



## Consumer Federation of America

May 4, 2020

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

**Re: File No. S7-26-19, Amendments to Rule 2-01, Qualifications of Accountants**

Dear Secretary Countryman:

I am writing on behalf of the Consumer Federation of America (CFA)<sup>1</sup> in response to the request for comment regarding proposed changes to the auditor independence rules. The proposal suffers from serious shortcomings both in terms of what it does and in terms of what it does not do. First, the SEC fails to take any meaningful steps to increase the independence of public company audits at a time when PCAOB inspection staff regularly report continued, often serious deficiencies related to auditor independence. This is, at best, a missed opportunity, at worst, a dereliction of the Commission's regulatory responsibility. Instead, the Commission proposes an approach to auditor independence that places increased reliance on audit firms' ability to exercise judgment in complying with the independence standards, despite strong evidence that many will not do so appropriately. It also proposes a risky change to the audit and professional engagement period definition that would dramatically weaken the independence rules that apply when domestic issuers engage in an IPO. The combined effect is a set of proposals that will further undermine audit firms' already shaky credibility, with harmful effects on both investor protection and capital formation.

**1) SEC should strengthen both the auditor independence standards and its enforcement of those standards.**

As the SEC itself has emphasized, our markets depend on “the steady flow of timely, comprehensive, and accurate information. The result of this information flow is a far more active, efficient, and transparent capital market that facilitates the capital formation so important to our nation's economy.”<sup>2</sup> Auditors have a central role to play in ensuring the accuracy of this information, a role that has over the years been extremely lucrative for audit firms entrusted with

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<sup>1</sup> CFA is a non-profit association of more than 250 national, state, and local pro-consumer organizations. It was established in 1968 to advance the consumer interest through research, advocacy, and education.

<sup>2</sup> SEC website, What We Do, <https://www.sec.gov/Article/whatwedo.html>.

that gatekeeper function. Audits only have value, however, if the auditor is independent and approaches the audit with an appropriate degree of professional skepticism. If investors can't trust auditors to stand up to management when needed, they will be less likely to trust the company's financial statements, and more likely to demand a risk premium to counterbalance that uncertainty. That's bad for investors, bad for honest companies, and bad for capital formation.

Auditors operate, however, in an issuer-pays business model that directly undermines their independence. Audit firms' profitability may depend on their ability to retain certain corporate clients, and their ability to retain those clients may hinge on their willingness to see things through management's eyes. Congress sought to address this fundamental conflict in the Sarbanes-Oxley Act, by giving independent audit committees responsibility for hiring and overseeing the auditor. Unfortunately, as the U.K.'s Competition and Markets Authority recently noted, "the fact that the auditor selection process has been reserved for independent audit committees" is "only a partial solution" to "the problem of companies playing the primary role in selecting their own auditors."<sup>3</sup> A subsequent U.K. report on improving audit quality and effectiveness found that "there is still a deep-rooted culture that confuses who the auditor's client is."<sup>4</sup> In addition to this fundamental conflict, other factors, such as providing non-audit services to audit clients, can further erode an audit firm's independence, particularly when those non-audit services are expansive enough to be important to the firm's bottom line.

These deeply embedded conflicts in the auditor business model have serious consequences for the reliability of financial reporting. Most notably, lack of auditor independence was a major contributing factor not only to accounting frauds at Enron and Worldcom that led to the passage of SOX, but also to financial misstatements at a host of other companies, large and small, in the late 1990s and early 2000s. Even before the Enron accounting scandal erupted, the Commission had recognized the need to toughen up auditor independence requirements, having found widespread independence violations, including numerous violations at one major firm (PricewaterhouseCoopers), and a lack of effective quality control systems at each of the six largest firms. In November 2000, the SEC adopted new independence rules to address those concerns.

In recognition of the critical importance of auditor independence to the reliability and credibility of our financial reporting system, the SEC's auditor independence rules require auditors to be independent of their clients both "in fact and appearance," as the Release notes. The rules set out a principles-based standard for judging auditor independence, which states that

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<sup>3</sup> Competition and Markets Authority, Press Release, CMA recommends shake-up of UK audit market, April 18, 2019 <https://www.gov.uk/government/news/cma-recommends-shake-up-of-uk-audit-market>. (CMA advocated "the separation of audit from consulting services, mandatory 'joint audit' to enable firms outside the Big 4 to develop the capacity needed to review the UK's biggest companies, and the introduction of statutory regulatory powers to increase accountability of companies' audit committees.")

<sup>4</sup> Sir Donald Brydon CBE, Assess, Assure and Inform: Improving Audit Quality and Effectiveness, Report of the Independent Review into the Quality and Effectiveness of Audit, December 2019 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/852960/brydon-review-final-report.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf). (Brydon proposed additional reforms, beyond those included in the CMA report, including measures designed to make it easier for regulators to determine whether "appropriate independence has been exercised.")

the “Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or 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.” The rule supplements this principles-based approach with a non-exclusive list of particular circumstances that the Commission considers to be inconsistent with the independence standard, including certain financial, employment, business, and non-audit service relationships between an accountant and its audit client. The 2000 rule also, for the first time, set forth quality control standards that firms should have in place to maintain their independence.

The purpose of the changes to the rule included in the current proposal, according to the Release, is to “maintain the relevance” of the SEC’s auditor independence requirements, to “evaluate their effectiveness in light of current market conditions and industry practices,” and to “more effectively focus the independence analysis on those relationships or services that we believe are most likely to threaten an auditor’s objectivity and impartiality.” The implication is that the independence rules are outdated or focused on non-essential matters, and in some limited cases this may be true. But that is just one side of the story. Entirely ignored in the proposal is extensive evidence that audit firms’ compliance with existing independence standards is inadequate, that lack of compliance undermines auditors’ ability or willingness to approach the audit with professional skepticism, and that more fundamental reform is needed to strengthen the rules and increase accountability for independence violations.

A review of recent PCAOB staff inspection reports shows that staff routinely finds deficiencies related to both auditor independence and professional skepticism, two cornerstones of an effective audit. As the Board indicated in its December 2018 Staff Inspection Brief, with regard to independence findings, “These recurring deficiencies suggest that some firms and their personnel either do not sufficiently understand applicable independence requirements or do not have appropriate controls in place to prevent violations.”<sup>5</sup> Violations found at both the largest firms and at smaller firms have included: a failure to have adequate systems in place to provide investors with confidence that the audit firm was in fact complying with the independence rules; and evidence that auditors were misleading audit committees by failing to provide them with the information they need to make informed decisions. In a related matter, inspection staff also “continue to raise concerns about whether some auditors appropriately apply professional

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<sup>5</sup> Inspections Outlook for 2019, Staff Inspection Brief, December 6, 2018, <https://pcaobus.org/Inspections/Documents/Inspections-Outlook-for-2019.pdf>. See also, PCAOB Staff Inspection Brief, Vol. 2016/3, July 2016, <https://pcaobus.org/Inspections/Documents/Inspection-Brief-2016-3-Issuers.pdf> (“Deficiencies observed in 2015 included instances in which some auditors provided impermissible non-audit services during the period under audit, and instances in which auditors did not obtain pre-approval from the audit committee prior to performing non-audit services.”); PCAOB Staff Inspection Brief, Vol. 2017/4, November 2017, <https://pcaobus.org/Inspections/Documents/inspection-brief-2017-4-issuer-results.pdf> (“Inspections staff continued to identify deficiencies related to non-compliance with PCAOB rules and/ or SEC rules and regulations related to auditor independence. Examples include instances in which auditors: ...conclude[d] inappropriately that a covered person’s lack of independence ... had not resulted in impairment of the firm’s independence; ... Entered into agreements through which their audit client agreed to indemnify the auditor against any liability or expense arising out of the engagement; Provided impermissible non-audit services during the period under audit ... Some deficiencies were also identified that indicated certain firms did not have a quality control system that provided sufficient assurance that outside firms or auditors involved in issuer audit engagements or the firm’s personnel were in compliance with the independence requirements.”).

skepticism in the course of their audits, particularly in those areas that involve significant management judgments or transactions outside the normal course of business, as well as the auditor's consideration of fraud."<sup>6</sup> In other words, where skepticism is most needed, auditors are too often falling down on the job.

Meanwhile, enforcement actions of both the SEC and PCAOB have cited numerous independence violations in recent years. For example, PricewaterhouseCoopers (PwC), which settled an enforcement action with the SEC in 2002 for independence violations that spanned a five-year period from 1996 to 2001,<sup>7</sup> recently settled yet another enforcement action with the SEC for independence violations over a period from 2013 through 2016.<sup>8</sup> In its latest action, the Commission found, among other things, that PwC had violated prohibitions on conducting non-audit services for its audit client, had failed to maintain adequate quality controls to ensure its independence, and had failed to comply with rules requiring it to "to describe in writing to the audit committee the scope of the work, discuss with the audit committee the potential effects of the work on independence, and document the substance of the independence discussion."<sup>9</sup> In an earlier state court legal action by Taylor, Bean & Whitaker Plan Trust against PwC regarding its 2004 audit of Colonial Bank, the court granted partial summary judgment based on the PwC's lack of independence, because PwC had included "prohibited indemnification language" in its 2004 contract with Colonial Brokerage.<sup>10</sup>

In 2016, the SEC settled another enforcement action against one of the largest audit firms, this time Ernst & Young (E&Y), for violating independence rules when two of the firm's audit partners got too close to their clients on a personal level. The audit partners in question formed close personal relationships with the audit client's chief financial officer in one case and its chief accounting officer in another. The firm was cited for not doing "enough to detect or prevent these partners from getting too close to their clients and compromising their roles as independent auditors."<sup>11</sup> Specifically, while the firm "required audit engagement teams to follow certain procedures to assess their independence, and employees were asked whether they had familial, employment, or financial relationships with audit clients that could raise independence

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<sup>6</sup> Staff Inspection Brief 2016. ("For example, Inspections staff continues to observe situations in which auditors seek to obtain only evidence that would support significant judgments or representations made by management, rather than to critically assess the reasonableness of management's judgments or representations, taking into account all relevant evidence, regardless of whether it confirmed or contradicted management's assertions.")

<sup>7</sup> Securities and Exchange Commission, Press Release, PricewaterhouseCoopers Settles SEC Auditor Independence Case, July 17, 2002 <https://www.sec.gov/news/press/2002-105.htm>.

<sup>8</sup> United States of America before the Securities and Exchange Commission, in the matter of PricewaterhouseCoopers LLC, Respondent, Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4c and 21c of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Securities and Exchange Act of 1934 Release No. 87052, Accounting and Auditing Enforcement Release No. 4084, Administrative Proceeding File No. 3-19490, Sept. 23, 2019 <https://www.sec.gov/litigation/admin/2019/34-87052.pdf>.

<sup>9</sup> SEC Administrative Proceeding, Accounting and Auditing Enforcement, Release No. 4084, Sept. 23, 2019 <https://www.sec.gov/litigation/admin/2019/34-87052.pdf>.

<sup>10</sup> Taylor, Bean & Whitaker Plan Trust v PricewaterhouseCoopers LLP, in the circuit Court of the Eleventh Judicial Circuit in and for Miami-Dade County, Florida, Case No. 13-33964-CA-40, Order Granting Motion for Summary Judgment – Lack of Independence 2004, Dec. 6, 2015.

<sup>11</sup> SEC Press Release, "Ernst & Young, Former Partners Charged with Violating Auditor Independence Rules," Sept. 19, 2016 <https://www.sec.gov/news/pressrelease/2016-187.html>.

concerns,” these procedures “did not specifically inquire about non-familial close personal relationships that could impair the firm’s independence.”<sup>12</sup>

Also in September 2019, the PCAOB censured and fined another large audit firm, Marcum LLP, for repeatedly violating “PCAOB rules and standards over the course of four years by failing to satisfy applicable independence criteria, including as set out in U.S. Securities and Exchange Commission (“Commission”) rules.”<sup>13</sup> The PCAOB found that, “from 2012 through 2017 – including after PCAOB staff brought independence concerns to the Firm’s attention in 2015 – Marcum failed to take sufficient steps to ensure that its system of quality control would provide reasonable assurance that the Firm would identify and appropriately address potential independence issues.”<sup>14</sup> The Board found, among other things, that Giugliano, who served as Assurance Services Leader and the partner in charge of compliance with auditor independence requirements, approved the firm’s MicroCap Conference, at which it touted as high quality investment options a group of companies that included dozens of audit clients, without conducting “any substantial independence deliberations concerning the conference.”<sup>15</sup>

In what appears to be a consistent theme in such cases, PCAOB found that over the 2012-2017 period covered by the enforcement action, Marcum failed to comply with quality control standards “because it failed to establish policies and procedures sufficient to provide the Firm with reasonable assurance that: (1) it would maintain independence in all required circumstances; and (2) the policies and procedures the Firm had established with respect to independence were suitably designed and were being effectively applied and monitored.” The Board noted, moreover, that even after PCAOB staff had notified the firm in 2015 “that its conduct appeared to be inconsistent with independence requirements,” the firm “failed to implement, apply, and monitor policies and procedures sufficient to provide reasonable assurance that it would identify and appropriately address potential independence issues in 2016 and 2017.”<sup>16</sup>

This pattern of independence violations over a period of several decades and across a variety of firms, large and small, suggests at the very least that enforcement of the standards and sanctions for violations are not sufficient to deter misconduct. It is important to recognize, moreover, that these examples are evidence, not of firms being tripped up by overly technical rules, as the focus of this rule proposal would suggest, but of a fundamental and disturbing lack of commitment to auditor independence. We are therefore struggling to understand why these auditor independence failures are not the central focus of the SEC’s rule proposal. After all, the Release itself acknowledges that, “an audit by an objective, impartial, and skilled professional contributes to both investor protection and investor confidence.”

Instead of tackling these issues, the Commission appears to be deliberately eroding the auditor independence rules, while ignoring evidence that existing rules either are not adequate or are not well enforced. To correct that deficiency, the Commission should withdraw much of the

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<sup>12</sup> *Id.*

<sup>13</sup> PCAOB, Order Making Finds and Imposing Sanctions in the Matter of Marcum LLP and Alfonse Gregory Giugliano, CPA, Respondents, PCAOB Release No. 105-2019-022, Sept. 10, 2019 <https://pcaobus.org/Enforcement/Decisions/Documents/105-2019-022%20-%20Marcum.pdf>.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

current proposal and instead focus its attention on making the rules more enforceable, increasing accountability within firms for independence failures, and encouraging competition based on audit quality, which should indirectly help to enhance auditor independence. Unfortunately, nothing in the current proposal would advance those goals. Instead, all the proposals put forward by the Commission would have the effect of loosening independence requirements to varying degrees.

**2) The Commission over-relies on auditor judgment in its proposed revisions, despite evidence that auditors cannot be relied on to exercise judgment responsibly.**

A key takeaway from both PCAOB staff inspection reports and recent enforcement actions is that audit firms cannot be relied on to maintain effective quality controls or consistently exercise good judgment in their compliance with independence standards. There is similar evidence that audit committees are not up to the job. A whistleblower investigation involving accounting errors at Mattel, Inc., for example, highlights the fundamental flaw in relying on the board audit committee to ensure the independence of the audit. In the company's 2019 proxy statement, the Report of the Audit Committee explicitly states that, "The members of the Audit Committee are not engaged in the accounting or auditing profession and, consequently, are not experts in matters involving accounting or auditing, including the subject of auditor independence."<sup>17</sup>

In lacking the expertise to effectively oversee the company audit, members of the Mattel audit committee are hardly alone. This has been a persistent problem both before and since the Enron scandal, despite efforts in SOX to shore up the independence and financial expertise of board audit committees. The practical effect of this lack of expertise is that the audit committees we rely on to oversee the audit are too often almost entirely reliant on the auditor in ensuring the independence and integrity of the audit. But, as recent SEC and PCAOB enforcement actions have documented, audit firms cannot be relied on to consistently provide audit committees with the information they need to assess independence, let alone maintain the independence of the audit.

Despite these grave concerns, several of the proposals put forward by the Commission rely on the auditor to exercise judgement in determining whether a practice or relationship poses a threat to auditor independence. For example, the proposal would add a "materiality qualifier" to the definition of audit client, as it applies to common control, sister entities and in the context of portfolio companies in ICC or private equity structure. Under this approach, "the audit firm, or those charged with governance of the entity under audit, may identify independence concerns in fact or in appearance, individually or in the aggregate, upon considering the nature, extent, relative importance and other aspects of the services or relationships between the auditor, the controlling entity, and such sister entities that are not material to the controlling entity."

In other words, the Commission proposes to put the audit firm and audit client – the two parties with the least incentive to take a hard line on independence – in the position of deciding whether something compromises auditor independence. It simultaneously removes the oversight

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<sup>17</sup> Mattel, 2019 Proxy Statement and Notice of Annual Meeting of Stockholders to Be Held on May 16, 2019, [https://www.sec.gov/Archives/edgar/data/63276/000119312519097947/d702870ddef14a.htm#tx702870\\_35](https://www.sec.gov/Archives/edgar/data/63276/000119312519097947/d702870ddef14a.htm#tx702870_35).

provided by Commission staff under the current approach, thus increasing the risk that companies and auditors will be lax in their assessments. Relying on auditors to assess their own objectivity is an approach the Commission specifically rejected when it adopted revisions to the auditor independence rules in November of 2000.<sup>18</sup> At that time, the Commission stated that the issue in determining independence “is whether providing these services makes it unacceptably likely that there will be an effect on the auditor’s judgment, *whether or not the auditor is aware of it.*” (Emphasis added) The Commission understood then that auditors may be poor judges of their own objectivity.

Now, despite extensive evidence to the contrary, the Commission confidently asserts the opposite view: that adding a materiality qualifier does not pose a risk to investor protection. In making that assertion, it fails to explain on what basis it has concluded that audit firms can be relied on to make that assessment in a way that benefits the public. On the contrary, it makes no attempt to square that confident assertion with conflicting evidence from the Commission’s own enforcement actions as well as PCAOB staff inspection reports that “some firms and their personnel either do not sufficiently understand applicable independence requirements or do not have appropriate controls in place to prevent violations.”

The Commission acknowledges that “adding an evaluation of materiality as proposed may result in additional work to be done by audit firms with ongoing monitoring responsibilities for the purposes of compliance with the independence rules.” However, it dismisses this concern on the grounds that auditors “have experience in applying a materiality standard when identifying affiliates, whether applying the independence rules of the SEC or AICPA.” The Commission fails to discuss any evidence it may have that firms consistently make those decisions appropriately. For example, it fails to address evidence that audit firms’ materiality judgments vary widely,<sup>19</sup> which strongly suggests that at least some firms are making those determinations inappropriately. It should, at the very least, examine the evidence before changing its current approach.

Finally, the Commission justifies its revised approach, at least in part, on the grounds that it “may broaden the pool of prospective accountants the potential ... audit client can evaluate and consider to engage as its auditor.” However, the fact there may in some cases be a shortage of audit firms for companies to consider is the direct result of policies that have permitted over-concentration in the auditing profession, particularly among firms with the capacity to audit large, multi-national companies. If that is a problem that deserves regulatory attention, and we believe that it is, the Commission should work with Administration antitrust officials to tackle the problem directly, not use it as an excuse to water down auditor independence rules. In the meantime, it should withdraw its proposal to add a materiality qualifier to the definition of audit client, as it applies to common control, sister entities and in the context of portfolio companies in ICC or private equity structure.

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<sup>18</sup> Securities and Exchange Commission, Final Rule: Revision of the Commission’s Auditor Independence Requirements, File No. S7-13-00, Nov. 21, 2000, <https://www.sec.gov/rules/final/33-7919.htm>.

<sup>19</sup> See Katherine Schipper et al., Auditors’ Quantitative Materiality Judgments: Properties and Implications for Financial Reporting Reliability, 52 J. Acct. Res. 1303 (Dec. 2019), available at <https://onlinelibrary.wiley.com/doi/abs/10.1111/1475-679X.12286>.

### **3) The Commission should withdraw the proposed amendment to the definition of audit and professional engagement period.**

CFA strongly opposes the proposal to shorten the look-back period for domestic first-time filers to the most recently completed fiscal year. This proposal would undermine the quality and reliability of financial reporting by first-time issuers despite evidence of increased risks in the IPOs of so-called “unicorns,” which too often suffer from inadequate corporate governance and lax accounting practices.<sup>20</sup> The recent canceled IPO at WeWork helped shine a spotlight on these concerns, but it is unique only in the scale of the fiasco, not the nature of the concerns. As reported by accounting expert Francine McKenna in *The Dig*, WeWork failed to report any material weaknesses in internal controls over financial reporting in its 2019 S-1s, despite obvious and pervasive problems.<sup>21</sup> These included what Columbia Law Professor Jack Coffee reportedly described as “a system of non-GAAP metrics that more than raised eyebrows.”<sup>22</sup> In failing to report any material weaknesses, WeWork was apparently like all other 2019 IPO clients of Ernst & Young (E&Y), which stood out from all the other Big Four firms in giving a clean report to all its IPO clients. Instead of looking to shore up accounting and audit practices as these behemoth private companies, however, the Commission is weakening the protections that apply when they go public.

Under current rules, in addition to the general, principles-based requirement to maintain their independence, auditors are prohibited from engaging in certain high-conflict activities during the “audit and professional engagement period.” This includes, for domestic issuers, both the “period covered by any financial statements being audited or reviewed” and the “period of the engagement to audit or review the ... financial statements or to prepare a report filed with the Commission.” In pursuit of consistency between domestic and foreign first-time issuers, the Commission proposes to narrow the definition to the most recently completed fiscal year. As a result, even if the registration statement for the domestic first-time filer includes three years of financial statements, for the purposes of Rule 2-01 the auditor and issuer would look back and assess independence only during the most recently completed fiscal year. Auditors of these first time issuers would, for earlier financial statements included in the registration statement, be free to engage in practices that place the auditor in certain financial, employment, and business relationships with the audit client, and to provide certain non-audit services, that the Commission has previously determined are inconsistent with the independence standard.

In proposing this revised approach, the Commission states its belief “that the proposed requirement to comply with applicable independence standards in all prior periods sufficiently mitigates the risk associated with shortening the look back provision for domestic first-time filers.” But it fails to explain on what basis it concluded that activities it has previously identified as inconsistent with auditor independence don’t pose a threat in this context. Placing its faith in the ability of auditors and issuers to independently assess what activities should be avoided – because such “services and relationships might be thought to reasonably bear on an auditor’s independence due to the nature, extent, relative importance, or other aspects of the service or

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<sup>20</sup> Renee M. Jones, *The Unicorn Governance Trap*, 66 U. Pa. L. Rev. Online 165 (2017), <http://bit.ly/2msD01w>.

<sup>21</sup> Francine McKenna, *WeWork: Auditor EY didn’t warn about the risks*, *The Dig*, Dec. 3, 2019 <https://thedig.substack.com/p/wework-auditor-ey-didnt-warn-about>.

<sup>22</sup> *Id.*



relationship” – is either naïve or cynical, in light of extensive evidence, noted above, of auditors’ recurring violations of independence standards.

Here again, the Commission proposes to adopt an approach it specifically rejected, after giving the issue extensive consideration, when it adopted the auditor independence rules in 2000. Removing the prohibition on certain specified services for these earlier audits places greater reliance on auditors and corporate boards to assure compliance with the principles-based auditor independence standards, without any basis for assuming they will do so appropriately. In its 2000 final rule release, the Commission explained the reason it did not believe auditors or audit committees could be relied on to enforce that principles-based standard. As discussed above, it did not believe audit firms could reliably assess their own objectivity. With regard to audit committees, the Commission stated: “While we welcome active oversight by audit committees with respect to auditor independence, we do not believe that this oversight obviates the need for the rule we adopt today. Audit committees bring business judgment to bear on the financial matters within their purview. Their purpose is not to set the independence standards for the profession, and we are not attempting to saddle them with that responsibility. On the other hand, we believe that the final rule facilitates the work of audit committees by establishing clear legal standards that audit committees can use as benchmarks against which to exercise business judgment.” The Commission now proposes to remove those clear benchmarks for all but the most recent audits of first-time domestic issuers.

The rationale that the Commission puts forward to justify this change is completely inadequate. In a classic example of a regulatory race to the bottom, the Commission argues that it must weaken the independence standards for domestic first-time issuers because it already applies weaker rules to foreign private issuers (FPIs). The Commission worries that “a domestic private company may need to delay its IPO or engage a new auditor in order to comply with the auditor independence rules, which would put it at a potential economic disadvantage when compared to an FPI.” As has become all too common in recent rule proposals, the Commission provides no meaningful analysis to support its arguments. For example, it provides no evidence that auditor independence rules are, in fact, a significant factor delaying IPOs. It fails to adequately consider the risks of weakening auditor independence standards for domestic first-time issuers or measure them against the purported economic disadvantage they face relative to FPIs. Nor does it explain why the domestic issuer that anticipates going public in a few years couldn’t just adhere to the independence rule prohibitions voluntarily in order to be ready to comply with the longer look-back requirement when the moment to conduct its IPO arrives. As the Commission itself acknowledges elsewhere in the Release, “the IPO is generally contemplated well in advance of its consummation.”

At a time when companies are staying private longer (for reasons that have nothing to do with the auditor independence rules) and, in many cases, growing to enormous size in the private markets, it is nothing short of regulatory malpractice for the Commission to weaken the auditor independence standards that apply when these companies do finally go public. Indeed, given the serious questions that have arisen around accounting practices at some of the largest private companies, encouraging a more rigorous approach to audits of these companies could provide significant investor protection benefits. Instead of weakening the applicable independence rules, the Commission should be looking to strengthen them and improve compliance, as discussed

above. If the Commission is convinced that it is important to harmonize standards for domestic and foreign private issuers, it should lengthen the lookback period for FPIs rather than weakening the standard for domestic issuers.

## **Conclusion**

Even as it acknowledges that auditor independence plays a critical role in promoting investor protection and confidence, this proposal undermines key aspects of the auditor independence rules. This is exactly the wrong direction for the Commission to take. We urge you to reverse course. Instead of weakening the independence rules, the Commission should be looking to address persistent failures among audit firms to live up to their independence obligations. Its failure to do so threatens to undermine market integrity and transparency, putting both investors and capital formation at risk.

Respectfully submitted,



Barbara Roper  
Director of Investor Protection