

March 16, 2020

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549

Re: File Reference No. S7-26-19

Dear Secretary Countryman,

I am writing in response to the Securities and Exchange Commission's (the "SEC" or "Commission") request for comment on potential amendments to the auditor independence rules, issued in connection with its December 30, 2019 proposal, *Amendments to Rule 2-01, Qualification of Accountants* (the "Proposal"). Public companies and auditors face practical challenges in navigating various aspects of the SEC's auditor independence rules in today's complex business environment, and I appreciate the Commission's request for comment on its proposed amendments which seek to 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.

Business and the world around us are evolving at an ever-increasing pace. While much of this change is technology driven, we are also seeing the emergence of new business models. The investment marketplace is now more fluid than ever before. Private equity is changing the way capital is accessed and allocated, and merger and acquisition ("M&A") activity is on the rise. Ownership structures are constantly in flux.

Based on my experience serving as the audit committee chair of different public companies, including Blackstone Group Inc., Eastman Kodak Company, Thermo Fisher Scientific Inc., and UBS AG, I believe that the application of the current SEC independence rules in today's environment imposes significant undue burdens on companies and their audit committees, and adversely impacts the efficiency and effectiveness of the capital markets. Specifically, private equity firms and their portfolio companies have to expend significant time, resources and effort in monitoring relationships with multiple audit firms and are required to provide extensive information to those firms on a frequent basis, often for matters which have no bearing on an auditor's objectivity and impartiality.

The audit committees I've been associated with still frequently receive communications from our auditors, which we are required to review, regarding independence matters that clearly do not impact their objectivity and impartiality. The amount of time required to undertake these activities distracts an audit committee from other critical activities.

Furthermore, the current auditor independence rules limit the pool of eligible and qualified firms from which companies and audit committees can choose as either their independent auditor or a provider of other services.

I want to emphasize that auditor independence is a non-negotiable—we need our auditors to be independent and perceived as such by investors. This has always been critical to the reliance on their work by audit committees and the investing public. I think the Commission’s Proposal is on the right track in focusing the rules on clear independence principles and rules consistent with its general standard and avoiding arcane and confusing nuances that a reasonable investor would not find to be problematic. Also, I believe the Proposal will help to reduce the volume of independence issues that are not deemed to impede auditor objectivity and impartiality and expand auditor choice which will allow better matching of audit expertise, improve audit quality and financial statement quality, and in turn benefit investors and increase market efficiency. Given this, I strongly support the Commission’s efforts to modernize certain aspects of the auditor independence rules including:

- conforming the definition of audit and professional engagement period for both first-time domestic issuers and foreign private issuers
- providing for a transition period for inadvertent violations that only arise as a result of merger and acquisition transactions;
- replacing the reference to “substantial stockholders” with beneficial owners (known through reasonable inquiry) of the audit client’s equity securities where such beneficial owner has significant influence over the entity under audit; and
- aligning the affiliate of the audit client and investment company complex definitions with that of The Code of Professional Conduct from the American Institute of Certified Public Accountants (“the AICPA Code”) and The International Code of Ethics for Professional Accountants (including International Independence Standards) (“the IESBA Code”) by adding a materiality qualifier to commonly controlled sister entities.

Notwithstanding the above, I believe the following four areas in particular merit additional consideration from the Commission to help minimize impractical outcomes that risk stifling capital formation without any real benefit for protecting the auditor’s objectivity and impartiality:

- further alignment of the affiliate definition with professional standards;
- for the business relationship rule, consistent application of the “beneficial ownership with significant influence” concept with the Loan Provision¹;
- expansion of the not subject to audit exception for non-audit services; and

¹ *Amendments to Rule 2-01, Qualifications of Accountants*, Release 33-10738 (December 30, 2019) [84 FR 2340 (January 15, 2020)].

- transition relief for independence matters at immaterial subsidiaries triggered by auditor changes that occur during the audit period.

First, I support the Commission's efforts to align its independence requirements with that of the AICPA Code and the IESBA Code by adding a similar materiality qualifier to commonly controlled sister entities. This will help ease the monitoring and compliance burden faced by global private equity firms as they undertake a high volume of acquisition and disposition transactions on a routine basis, allowing firms to focus their time and efforts on potential matters which may impact independence. However, I believe that the Commission should consider further aligning its affiliate definition with that of the AICPA Code and the IESBA Code, so that a commonly-controlled sister entity would not be deemed an affiliate if either of the following conditions are met: 1) the entity under audit is not material to the common controlling entity; or 2) the sister entity is not material to the common controlling entity. Such modifications to the Proposal would better align the SEC independence rules with those outlined in the AICPA Code and the IESBA Code and help audit committees focus their time in evaluating and monitoring services and relationships at entities that may have an impact on the auditor's objectivities and impartiality.

Next, in my opinion, the broad reach of the current business relationship rule – particularly when coupled with the affiliate definition – can lead to outcomes that inhibit growth and do not seem to advance investor protection in any meaningful way. Therefore, I agree with the amendments the Commission has put forth to replace “substantial stockholder in a decision-making capacity” with “beneficial ownership with significant influence” as that concept is used in the Loan Provision. In addition, I recommend that the Commission consider clarifying that, similar to the Loan Provision, entities under common control with or controlled by a beneficial owner with significant influence over the entity under audit, would be scoped out of the business relationship rule. Consistent application of the “beneficial owner with significant influence” concept will improve clarity and reduce complexity and compliance costs. I saw first-hand the confusion and complexity that the interpretations of the Loan Rule caused in recent years and would urge the Commission to avoid similar unnecessary issues with the Business Relationship Rule.

Furthermore, I recommend that the Commission consider expanding the current “not subject to audit” exception in the independence rules to apply to all non-audit services. Today, this applies only to certain specified services. When other types of non-audit services are provided to commonly controlled portfolio companies within a private equity structure, companies and their auditors cannot avail themselves of the “not subject to audit” exception, even though the services at the sister company are clearly not subject to audit and would have no impact on or connection to the entity under audit. It is well understood that the business purposes, economics and accounting methods for private equity firms are substantively different from those of traditional corporate entity

structures. Private equity funds are intentionally designed such that each of their portfolio companies operates autonomously from business, operation and governance standpoints. Specifically, other than having the private equity firm as a common investor, portfolio companies typically do not have business dealings or share internal control structures, information systems, organizational structure or management personnel with one another.

For example, under the current rules, if an audit firm provides permissible tax compliance services to a commonly controlled affiliate, in a private equity structure or within an investment company complex, pursuant to a loaned staff arrangement, although the services themselves are permissible, the loaned staff aspect would trigger the management function prohibition and result in a violation. I believe audit committees, with knowledge of all relevant facts and circumstances, would conclude that the tax compliance services performed under a loaned staff arrangement at a commonly controlled portfolio company would not impair the auditor's independence. Consequently, I request that the Commission expand the "not subject to audit" exception to all non-audit services, provided that both the audit committee and the audit firm conclude that such services would not impair the auditor's independence.

Finally, I urge the Commission to consider expanding the proposed M&A transition framework to provide transitional relief where independence issues at immaterial subsidiaries arise from auditor changes occurring in the middle of the audit period. For example, if a company and its audit committee determines, in April 2020, that it is critical for the company to engage a new auditor for its calendar year ending December 31, 2020 based on audit quality and other considerations, it could come to find out that, other than the incumbent auditor, none of the qualified audit firms that it prefers to engage is independent under the SEC independence rules. In these situations, to the extent that the identified non-audit services and relationships are at immaterial subsidiaries and would not result in the auditor auditing its work in connection with the December 31, 2020 year-end audit, I believe it is reasonable for the Commission to provide a limited transition period to allow the preferred and qualified audit firm to terminate, modify and transition out of the prohibited services and relationships as expediently as possible prior to it being engaged as the new auditor. This will serve to expand the pool of qualified audit firms that a company could evaluate and engage as its new auditor without increasing the potential threat to an auditor's objectivity and impartiality.

I appreciate the efforts already underway at the SEC to afford audit committees up-to-date guidance and enforce common-sense compliance. As the Commission has acknowledged in its Proposal, focusing the independence analysis on those services or relationships that are most likely to threaten an auditor's ability to exercise objectivity and impartial judgement is critical to maintaining investor protections and promoting efficiency, competition, and capital formation. The steps you take now to modernize the independence rules will benefit U.S. companies and the investing public alike.

I have shared the content of this message with the entire Blackstone Audit Committee, who support the submission.

Sincerely,

/S/ Bill

William G. Parrett