



CENTER FOR CAPITAL MARKETS  
COMPETITIVENESS

**TOM QUAADMAN**  
EXECUTIVE VICE PRESIDENT

1615 H STREET, NW  
WASHINGTON, DC 20062-2000  
(202) 463-5540  
tquaadman@uschamber.com

March 16, 2020

Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: *Proposed Amendments to Rule 2-01, Qualifications of Accountants***  
**(Release No. 33-10738; 34-87864; FR-86; IA-5422; IC-33737; File No. S7-26-19;**  
**RIN 3235-AM63)**

Dear Secretary Countryman:

The U.S. Chamber of Commerce’s (“the Chamber”) Center for Capital Markets Competitiveness (“CCMC”) appreciates the opportunity to comment on the Securities and Exchange Commission (“SEC” or “Commission”) Proposed *Amendments to Rule 2-01, Qualifications of Accountants* (the “Proposal” or “Proposed Amendments”).

The Proposal would update a few conditions in the nonexclusive list of detailed circumstances and related specifics on auditor independence in Rule 2-01 of SEC Regulation S-X.<sup>1</sup> CCMC has been a proponent of periodic review of existing regulations. Such reviews allow regulators to keep rules up to date and consistent with evolutions in our markets, businesses, technology, and regulatory environment. CCMC applauds the Commission for recognizing the need for the Proposed

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<sup>1</sup> Throughout our letter the term “auditor” refers to both the accounting firm and its accountants, consistent with the SEC’s auditor independence rules (also, the SEC uses the terms “accountants” and “auditors” interchangeably).

Amendments to maintain the relevance and effectiveness of Rule 2-01 in light of current market conditions and industry practices.

The Proposal is an outgrowth of the Commission staff's experiences administering Rule 2-01 over the last two decades,<sup>2</sup> and in response to recent and longer-term feedback on the auditor independence rules received from market participants. More recent feedback includes recommendations received during the SEC's due process that amended one specific circumstance in Rule 2-01's nonexclusive list related to auditor independence in the context of the loan provision.<sup>3</sup>

CCMC appreciates that the Commission has responded to the internal and external input, including that from CCMC,<sup>4</sup> with the Proposed Amendments to update other detailed aspects of the SEC's auditor independence rules. CCMC strongly supports the Proposed Amendments.

Below we provide additional background on the auditor independence rules and the Proposed Amendments, along with a few observations and recommendations for the SEC's consideration related to the Proposed Amendments.

### **Background and Proposed Amendments**

Rule 2-01 of SEC Regulation S-X applies to accounting firms and their accountants on audits of all types of entities that file financial statements with the SEC, including operating companies, registered investment companies, registered investment advisers, pooled investment vehicles, and registered broker-dealers. Rule 2-01 requires auditors to be independent of their audit clients both "in fact and in appearance."

Rule 2-01 contains a general standard that "the Commission will not recognize an accountant as independent with respect to an audit client if the accountant is not

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<sup>2</sup> The auditor independence framework and detailed circumstances and related specifics in Rule 2-01 were initially adopted in 2000, with revisions in 2003 as the SEC implemented the requirements of the Sarbanes-Oxley Act of 2002 ("SOX").

<sup>3</sup> See *Auditor Independence With Respect to Certain Loans or Debtor-Creditor Relationships* (SEC Release No. 33-10648; 34-86127; FR-85; IA-5255; IC-33511; File No. S7-10-18; RIN 3235-AMO1), final rules effective on October 3, 2019.

<sup>4</sup> For example, see the attached letter from the CCMC to the SEC dated July 9, 2018 on *Auditor Independence With Respect to Certain Loans or Debtor-Creditor Relationships* (Release No. 33-10491; 34-83157; IC-33091; IA-4904; File No. S7-10-18; RIN 3233-AMO1),

(or if 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.”<sup>5</sup>

Rule 2-01 also provides four guiding principles for assessing an auditor’s independence. Assessments must consider all relevant circumstances, including all relationships between the accountant and the audit client, in determining whether an auditor is independent.

In addition, Rule 2-01 has an extensive, but nonexclusive, list of detailed circumstances and specifics that the Commission considers inconsistent with the auditor independence standard, including certain financial, employment, business, and non-audit service relationships between an accountant and its audit client.

The Proposed Amendments would not change the general standard or the guiding principles. Rather, the Proposed Amendments would update a few provisions in the nonexclusive list of detailed circumstances and related specifics, as follows:

- Amend the definition of an affiliate of the audit client, in Rule 2-01(f)(4) and Investment Company Complex (“ICC”), in Rule 2-01(f)(14) to include materiality qualifiers in the respective common control provisions and to distinguish how the definition applies when an accountant is auditing a portfolio company, an investment company, or an investment adviser or sponsor;<sup>6</sup>
- Amend the definition of the audit and professional engagement period, specifically Rule 2-01(f)(5)(iii) to shorten the look-back period for domestic first-time filers in assessing compliance with the SEC’s auditor independence rules;<sup>7</sup>
- Add certain student loans and de minimis consumer loans to the categorical exclusions from independence-impairing lending relationships, in Rule 2-01(c)(1)(ii)(A)(1) and (E);<sup>8</sup>

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<sup>5</sup> See the Proposed Amendments, page 5.

<sup>6</sup> See the Proposed Amendments, page 10.

<sup>7</sup> See the Proposed Amendments, page 27.

<sup>8</sup> See the Proposed Amendments, pages 30 and 33.

- Replace the reference to “substantial stockholders” in the business relationship rule (Rule 2-01(c)(3)) with the concept of beneficial owners with significant influence;<sup>9</sup>
- Replace the outdated transition and grandfathering provision in Rule 2-01(e) with a new Rule 2-01(e) to introduce a transition framework to address inadvertent independence violations that only arise as a result of merger and acquisition (“M&A”) transactions;<sup>10</sup> and
- Make certain miscellaneous updates to terminology and delete outdated transition and grandfathering provisions.<sup>11</sup>

CCMC is pleased to strongly support the Proposed Amendments. CCMC supports a focus on circumstances and specifics that really matter for threats to an auditor’s ability to exercise objective and impartial judgment. CCMC believes the Proposed Amendments will benefit both companies and the economy, and agrees with the Commission that the Proposed Amendments will enhance the efficiency of rule implementation, reduce compliance burdens, and increase competition among auditors.<sup>12</sup>

For example, the Proposed Amendments make it easier for domestic first-time filers to access the capital markets by shortening the IPO look-back period to one-year and therefore, facilitates capital formation. The proposed transition framework allows for orderly transition of prohibited non-audit services or relationships within six-months after the effective date of the merger and acquisition transaction, which helps to reduce business disruptions to companies. We also note that the expanded pool of qualified auditors may allow for better alignment of auditor expertise to audit engagements, and anticipate that the improved alignment would positively influence audit and financial reporting quality, thereby benefiting investors and improving market efficiency.<sup>13</sup>

In addition, CCMC would like to provide a few observations and recommendations for the Commission’s consideration related to the Proposed Amendments.

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<sup>9</sup> See the Proposed Amendments, page 37.

<sup>10</sup> See the Proposed Amendments, pages 40-42.

<sup>11</sup> See the Proposed Amendments, pages 43-44.

<sup>12</sup> See the Proposed Amendments, page 65.

<sup>13</sup> See the Proposed Amendments, page 60.

## Observations and Recommendations

### *Definitions of Affiliate of the Audit Client and the Investment Company Complex*

CCMC supports the Commission's proposal to amend the affiliate of the audit client definition and the Investment Company Complex definition by adding a materiality qualifier to commonly controlled sister entities. We believe this will more appropriately focus the independent analysis of those relationships that are likely to impair the auditor's objectivity and impartiality, and help to reduce the compliance costs and alleviate challenges associated with the application of current definitions. The amendments will likely increase choice of qualified audit firms and improve audit quality, without compromising independence.

To further reduce complexity and compliance challenges in applying the affiliate definition, we recommend that the Commission consider further alignment with the definitions of "affiliate" in the American Institute of Certified Public Accountants *Code of Professional Conduct* ("AICPA Code") and *The Code of Ethics for Professional Accountants (including International Independence Standards)* ("the IESBA Code").<sup>14</sup> Further aligning the SEC's affiliate definition with the AICPA Code and the IESBA Code would allow registrants and their auditors to apply both consistent affiliate evaluations and global monitoring approaches.

In addition, when the entity under audit is immaterial to the controlling entity, we believe relationships or services between the auditor and other entities under common control would not impact the auditor's ability to maintain objectivity and impartiality in fact or appearance. For the same reason, we also recommend that the definition in Rule 2-01(f)(14)(i)(D) be amended to include sister investment advisers and investment companies only when both the sister entity and the investment adviser under audit, or the investment adviser/sponsor of an investment company under audit, are material to the controlling entity.

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<sup>14</sup> The AICPA Code, Definitions, 0.400.02(e) defines "affiliate" as "[a] sister entity of a financial statement attest client if the financial statement attest client and sister are each material to the entity that controls both" and the IESBA Code defines "related entity", in subsection (e) of the Glossary, Including List of Abbreviations as "[a]n entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity."

### *Business Relationship Rule*

CCMC notes that in the adopting release for the Loan Provision, the Commission stated that "... entities that are under common control with or controlled by the beneficial owner of the audit client's equity securities when such beneficial owner has significant influence over the audit client, are excluded from the scope of the Loan Provision." CCMC would like to recommend the Commission consider conforming amendments to clarify that entities which are under common control with, or controlled by, a beneficial owner with significant influence, are also excluded from the scope of the business relationship rule. We believe this will improve clarity and consistency, while reducing complexity and compliance costs.

CCMC agrees with the additional guidance the Commission provided on the reference of "audit client" when referring to persons associated with the audit client in a decision-making capacity, including the beneficial owner with significant influence.<sup>15</sup> This guidance directs auditors to focus on whether significant influence exists at the "entity under audit", when evaluating lending or business relationships with officers, directors or beneficial owners with significant influence over an affiliate pursuant to the Loan Provision or the current or proposed business relationship rule. CCMC believes that this is helpful guidance and recommends the Commission consider codifying this focus on the "entity under audit" concept in the rule text for both the business relationship rule and Loan Provision, so as to establish statutory authority to ensure clarity and promote compliance in the future.

### *M&A Transition Framework*

In regards to the M&A transition framework, CCMC recommends that the SEC clarify that matters arising from a merger and acquisition transaction that meet the conditions of the proposed framework would not constitute a violation of the SEC independence rules. While we would expect such matters to be reported to the audit committee, treating such matters as rule violations could lead to confusion on the part of an audit committee in performing its governance function. Further, we recommend the SEC clarify that the proposed framework can be used in situations where the auditor has not identified the M&A transaction until after the close.

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<sup>15</sup> See the Proposed Amendments, pages 35-37.

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*Conforming Changes to PCAOB Rules*

Lastly, CCMC encourages the SEC to work with the Public Company Accounting Oversight Board (“PCAOB”) to make needed conforming changes in PCAOB definitions and rules to address inconsistencies between any changes to the Commission’s independence rules adopted and the PCAOB’s independence standards.

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Thank you for your consideration and we stand ready to discuss our comments with you further

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' followed by a long horizontal flourish.

Tom Quadman