial information is easily accessible.

We encourage the SEC to continue outreach to investors on the overall utility of selected financial data.

Supplementary financial information

S-K Item 302, *Supplementary financial information*, requires presentation of certain financial information for a registrant, covering the last two fiscal years (that is, the eight fiscal quarters comprising those two years). This information is presented in Form 10-K, and is required in registration statements other than IPO registration statements. Further, this information is not required for SRCs.

Similar to selected financial data, providing this information does not appear to be burdensome to registrants. Information, aside from the details of the fourth quarter, has already been reported by management and reviewed by independent auditors. However, we have observed some challenges with respect to companies that file a follow-on registration statement after their IPO registration statement, but before they file their first annual report on Form 10-K. A company in this situation would not be required to comply with S-K Item 302 for purposes of the IPO Form S-1, because the entity does not have securities registered pursuant to Exchange Act Sections 12(b) or 12(g). However, that same entity would be required to comply with S-K Item 302 if they filed a follow-on registration statement immediately after the effectiveness of the IPO. This can be problematic for a new registrant as they likely have not presented two full

[12] See the CorpFin Financial Reporting Manual, Section 11100.1.
[13] Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) (as amended by Accounting Standards Update No. 2015-14) and IFRS 15, *Revenue from Contracts with Customers*.

years of quarterly information, nor had those periods been subject to the interim review requirements of Regulation S-X, Article 10, *Interim Financial Statements*.

This is another area where we encourage the SEC to continue outreach to investors regarding the overall utility of supplementary financial information. If the SEC determines having this quarterly information summarized in one location is important to investors, perhaps this information could be in another summary document for ongoing reporting, or incorporated into a "company profile document" we described earlier. Further, the Commission might consider relief for a newly public company to build-up its quarterly information (that is, to only report under S-K Item 302 information included in Exchange Act reports subsequent to IPO registration statement effectiveness, similar to the accommodations given to EGCs with respect to selected financial data).

Preferability letters

As indicated in the Concept Release, the preferability letter requirement was put in place by the Commission over 40 years ago. At that time, auditors were not as actively involved in interim reporting, so the requirement to obtain a preferability letter for a voluntary change in accounting principle was an important gatekeeping mechanism for investor protection. However, since that time, many things have occurred in the reporting landscape. Primarily, U.S. GAAP has significantly evolved. Through these enhancements, and more specifically, the issuance of ASC 250, *Accounting Changes and Error Corrections*, companies are now required to include robust disclosures in their financial statements when making an election to change the application of an accounting principle. Secondarily, prior to filing Form 10-Q, registrants are now required to obtain an independent auditor's review of their interim financial statements[14]. Therefore, auditors must evaluate the change in application of accounting at an interim period, including evaluating the related disclosures within the financial statement footnotes, in order to complete the interim review. Preferability letters are issued at that point, in order to comply with S-K Item 601(b)(18). However, in our view, the issuance of that letter does not change the level of documentation and disclosure otherwise required by management, or review required of auditors.

The Concept Release requested feedback regarding the lack of frequency of the filing of preferability letters and whether that indicates decreased utility and importance. Investors will provide their input with respect to utility and importance, but we would offer our view that the small number of filed letters may be due to the proliferation of accounting standards since the requirement for preferability letters was put in place. Said another way, there are fewer and fewer accounting standards that offer a true opportunity to apply alternative methods.

As U.S. GAAP requires registrants to establish preferability, and auditors are required to assess the change as disclosed in the interim financial statements in connection with their interim review procedures, the preferability letter may not today provide the gating mechanism it did 40 years ago.

[14] Regulation S-X, Rule 10-01(d), *Interim review by independent public accountant*.

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We commend the Commission for the spotlight given to the initiative to enhance the effectiveness of public company disclosures and to modernize the content of registration statements and periodic reports. We appreciate the opportunity to provide our views related to the content of the Concept Release and would be pleased to discuss our comments with you. If you have any questions, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at [redacted] or [redacted].

Sincerely,

Grant Thornton LLP