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March 10, 2020

By email: rule-comments@sec.gov

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

Attn: Vanessa A. Countryman, Secretary

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

Dear Office of the Secretary:

BDO USA, LLP appreciates the opportunity to respond to the Securities and Exchange Commission's ("Commission" or "SEC") Proposed Rule, *Amendments to Rule 2-01, Qualifications of Accountants* ("the Independence Rule").

We support the Commission's endeavor to address the significant challenges that auditors have been facing in complying with certain aspects of Rules 2-01, *Qualifications of Accountants*. We believe that the proposed revisions to the Independence Rule will mitigate these challenges and more effectively focus the independence analysis on those relationships or services that are more likely to pose threats to an auditor's objectivity and impartiality.

We have provided our views on the various components of the proposed amendments to the Independence Rule below as well as our responses to certain of your specific requests for comments.

Specific Request for Comments

A. Proposed Amendments to Definitions

1. Proposed Amendments to Affiliate of the Audit Client and the Investment Company Complex

a. *Proposed Amendments for Common Control and the Affiliate of the Audit Client (Questions 1 – 5)*

We support the Commission's proposal to amend Rule 2-01(f)(4), *Affiliate of the audit client* (the "client affiliate definition"), to include a materiality requirement with respect to operating companies under common control (sister entities). We believe that providing services to, or having relationships with, sister entities that are not material to the controlling entity do not present threats to an audit firm's objectivity and impartiality.

Further, we believe that if an audit firm provides services to, or has a relationship with, a sister entity of an audit client when the audit client is not material to the controlling entity, generally, there will not be threats to the audit firm's objectivity and impartiality. As such, we suggest that the client affiliate definition should only consider sister entities to be affiliates of the audit client when the audit client and sister entity are both material to the controlling entity. As pointed out by the Commission in the Proposed Rule, in situations where threats to independence may be posed by services to, or relationships with, sister entities when the audit client is not material to the controlling entity, the threats are sufficiently covered by the general standard. For the same reasons, we believe the entity that controls the audit client should only be considered an affiliate when the audit client is material to the controlling entity. Again, we believe any threats to independence that may exist when the audit client is immaterial to the controlling entity are sufficiently covered by the general standard.

We believe adding a materiality threshold to the affiliate definitions as described above, would allow an audit firm to more easily and intently focus on those entities and potential relationships that could present the most significant threats to the auditor's independence (in both fact and appearance) while still safeguarding the audit firm's objectivity and impartiality. Lastly, this suggested amendment to the proposal would align the client affiliate definition with that of the International Ethics Standards Board for Accountants (IESBA) and the American Institute of Certified Public Accountants (AICPA). Alignment with the IESBA and the AICPA promotes consistency of application and strengthens compliance.

b. *Proposed Amendments to the Investment Company Complex*

i. Entity Under Audit and Unregistered Funds (Questions 6 and 7)

We support proposed Rule 2-01(f)(14) (the Investment Company Complex or "ICC" definition) specifically referencing the entity under audit, as, this adds clarity to the application of the definition. Further, we believe it is appropriate to direct auditors of an advisor, sponsor or investment company (including an unregistered fund) to the ICC definition. This also adds clarity to the application of the rules and will promote consistency across the profession.

ii. *Common Control with any Investment Company, Investment Adviser or Sponsor (Questions 8 - 11)*

We support the Commission's proposal to include a materiality qualifier in Rule 2-01(f)(14)(i)(D) so that (other than those advised by the same investment adviser) only sister investment companies or investment advisers or sponsors that are material to the controlling entity be considered affiliates in an ICC. We believe this proposed amendment to be appropriate for the same reasons we noted above with respect to the client affiliate definition for operating companies (Rule 2-01(f)(4)) and believe the revision would bring the ICC definition into closer alignment with that definition. In addition, we do not believe auditors would face challenges assessing materiality in connection with unregistered funds as

auditors are well versed in making materiality assessments in other aspects of the audit and independence matters.

However, we believe that as currently drafted, the ICC definition would scope in all entities (such as portfolio companies) controlled by those sister investment companies advised by the same investment adviser. We do not believe this to be the intent of the Commission. This presumed unintended consequence would be inconsistent with the proposed revisions to the client affiliate definition in Rule 2-01(f)(4) and could have a significant impact when applied to a fund audit client that is part of a private equity structure. For the following example, please refer to "ATTACHMENT (Diagram A)" of this letter. Assume a firm audits Fund 1 which is advised by a registered investment advisor (RIA). Funds 2 and 3 are also advised by said RIA. Fund 2 controls portfolio company B, Fund 3 controls portfolio company C, and portfolio company C controls subsidiary 1. Under Rule 2-01(f)(14)(i)(C) as proposed, the firm would have to be independent of portfolio companies A and C as well as subsidiary 1 as follows:

"(C) Any entity controlled by…any investment advisor…identified in paragraph…(B)…"

Note that (B) above refers to "The investment advisor or sponsor of any investment company identified in paragraph (f)(14)(i)(A)…"

The investment advisor identified in (B) and referenced in (C) above would include the RIA of Funds 1, 2 and 3 and all portfolio companies and subsidiaries controlled by the RIA. Accordingly, the portfolio companies B and C and subsidiary 1 would be considered affiliates of the audit client (Fund 1). In a private equity environment, each fund could have many portfolio companies which generally have no connection to one another and the task of monitoring all portfolio companies is often difficult due to the significant transaction activity within a private equity firm. A such, we recommend the following edits (inserts in ***bold italics*** and deletions in ~~strikethrough~~) to the proposed ICC definition in order to scope out portfolio companies (and their subsidiaries) of sister funds of a fund audit client:

> (C) Any entity controlled by or controlling any investment adviser or sponsor identified in paragraph (f)(14)(i)(A)(2) ~~or (B)~~, or any investment company identified in paragraph (f)(14)(i)(A)(1) of this section.
>
> ***(D) Any entity controlled by (B), if the entity is an investment company.***

We believe the proposed edits will appropriately scope out portfolio companies (and their subsidiaries) of sister funds of a fund audit client. See "ATTACHMENT (Diagram B)" for an illustration of this proposed edit using the previous fact pattern.

While we believe portfolio companies of a sister fund should be excluded from the ICC definition, if the Commission believes they should be considered affiliates, then we ask that the Commission consider revising the definition to scope out immaterial portfolio companies (and their subsidiaries) of sister funds of the fund audit client. In order to achieve this, we recommend the following revision:

> (C) Any entity controlled by or controlling any investment adviser or sponsor identified in paragraph (f)(14)(i)(A)(2) ~~or (B)~~, or any investment company identified in paragraph (f)(14)(i)(A)(1) of this section.

(D) Any entity controlled by (B), if the entity is either:
(1) An investment company, or
(2) Material to (B). …

We believe this proposed language will scope out the immaterial sister portfolio companies and their subsidiaries while still including all sister funds advised by the same investment adviser.

iii. ***Investment Companies that Share an, Investment Adviser or Sponsor or Included Within the ICC Definition (Question 13)***

We agree that paragraph (f)(14)(i)(F) should be adopted as proposed and include within the ICC definition any investment company that that has an investment adviser or sponsor that is an affiliate of the audit client pursuant to proposed paragraphs (f)(14)(i)(A) through (D).

iv. ***Significant Influence within the ICC Definition (Questions 14 and 15)***

We agree that the significant influence prong should be incorporated into the ICC definition as proposed. Further, we agree that Rule 2-01(f)(c) should include the proposed reference to paragraph (f)(14)(i)(E).

2. Proposed Amendment to Audit and Professional Engagement Period (Question 16)

We support the Commission's proposal to amend 2-01(f)(5) to shorten the look-back period for all first-time filers to the most recently completed fiscal year. We agree that applying the same framework that applies for foreign private issuers to audit clients planning an IPO is a reasonable approach to address the challenges facing companies and their auditors when a company decides to go public. These challenges are especially relevant in the private equity environment where a private equity firm might decide to change strategy and take a portfolio company audit client public within a one- or two-year time frame. We believe the proposal will provide appropriate transition relief while still safeguarding auditor independence and promoting investor protection. Specifically, the audits of the prior periods would still be subject to robust independence standards of the AICPA or IESBA (or other relevant standard-setter) and as noted by the Commission, which will sufficiently mitigate the risk associated with shortening the look back provision.

B. Proposed Amendments to Loans or Debtor-Creditor Relationships

1. Proposed Amendment to Except Student Loans (Questions 17 – 19)

We agree with the proposal to except student loans for a covered person's educational expenses that were not obtained while the individual in the firm was a covered person. However, we believe this should also extend to immediate family members of the covered person, which would be consistent with the other loan provisions under "Loan/debtor-creditor relationship." The threat to an auditor's objectivity and impartiality would not be any greater due to the loan belonging to a spouse or a dependent as opposed to the covered person.

We would expect the phrase "educational expenses" to include expenses for room and board, as well as other educational expenses in addition to tuition. While the Commission may not choose to define the phrase, we would appreciate if the Final Rule would include more detailed guidance. Finally, we recommend that the Commission not limit the exception to only "accounting and auditing" educational expenses. We believe there are no greater threats to independence if the student loan were to cover other curricula and many audit and accounting firms have non-audit partners and employees who should also be able to benefit from the exception.

Finally, we do not believe it is necessary to include a limit on the amount of the student loan outstanding provided they are paid under the specified terms and requirements.

2. Proposed Amendment to Clarify the Reference to "a Mortgage Loan" (Question 20)

We agree with the proposed revision to Rule 2-01(c)(1)(ii)(A)(l)(iv) to refer to "mortgage loans" instead of "mortgage loan."

3. Proposed Amendment to Revise the Credit Card Rule to Refer to "Consumer Loans" (Questions 21 – 24)

We agree with the proposal to amend Rule 2-01(c)(1)(ii)(E) to refer to "consumer loans" rather than "credit cards." Further, we believe that the limit should be raised, to reflect current consumer behavior, to a $20,000 balance limit.

We believe the term "current basis" pertaining to consumer loans is well understood. As noted by the Commission, the current basis of a consumer loan would be based on the payment due date and any available grace period.

The Commission notes that consumer loans would cover consumer financing that borrowers would routinely obtain for personal consumption (e.g., retail installment loans, cell phone installment plans, and home improvement loans not secured by a mortgage). We believe this term will be understood and therefore no further guidance is necessary.

C. Proposed Amendment to the Business Relationship Rule

1. ***Proposed Amendment to the Reference to "Substantial Stockholder" (Question 25)***

We agree with the proposed amendments pertaining to the Business Relationship Rule to remove the phrase "substantial stockholders" and replace it with "beneficial owners (known through reasonable inquiry) of the audit client's equity securities where such beneficial owner has significant influence over the audit client" to be consistent with the language used in the recently adopted Loan Provision.

2. ***Additional Guidance on the Reference to "Audit Client" when Referring to Persons Associated with the Audit Client in a Decision-Making Capacity, including the Beneficial Owner with Significant Influence (Question 26)***

We agree with the proposed amendments to clarify that the independence assessment should focus on those business relationships where a beneficial owner has significant influence over the entity under audit and not those where such beneficial owner might have significant influence over an affiliate of the entity under audit. We believe that only those beneficial owners who have significant influence over the client itself could result in a threat to the auditor's objectivity and impartiality.

D. Proposed Amendments for Inadvertent Violations for Mergers and Acquisitions (Questions 29 -32)

We support the proposed transition framework to address inadvertent independence violations arising from mergers and acquisitions of the audit client. We believe that the quality control requirement is sufficiently clear and that there are no other criteria that should be considered. This is especially important in the private equity environment where there is a high volume and frequency of transaction activity over which the audit firm has no control. We agree that in such situations, the auditor should be in compliance with the applicable independence standards related to the services or relationships when the services or relationships originated and have in place an adequate quality control system for monitoring the audit client's merger and acquisition activity. We further agree that the auditor should be required to correct any independence issues as promptly as possible and that "all corrective action would be taken no later than six months after the effective date of the merger or acquisition that triggered the independence violation." As noted by the Commission, the framework is closely aligned to the standard within the IESBA Code of Ethics and therefore auditors should already be familiar with its application in practice.

We also do not believe any prohibited services or relationships should continue to be considered an independence violation as the proposed framework provides sufficient safeguards to mitigate any threats to independence.

E. Proposed Amendments for Miscellaneous Updates (Question 35)

We agree with the proposed updates to: replace references to "concurring partner" with the term "Engagement Quality Reviewer;" delete the outdated transition and grandfathering provision; and make a technical amendment to the Preliminary Note to Rule 2-01.

Other Considerations for Private Equity and Related Investment Company Complexes

Finally, we believe that the relative significance of the non-attest fees and services to the attest fees and services performed by an audit firm for an investment company complex could compromise the audit firm's objectivity or independence from the perspective of a reasonable investor. For example, the auditor may be engaged to perform non-attest services for, or enter into a strategic business relationship with, an immaterial sister portfolio

company that eclipse the attest services provided to the rest of the investment company complex, and the fees from such non-attest services may be significant to the audit firm, the portfolio company and possibly to the private equity firm. Accordingly, we recommend that the Commission consider whether such situations would be adequately addressed through the general standard in Rule 2-01(b) or whether further clarification or rule-making might be appropriate.

* * *

We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct any questions to Christopher Tower, National Assurance Managing Partner – Audit Quality and Professional Practice at ctower@bdo.com or Lisa Snyder, National Assurance Managing Partner – Independence at lsnyder@bdo.com.

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP

cc:

SEC
Jay Clayton, Chairman
Robert J. Jackson Jr., Commissioner
Hester Peirce, Commissioner
Michael S. Piwowar, Commissioner
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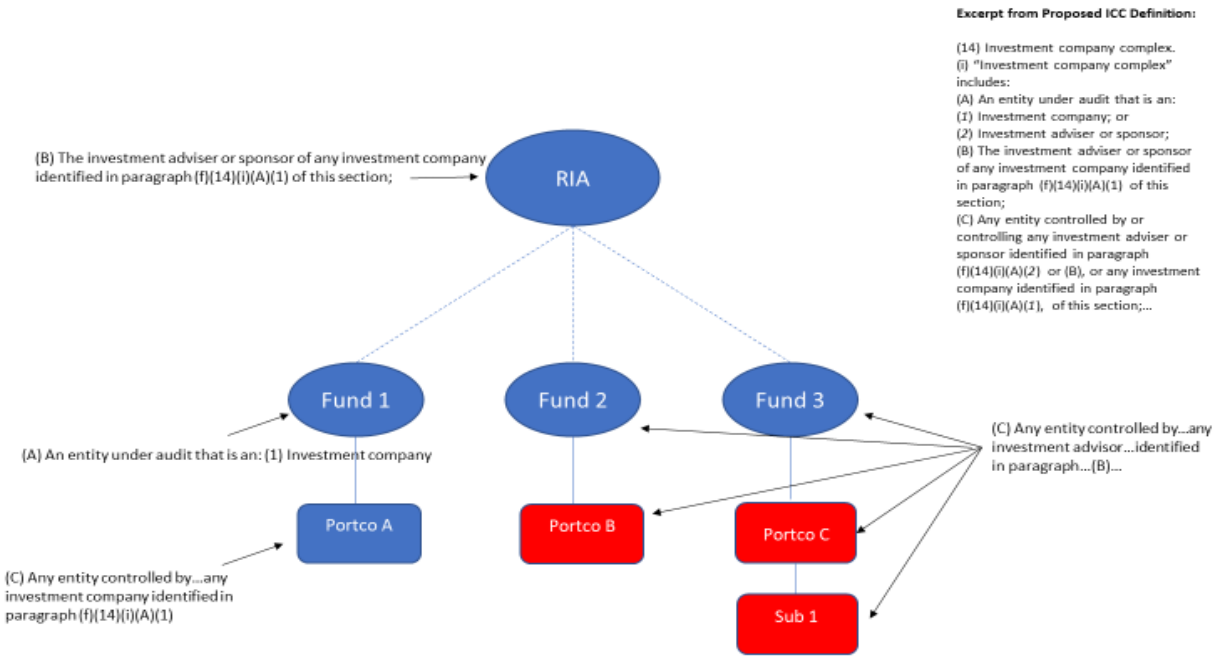
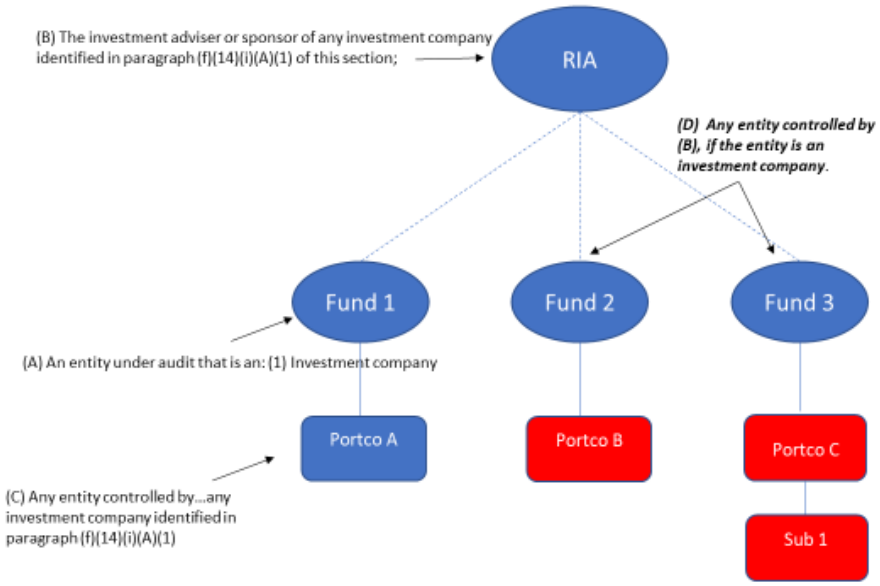
Wesley R. Bricker, Chief Accountant
Julie A. Erhardt, Deputy Chief Accountant
Marc A. Panucci, Deputy Chief Accountant
Sagar S. Teotia, Deputy Chief Accountant

ATTACHMENT

SEC PROPOSED ICC DEFINITION (Diagram A):



REVISED ICC DEFINITION PROPOSED BY BDO (EXCLUDES PORTCOS B & C, SUB 1) (Diagram B)



Revision to Proposed ICC Definition:

(14) Investment company complex.
(i) "Investment company complex" includes:
(A) An entity under audit that is an:
(*1*) Investment company; or
(*2*) Investment adviser or sponsor;
(B) The investment adviser or sponsor of any investment company identified in paragraph (f)(14)(i)(A)(1) of this section;
(C) Any entity controlled by or controlling any investment adviser or sponsor identified in paragraph (f)(14)(i)(A)(2) ~~or (B)~~, or any investment company identified in paragraph (f)(14)(i)(A)(1) of this section.
(D) Any entity controlled by (B), if the entity is an investment company.
(E) ~~(D)~~ Any entity under common control;...