RSM

July 9, 2018

RSM US LLP

Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

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 Mr. Fields,

RSM US LLP appreciates the opportunity to comment on the Securities and Exchange Commission's (the "Commission") proposed rule, *Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships* (the "proposal"). We support the Commission's proposed revisions and believe they will increase the effectiveness of the restriction on debtor-creditor relationships in Regulation S-X Rule 2-01(c)(1)(ii)(A) (the "Loan Provision") by focusing only on those areas where a lending relationship may jeopardize auditor integrity and objectivity in the performance of an audit. Following are our responses to the Commission's requests for specific comments, as well as our additional comments and suggestions for the Commission's consideration.

Responses to the Commission's Requests for Specific Comments

Focus the Analysis Solely on Beneficial Ownership

We support the Commission's proposal to remove the reference to record owners from the current Loan Provision and focus the analysis solely on beneficial owners. Record owners of an audit client's securities, such as broker-dealers or custodians, are holding such securities simply for the benefit of their customers and do not directly benefit from their holdings of the audit client's securities. Such record owners have little to no incentive to utilize the lending relationship to influence the auditor. Therefore, a lending relationship between an accounting firm and a party that is also a record owner with respect to an investment in an audit client presents no threat to independence. Focusing on beneficial ownership better enables identification of possible relationships where a shareholder (that is also a lender) might have a "special and influential role" with the audit client, and thus better aligns with the underlying purpose sought to be achieved by the Loan Provision.

"Significant Influence" Test

The Commission's proposal to replace the 10% ownership threshold with the "significant influence" test represents an important modification to the Loan Provision that ties closely to the underlying goal of identifying lenders that potentially have a "special and influential role" over the audit client. As noted by the Commission, the current bright-line 10% threshold in the rule captures situations where the lending relationship presents no threat to the integrity and objectivity of the auditor while also failing to recognize situations where the lending relationship may present such a threat. The "significant influence" test is one that auditors are familiar with and better captures lenders who have a "special and influential role" over the audit client, while leaving outside the scope of the rule those lending relationships that are unlikely to pose a threat to auditor independence.

We believe that the term "significant influence" as defined by Topic 323, "Investments – Equity Method and Joint Ventures," of the Financial Accounting Standards Board Accounting Standards Codification is sufficiently clear and an appropriate standard for determining whether a beneficial owner can exercise significant influence over the audit client. Auditors are already familiar with this definition as it is being applied to evaluate other independence matters, such as whether an investor or investee would be considered to be an affiliate of an audit client.

"Known Through Reasonable Inquiry"

We agree with the Commission's proposal to include a "known through reasonable inquiry" standard to the rule as such a standard recognizes that the responsibility for appropriate identification of audit client shareholders lies both with the auditor and the audit client. This standard also reflects a practical approach to applying the rule, particularly given the difficulty in accessing records and other information that disclose the ownership percentages of an audit client or its affiliates. We agree with the Commission that if, after reasonable inquiry, the auditor is not aware that one of its lenders is also a beneficial owner of the audit client's securities, it is unlikely that the lending relationship would create threats to the auditor's independence.

The Commission notes that the "known through reasonable inquiry" standard is generally consistent with regulations implementing the Investment Company Act, the Securities Act and the Exchange Act, and therefore should be a familiar concept for auditors. While auditors might be familiar with the concept, we believe it would be helpful if the Commission provided further guidance as to what steps an auditor would be expected to take in order to meet this standard. Such guidance would help to ensure consistent application of the Loan Provision by auditors and their clients.

Proposed Amendment to Exclude from "Audit Client" Other Funds that Would Be Considered an "Affiliate of the Audit Client"

We support the Commission's proposal to exclude funds that otherwise would be considered an affiliate of the audit client from the definition of "audit client" for purposes of the Loan Provision. This modification reflects a reasonable approach where it is evident that no possible threat to an auditor's integrity and objectivity exists.

The onerous definition of an "affiliate of an audit client," especially as it relates to an investment company complex (ICC), has resulted in significant compliance challenges for audit firms due to the difficulty in determining shareholders of other funds when the firm is not also the auditor of those funds. We agree with the Commission that investors in a fund typically do not possess the ability to influence the policies or management of another fund in the same fund complex, and therefore the auditor should not be required to monitor and comply with the requirements of the Loan Provision with respect to these other funds.

The proposal, however, only excludes other affiliated *funds* within the ICC; it does not exclude other *non-fund affiliates* within the ICC, such as an investment advisor, a bank or a broker dealer. In cases where the auditor does not audit these other entities, we believe the same rationale applies and therefore recommend that they also be excluded from the definition of audit client.

Finally, the same rationale that underlies the exclusion for funds also can be applied outside the fund context. For example, it is unlikely that an investor with significant influence over an immaterial subsidiary of an issuer that is being audited would have any "special or influential role" over the issuer. Therefore, we encourage the Commission to consider broadening the proposed exclusion for purposes of the Loan Provision, so that it applies to all downstream and commonly-controlled affiliates of any registrant under audit (not only to a fund under audit).

Other Provisions Considered but Not Proposed

Materiality

In the proposal, the Commission states that it believes adding a materiality qualifier to assess the significance of the lender's investment in the audit client's equity securities is unnecessary, but nonetheless seeks views on this issue.

If the Commission adopts the previously discussed recommendations to clarify the scope of affiliates that will be excluded, we agree with the Commission and believe it is not necessary to add a materiality qualifier to evaluate the lender's investment in the audit client's securities. However, if these proposals are not adopted as part of the final rule, a materiality qualifier for the lender's investment in the audit client would be beneficial, including for the reasons stated in the section above. Because the definition of "audit client" includes affiliates of the audited entity, the Loan Provision currently applies to situations in which a lender has an investment in an affiliate of the audit client over which it exerts significant influence, regardless of whether that lender has any influence over the audit client. Such a relationship is unlikely to impact an auditor's integrity or objectivity. Including a materiality qualifier would better serve investors by reducing compliance costs while maintaining protections that are designed to promote auditor independence.

Additionally, we recommend that the Commission consider including a materiality qualifier as it relates to whether the loan is material to the accounting firm or the covered person. Specifically, the lending relationship should only be prohibited if the beneficial owner had significant influence over the audit client and the loan is material to the accounting firm or covered person. We believe that in cases where the lending relationship is not material to the accounting firm or the covered person, integrity and objectivity are not impaired.

Accounting Firms' "Covered Persons" and Immediate Family Members

The Commission has requested feedback on whether the definition of "covered person" for purposes of the Loan Provision or elsewhere in the auditor independence rules, should be amended. We believe the Commission's independence rules should continue to apply to all covered persons and their immediate family members. This treatment is consistent with the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct and the rules of most state boards of accountancy.

The Commission also has requested feedback on whether it should consider expanding or otherwise modifying the specific types of loans that will not implicate independence under the Loan Provision. We believe the Commission should permit other loans such as student loans and home mortgages from a financial institution, to fall outside of the Loan Provision under two conditions: (i) if the loan is obtained under the financial institution's normal lending terms and conditions, and (ii) if the loan is obtained (a) prior to the individual becoming a covered person with respect to the client, or (b) prior to the financial institution becoming an audit client of the firm through its acceptance protocol or as a result of an acquisition of another firm. We also believe the Commission should consider permitting other secured loans and immaterial unsecured loans if obtained under these same conditions. The following additional conditions should be applied to any permitted loans 1) the loan terms should be maintained in a state of compliance, 2) terms should not change in any manner not provided for in the original agreement and 3) the estimated fair value of the collateral for secured loans should be at least equal to the outstanding balance during the term of the loan and if not; the unsecured portion should not be material to the covered person's net worth.

Evaluation of Compliance

We do not believe it is necessary to include in the Loan Provision a requirement that loans or other financial relationships be assessed at specific dates during the audit and professional engagement period, or the beginning or end of specific periods. Such a requirement would be impractical to implement due to the differences in firms' compliance systems and processes, the various types of audit clients within each firm, and the specific circumstances of each audit. We believe firms should be responsible for determining how and when compliance is best assessed based on the relevant facts and circumstances of each situation.

Other Changes to the Commission's Auditor Independence Provisions

The Commission also inquired as to whether other changes to the auditor independence rules are warranted. We appreciate the opportunity to provide our thoughts to the Commission regarding aspects of the independence rules we believe can be improved and commend the Commission for being receptive to the need for other potential changes to its auditor independence rules. There are some aspects of existing rules that create significant challenges to firms with respect to monitoring and compliance where threats to auditor independence, integrity and objectivity, if any, are negligible. Modifications to the auditor independence rules could help align the overall approach to independence with current business structures, reduce or eliminate the high costs of compliance for firms and their audit clients where such threats are negligible, reduce the impact on and disruption to investors when such instances occur, and enhance investor confidence. Such modifications could also help facilitate capital formation, while maintaining independence in fact and appearance. We discuss three such matters below and respectfully request that the Commission consider appropriate modifications.

The Definition of "Affiliate of the Audit Client"

The audit client has evolved, and business structures have changed considerably since "affiliate of the audit client" was defined. In particular, the significant expansion of private equity investment has made the ownership structures of audit clients more complex and far reaching than ever before. Additionally, in 2012, in order to take advantage of the audit exception in Rule 206(4)-2 (17 C.F.R. § 275.206(4)-2) promulgated under the amended Investment Advisers Act of 1940 (the "Custody Rule"), a large number of investment advisors registered with the Commission, which expanded the number of audit clients subject to the Commission's independence rules. Due to this changing environment, the current definition of "affiliate of the audit client" has become increasingly challenging for audit firms, and their audit clients, from both a monitoring and compliance perspective. For the firm, which may only audit one or two entities within the broader relationship, the information necessary to determine the entities that exist within the audit client's "family tree" and which of those entities meet the definition of an affiliate can be extremely difficult to obtain. Moreover, given the nature of private equity transactions, affiliations may change before such information is provided by the audit client to the auditor and may not be information to which the auditor independently has access. For the audit client, monitoring the services being provided to entities that may be deemed an affiliate, especially where there may be multiple portfolio companies and several entities invested in those portfolio companies, can be both expensive and difficult. In addition, the current definition captures entities whose relationships with the accounting firm (and its professionals) pose no threat to independence in fact or appearance with respect to the audit client.

For example, assume the accounting firm (AF) audits Portfolio Company 1 (PC1) controlled by Private Equity Fund A (Fund A). The accounting firm does not audit Fund A. Fund A also controls Portfolio Company 2 (PC2), which is also not audited by the accounting firm. PC2 has many controlled subsidiaries located around the globe. Another accounting firm, located in a different country, that is considered an associated entity of AF under the independence rules provides payroll outsourcing services to one of PC2's international subsidiaries and charges a few hundred dollars for the service.

Current application of the affiliate rule would conclude that AF's independence has been impaired even though PC1 and PC2 have no financial interest in one another, no control or influence over one another, and the results of any services provided to the PC2 international subsidiary will not be part of the audited financial statements of PC1 that are being opined on by AF. We believe that a reasonable investor with knowledge of the facts and circumstances would find this far-reaching application of the affiliate rule to be unreasonable and unnecessary.

The definition of "audit client" also encompasses any entity that the audit client controls, even in situations where the financial statements of the controlled entity are not consolidated into the "parent" entity's financial statements and when that entity is audited by another accounting firm.

For example, assume the accounting firm (AF) audits Private Equity Fund B (Fund B). Fund B has a registered investment advisor and the audit of Fund B is being utilized for purposes of the "audit exception" under the Custody Rule. Fund B controls Portfolio Company 3 (PC3). Fund B records its investment in PC3 at fair value in its financial statements. Another accounting firm, unrelated to AF, audits PC3. However, AF calculates the deferred taxes recorded on the financial statements of PC3. Current application of the affiliate rule would conclude that the auditor's independence has been impaired, even though PC3 is audited by another accounting firm, the deferred taxes may be *de minimis* for the entity, and the results of the services provided to PC3 are not consolidated into the financial statements of Fund B. As with the example above, we believe that a reasonable investor with knowledge of the facts would find this conclusion to be unreasonable and unnecessary.

Outside of the fund complex, the relationship between the issuer audit client, especially those with international affiliates, and its employee benefit plans can be attenuated such that independence, integrity and objectivity could be deemed not threatened. For example, assume the accounting firm ("AF") audits the employee benefit plan of multi-national issuer Z ("Z"). The employee benefit plan files an annual Form 11-K with the Commission and the only participants in the plan are employees of Z's United States-based subsidiary. AF does not audit Z. Z has hundreds of foreign affiliates, and no employee of any foreign affiliate is eligible to participate in the employee benefit plan filing the Form 11-K. Another accounting firm, located in a different country, that is considered an associated entity of AF under the independence rules, provides corporate secretarial services to and pays certain regulatory fees (which are later reimbursed by Z pursuant to regular billing practices) on behalf of one of Z's foreign subsidiaries. Current application of the rules would conclude that AF's independence has been impaired even though the financial statements of Z's foreign subsidiary are unrelated to the financial statement of the employee benefit plan, the results of any services provided to the foreign affiliate would not be incorporated in to the financial statements of the employee benefit plan, and the relationship between the United States-based subsidiary and the foreign subsidiary is remote. We believe that a reasonable investor, as well as participants in the plan, with knowledge of the facts and circumstances would find this far-reaching application of the affiliate rule to be unreasonable and unnecessary.

The AICPA definition of "affiliate" has been in place for a number of years and appears to be operating effectively. We believe the existing AICPA definition of "affiliate" provides a reasonable approach to capture those entities affiliated with an audit client that could create potential threats to auditor independence without resulting in a significant burden on audit firms in monitoring and complying with the independence requirements. Under the AICPA approach, sister entities of the audit client are considered to be affiliates only if the audit client and sister entity are both material to the non-client parent entity. Similarly, a non-client parent entity is considered an affiliate of the audit client only when the audit client is material to the non-client parent.

With respect to investment company complexes (ICC), the all-inclusive definition of "affiliate of the audit client" presents significant challenges outside the Loan Provision context. Again, we believe the AICPA definition of an affiliate strikes a reasonable balance and therefore recommend that the Commission consider revising the definition of “affiliate of the audit client” in the context of funds and ICCs to align with that of the AICPA. Where the audit client is a fund, the AICPA definition of affiliate includes investment advisers, general partners and trustees of the fund if the fund is material[1] to those entities and they have either control or significant influence over the fund. We do not believe other funds or non-fund entities within the ICC that are not audit clients of the firm should be considered affiliates of the fund audit client. In cases where the auditor does not audit these other funds, we believe any threats created by relationships with such funds would be insignificant.

In light of the concerns and scenarios described above, we encourage the Commission to consider amending the affiliate definition, including consideration of alignment with the AICPA definition. In addition to being a reasonable approach to capture those entities that could create potential threats to an auditor’s independence, we believe a consistent definition of affiliate within the audit profession will help to facilitate compliance with the Commission’s independence requirements.

Application of the “Not Subject to Audit Exception”

Five of the prohibitions in the Commissions’ rules for providing services (bookkeeping, internal audit outsourcing, valuation services, actuarial services, information system design and implementation), include a modifier that allows the auditor to provide these services to an affiliate of the audit client when "it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements." This exception language is permitted to be applied to otherwise prohibited services provided to a brother/sister entity of the audit client. We believe the Commission should consider expanding this exception language to other services also prohibited under the Commission rules. While we recognize that there are instances where services provided to an affiliate of the audit client create threats to independence beyond the threat that the auditor is auditing his/her own work (such as appearing to act as management of the audit client or advocating on behalf of the audit client) and adversely impact the auditor’s integrity and objectivity, there are also many instances where other prohibited services provided to an entity under common control with a private-equity-owned audit client have no impact on the auditor’s independence either in fact or appearance. As in the examples in the affiliate section directly above, the audit client and the entity receiving the prohibited outsourcing services have no financial interest in one another, no control or influence over one another, and the results of any services provided to the non-client affiliate will not be part of the audited financial statements being opined on by the auditor (and are likely audited by another firm).

We encourage the Commission to consider amending the ability to apply the “not subject to audit” exception to relationships with affiliates of the audit client in light of the concerns described above.

Safe Harbor Exception

The Commission’s independence rules include a “safe harbor” provision in Regulation S-X Rule 2-01(d), which applies in situations where the independence of a covered person is inadvertently impaired, provided that the violation is promptly corrected and the firm maintains an adequate quality-control system. We encourage the Commission to consider adding a similar safe harbor provision for inadvertent violations of the business relationships and non-audit services rules under Rules 2-01(c)(3) and (4) of Regulation S-X.

[1] For purpose of determining materiality under the AICPA rules, investments in, and fees received from, the fund are considered.

The restrictive nature of the Commission’s rules on non-audit services and business relationships creates significant challenges for global networks of firms, especially when coupled with the challenges noted above concerning the scope of client affiliates given the evolving nature of business relationships since the rules were first promulgated. In many cases, a violation involves insignificant services for which the fees received are minimal, whereas the cost of assessing and addressing the potential impact of such services is high for both the auditor and the audit client. When evaluated by the auditor, it is clear the services provided have no impact on the audit engagement team’s ability to maintain the necessary integrity and objectivity to perform the audit. Moreover, a reasonable investor with knowledge of all relevant facts and circumstances would not view such violations as adversely impacting the auditor’s integrity and objectivity.

RSM US LLP appreciates the opportunity to provide these comments and would be pleased to respond to questions the Commission may have about them. Please direct any questions to Shelly Van Dyne [redacted]), National Director of Independence.

Sincerely,

RSM US LLP

RSM US LLP