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March 16, 2020

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

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

Re: File Number S7-26-19: Amendments to Rule 2-01, *Qualification of Accountants*; Release Nos. 33-10738; 34-87864; FR-86; IA-5422; IC-33773

Dear Office of the Secretary:

Crowe LLP appreciates the opportunity to provide our input on the Securities and Exchange Commission's ("Commission" or "SEC") Amendments to Rule 2-01, Qualification of Accountants.

We commend the Commission's efforts to modernize certain provisions of Rule 2-01 of Regulation S-X. We agree the current rules may not be functioning as intended under current market and industry conditions. Complexities caused by an expanding global marketplace, changes in corporate structures, growth in private equity structures, and other environmental changes warrant new perspectives on how the independence rules are applied in today's environment and how investors can be protected while reducing unnecessary compliance costs for activities that do not promote auditor independence and objectivity. The changes proposed help in addressing some of those complexities, while preserving investor protections.

We see potential benefits from the revisions to the rules that have been proposed, including reducing the number of independence violations previously reported by auditors that reasonable investors would not believe impaired the auditor's objectivity and impartiality; and increasing competition by not eliminating qualified audit firms from providing audit services because of relationships or services provided to sister entities that have no control or influence over the entity under audit. We believe that when numerous violations are reported over time, it is possible audit committees may become desensitized and may not properly distinguish and respond to more significant violations.

We affirm our agreement with the majority of the provisions of the Amendments, but have outlined our abbreviated recommendations below, with further details provided in the remainder of this letter.

We believe it is in the best interest of issuers, governance boards, and practitioners when authoritative standards are aligned whenever possible. This helps eliminate confusion and assists with streamlining reporting and monitoring systems. With that in mind, we provide the following recommendations where we encourage the Commission to consider adopting rules that would be consistent with other standards applicable in the industry.

- The audit client affiliate definition could include sister entities when both are material to the controlling entity and the controlling entity would only be included if the entity under audit is material to that entity.

- The investment company complex affiliate definition[1] could be amended to include the same concepts as Rule 2-01(f)(4)(i) focusing on control, significant influence, and sister entities without including all entities under common control.
- Business relationships with beneficial owners with significant influence should be based on whether that individual has significant influence over the entity under audit, not all entities within the audit client definition.

We appreciate the opportunity to respond to the Commission's proposal and have included our observations on the major provisions of the proposed amendments and our responses to the Commission's requests for comment. We have provided our responses to the Commission's questions within the sections outlined below.

Proposed Amendments to Rule 2-01

Audit Client Affiliate Definition

We agree with the change proposed to the "common control" prong of the audit client affiliate definition. We believe that prohibited services or relationships with a sister entity that is not material to the controlling entity typically do not threaten the auditor's objectivity or impartiality. We agree that focusing on sister entities that are material to the controlling entity would relieve some of the compliance burden associated with determining independence. This change moves closer to aligning with the affiliate definition used by the AICPA and IESBA; however, there are still key differences between the different independence standards.

First, AICPA and IESBA both include entities under common control with the audit client if the sister entity and the audit client are both material to the controlling entity. If the entity under audit is not material to the controlling entity, then we believe it is reasonable to conclude services provided to a sister entity, regardless of the materiality of that entity, would not impact the auditor's objectivity and impartiality. We believe the threats to independence increase when both entities are material to the controlling entity since the likelihood of the ability to influence each other could increase. If the entity under audit is not material to the controlling entity, we do not believe services or relationships with a material sister entity automatically bears on the independence of the auditor. Accordingly, we suggest the Commission consider amending the common control prong to only include sister entities when both are material to the controlling entity.

We do not believe focusing only on material sister entities creates an increased risk of lack of independence as we believe the general standard of independence is sufficient for identifying services and relationships that threaten independence when they arise with immaterial sister entities. Auditors and issuers are familiar with the concept of materiality when applying other independence requirements. Accordingly, we do not believe additional materiality guidance is necessary.

In addition, AICPA and IESBA include the entity that has control over the audit client if the audit client is material to that entity. We recommend the Commission consider adding a materiality qualifier for an entity that controls the entity under audit. This concept is well known by auditors and issuers since it is consistent with other standards and provides for consistency in applying the affiliate rules. Ultimately, we believe the affiliate definitions used by the AICPA and IESBA include the entities that present a reasonable risk to independence if the accountant had relationships with those entities; and therefore, we do not believe other entities need to be included.

[1] Rule 2-01(f)(14)

The SEC's independence rule includes the following definition of an *audit client*, "Audit client means the entity whose financial statements or other information is being audited, reviewed or attested and any affiliates of the audit client."[2] We believe this definition creates a circular reference when applying the *affiliate of an audit client* definition[3]. The affiliate definition includes references to *audit client*, which then creates a circular reference. For example, when applying the first prong of the affiliate definition, an accountant must be independent of an entity that has control over the audit client. Since the term audit client is defined to include "and affiliates", it is assumed that an auditor needs to be independent of all entities that control affiliates. It is not clear this is the intention of the rules, which causes complexity when applying. We suggest the Commission consider whether creating separate definitions for entity under audit, audit client or affiliates would help eliminate any confusion in applying the rules.

Investment Company Complex Affiliate Definition

We appreciate the SEC's clarification that this prong only applies when the entity under audit is an investment company, investment adviser or sponsor. This application allows operating companies, that are owned by investment companies, to be subject to the affiliate definition in Rule 2-01(f)(4) as opposed to Rule 2-01(f)(14). Previously including these companies within the investment company complex affiliate definition had the potential for creating independence violations that did not threaten the accountant's objectivity and impartial judgment. We believe it is appropriate to have a separate investment company complex (ICC) prong within the audit client affiliate definition since ICC entities have unique structures that may not be fully addressed in other prongs of the affiliate definition. In addition, we appreciate the Commission clarifying that unregistered funds are included in the affiliated definition proposed by Rule 2-01(f)(14). Under the current rules it was not clear if unregistered funds would be part of the investment company complex (ICC) definition which created uncertainty and inconsistency in practice.

In addition, we agree with the SEC's addition of a materiality qualifier for entities under significant influence and for entities that have significant influence over the entity under audit. This better aligns the rules to include entities that have a greater chance of having services or relationships that could bear on the accountant's objectivity and impartial judgment.

The SEC's current definition of an "affiliate of the audit client" for an investment company complex includes entities where there is minimal, if any, opportunity for entities to influence one another. In particular, there is rarely an ability to influence when dealing with entities under common control. If the accountant had relationships with those entities, there would be no impact on the accountant's objectivity and impartiality. This broad definition of affiliates presents compliance challenges with the independence rules and result in violations that we believe a reasonable investor would not view as implicating an accountant's objectivity and impartiality. The SEC's proposal provides some relief by adding a materiality qualifier for certain entities under common control with the entity under audit. However, the SEC's investment company complex definition also applies to unregistered funds, which means that the rules, as currently proposed, would include all controlled portfolio companies in the affiliate definition including companies controlled by another fund. We recommend the Commission consider excluding these portfolio companies controlled by another fund from the investment company complex definition or add a materiality qualifier.

[2] Rule 2-01(f)(6)

[3] Rule 2-01 (f)(4)

Audit and Professional Engagement Period

We support the SEC's proposal to modify the "audit and professional engagement period" definition to apply consistently to foreign and domestic first-time filers. When an audit client undertakes an initial public offering (IPO), particularly an IPO that has not been planned years in advance, the audit client may be required to engage a new accountant if the current accountant is not in compliance with the SEC's independence rules. We believe that a reasonable investor, when presented with the relevant facts and circumstances, would conclude that prior relationships that were permissible under independence rules applicable at the time of the audit do not impact the accountant's objectivity and impartiality when later required to follow the independence rules of the Commission.

We also suggest the Commission clarify the definition of "first-time filer" in the release adopting the final rule. For example, if a company filed a confidential registration statement that did not become effective, could that company be considered a "first-time filer" for a subsequent registration statement since their first filing was never effective.

Loans or Debtor-Creditor Relationships

We support the Commission's revisions of the debtor-creditor rules. We agree an exception should be added for student loans obtained prior to an individual becoming a covered person; however, we suggest the Commission consider allowing student loans of immediate family members also be excluded. We do not believe these loans present a threat to the accountant's objectivity and impartiality if they were obtained from an audit client under its normal lending procedures, terms and requirements and if they were obtained before the individual was a covered person. We believe if the previous criteria have been met, all student loans should be exempted, regardless of the dollar amount of those loans. Limiting the exemption to accounting and auditing educational expenses does not seem necessary as the threat to objectivity and impartiality does not increase based on the type of educational expenses. In addition, since we are suggesting the exemption be extended to immediate family members their educational expenses may not be related to accounting and auditing. The proposed rule covers student loans obtained for educational expenses. We suggest the Commission provide guidance for determining how educational expenses would be defined. We believe it is reasonable to include all costs associated with pursuing a degree and the proposed rule should not be limited to only certain costs. This change will also serve to reduce unnecessary complexity.

We appreciate the Commission's clarification that the mortgage loan exception can be applied to multiple loans. This should alleviate any confusion in applying the rules since it is not uncommon for individuals to have multiple loans collateralized by their primary residence. We suggest the Commission consider extending the mortgage loan exemption to include mortgage loans collateralized by property other than primary residences as non-primary residences do not appear to present heightened risks to the accountant's independence. If the Commission is concerned this may create the potential for multiple loans aggregating to a material amount, then a materiality qualifier could be added. For example, the rule could be limited to no more than two properties which would allow the covered person to have a mortgage on their primary residence and a secondary residence but limit the risk of the loans aggregating to a material amount.

The Commission's expansion of the exception for credit card debt to include other similar consumer loans is consistent with the principle that immaterial loans should be excluded from the independence rules because the loans do not present a threat to the accountant's objectivity and impartiality since the loans are immaterial. The proposed limit of $10,000 seems to represent an amount that a reasonable investor would consider immaterial. We agree with this proposal.

Business Relationship Rule

The current business relationship rule applies to “substantial stockholders in a decision-making capacity”, which may include stockholders that do not have significant influence. We support the Commission’s proposal which replaces the current “substantial stockholders in a decision-making capacity” requirement with a significant influence test. We agree business relationships between beneficial owners with significant influence over the audited entity and the accountant represent business relationships that might be viewed to impact the accountant’s objectivity and impartial judgment. Narrowing the definition to a significant influence test will reduce the number of relationships prohibited under the current rules that do not impair objectivity or impartial judgement. We also recognize this change provides consistency within the rules, eases compliance, and reduces confusion and complexity while preserving independence.

The SEC’s proposed rule applies to, “…beneficial owners (known through reasonable inquiry) of the audit client’s equity securities…”; however, we noted the SEC’s proposal says the auditor should focus on whether the significant influence exists at the entity under audit.[4] We believe this is an important distinction to clarify that the significance influence is over the entity under audit and not another entity within the definition of “audit client”. We encourage the Commission to clarify this point in the final rule or at a minimum in the release adopting the final rule.

Inadvertent Violations for Mergers and Acquisitions

Rule 2-01(c) outlines non-audit services and business relationships that are prohibited as they are believed to violate the general standard of independence. Despite best efforts to comply with these requirements, inadvertent and immaterial violations may occur, in particular when providing non-attest services or entering into relationships with affiliates of the audit client. In many situations, these services or relationships involve a newly identified affiliate arising from a merger or acquisition. After evaluating the violation, it is not uncommon for accountants and issuers to determine that a reasonable investor would not believe the accountant’s objectivity or impartiality has been impaired and the accountant can continue as the external auditor.

We agree the Commission’s proposed framework will assist accountants in evaluating services and relationships. The proposed rule says, ”an accounting firm’s independence will not be impaired” if the criteria of the framework is met.[5] We note that Rule 2-01(e)(ii) says an accounting firm’s “lack of independence under this rule” has been or will be corrected as promptly as possible.[6] These sections seem to contradict as one section says independence will not be impaired and the other refers to a lack of independence. We believe the Commission could clarify section (e)(ii) by saying, “the accounting firm’s relationship or service inconsistent with this rule has been or will be discontinued as promptly as possible.”

The proposed framework requires the accountant to be in compliance with applicable independence standards, discontinue the service or relationship as promptly as possible, and have quality control system to monitor audit client’s merger and acquisition activity and identify services and relationships with newly identified affiliates. We believe this framework provides a reasonable basis for an accountant to evaluate and conclude on independence and the requirements are comprehensive. The proposed framework includes having procedures and controls for identifying potential violations before the merger or acquisition has occurred. While accountants are often aware of potential mergers and acquisitions directly related to the entity under audit, identification of mergers and acquisitions impacting affiliates such

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[4] Proposed Rule, page 37.

[5] Proposed Rule, page 83.

[6] Proposed Rule, page 84.

as common controlled entities might not be identified prior to the transaction closing. We encourage the Commission to consider allowing services and relationships identified at or soon after closing be evaluated using the proposed framework. We believe the requirement that prohibited services and relationships be corrected as promptly as possible will sufficiently address any services or relationships identified shortly after the closing.

The proposed framework requires prohibited services and relationships be corrected as promptly as possible. The Commission's proposal sets the expectation that all corrective actions would be taken no later than six months after the effective date of the merger or acquisition. We believe most services and relationships can be discontinued within a few months of closing; however, we acknowledge that in some situations a period of several months may be required. Accordingly, we believe the Commission's expectation of six months is a reasonable period. We encourage the Commission to include this expectation in the release of the final rules even though these requirements are already part of the international ethical standards.

The proposed framework does not have a requirement to communicate with the audit committee or seek approval to continue providing prohibited services for a short period of time. Given the Commission's viewpoint that registrants have a shared responsibility for independence, we suggest the Commission consider whether there should be some audit committee reporting or approval requirements as part of the framework.

We appreciate the opportunity to comment on this Proposal. Please contact Jennifer C. Kary at (574) 239-7886 or James A. Dolinar at (630) 574-1649 to answer any questions.

Sincerely,

Crowe LLP

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