SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 230, 240, and 249

[Release No. 34-88365; File No. S7-06-19]

RIN 3235-AM41

Amendments to the Accelerated Filer and Large Accelerated Filer Definitions

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting amendments to the accelerated filer and large accelerated filer definitions to more appropriately tailor the types of issuers that are included in the categories of accelerated and large accelerated filers and promote capital formation, preserve capital, and reduce unnecessary burdens for certain smaller issuers while maintaining investor protections. The amendments exclude from the accelerated and large accelerated filer definitions an issuer that is eligible to be a smaller reporting company and that had annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available. The amendments also include a specific provision excluding business development companies from the accelerated and large accelerated filer definitions in analogous circumstances. In addition, the amendments increase the transition thresholds for accelerated and large accelerated filers becoming non-accelerated filers from $50 million to $60 million, and for exiting large accelerated filer status from $500 million to $560 million. Further, the amendments add a revenue test to the transition thresholds for exiting from both accelerated and large accelerated filer status. Finally, the amendments add a check box to the cover pages of Forms 10-K, 20-F, and 40-F to indicate whether an internal control over financial reporting ("ICFR") auditor attestation is included in the filing. As a result

of the amendments, certain low-revenue issuers will remain obligated, among other things, to establish and maintain ICFR and have management assess the effectiveness of ICFR, but they will not be required to have their management's assessment of the effectiveness of ICFR attested to, and reported on, by an independent auditor.

DATES: *Effective date*: The final rule amendments are effective [INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION: We are amending 17 CFR 229.10(f) ("Item 10(f)") under Regulation S-K;[1] 17 CFR 230.405 ("Rule 405") under the Securities Act of 1933;[2] and 17 CFR 12b-2 ("Rule 12b-2"), 17 CFR 249.220f ("Form 20-F"), 17 CFR 249.240f ("Form 40-F"), and 17 CFR 249.310 ("Form 10-K") under the Securities Exchange Act of 1934 ("Exchange Act").[3]

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[1] 15 U.S.C. 229.10 through 229.1305.

[2] 15 U.S.C. 77a *et seq*.

[3] 15 U.S.C. 78a *et seq*.

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I. INTRODUCTION

On May 9, 2019, we proposed amendments[4] to the "accelerated filer" and "large accelerated filer" definitions in Rule 12b-2.[5] We proposed these amendments to promote capital formation for certain smaller issuers while maintaining investor protections by more appropriately tailoring the types of issuers that are included in the categories of accelerated and large accelerated filers and revising the transition thresholds for accelerated and large accelerated filers. Specifically, we proposed to exclude from the accelerated and large accelerated filer definitions an issuer that is eligible to be a smaller reporting company ("SRC")[6] and that has annual revenue of less than $100 million in the most recent fiscal year for which audited financial statements are available ("SRC revenue test"), with the effect that such an issuer would not need to satisfy the requirements applicable to an accelerated or large accelerated filer. We also proposed to increase the public float transition threshold for accelerated and large accelerated filers to become a non-accelerated filer from $50 million to $60 million, and to increase the exit threshold in the large accelerated filer transition provision from $500 million to $560 million in public float. Finally, we proposed to add a revenue test to the transition thresholds for exiting both accelerated and large accelerated filer status.

We received over 60 comment letters on the proposal, including over 40 unique letters and approximately 20 letters that were substantially similar. Many of the commenters generally

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4 *Amendments to the Accelerated and Large Accelerated Filer Definitions*, Release No. 34-85814 (May 9, 2019) [84 FR 24876 (May 29, 2019)] ("Proposing Release").

5 Although Rule 12b-2 defines the terms "accelerated filer" and "large accelerated filer," it does not define the term "non-accelerated filer." If an issuer does not meet the definition of accelerated filer or large accelerated filer, it is considered a non-accelerated filer.

6 *See* Item 10(f), Rule 405, and Rule 12b-2 (defining SRC).

supported the proposed amendments[7] while other commenters generally opposed them or suggested the need for further empirical study.[8] In addition, the SEC's Small Business Capital Formation Advisory Committee ("SBCFAC") adopted a recommendation supporting the proposed amendments,[9] and the 2019 SEC Government-Business Forum on Small Business

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[7] *See, e.g.*, letters from Adamas Pharmaceuticals, Inc. (July 19, 2019) ("Adamas"); Advanced Medical Technology Association Accel (July 26, 2019) ("AdvaMed"); Aequor, Inc. (July 18, 2019) ("Aequor"); Ardelyx, Inc. (July 18, 2019) ("Ardelyx"); American Securities Association (July 29, 2019) ("ASA"); Biotechnology Innovation Organization (July 29, 2019) ("BIO"); Broadmark Capital (July 29, 2019) ("Broadmark"); California Life Sciences Association (Jun. 10, 2019) ("CLSA"); Catalyst Biosciences, Inc. (July 29, 2019) ("Catalyst"); Cerecor Inc. (July 3, 2019) ("Cerecor"); Chiasma, Inc. (July 11, 2019) ("Chiasma"); Coalition of Four Small Businesses and their Investors (July 24, 2019) ("AdvaMed *et al.*"); Concert Pharmaceuticals, Inc. (July 1, 2019) ("Concert"); Corvus Pharmaceuticals, Inc. (July 19, 2019) ("Corvus"); Council of State Bioscience Associations (July 25, 2019) ("CSBA"); CSB Bancorp, Inc. (July 26, 2019) ("CSB"); CymaBay Therapeutics, Inc. (July 24, 2019) ("CymaBay"); Daré Bioscience, Inc. (July 10, 2019) ("Daré"); Darian B. Andersen, General Counsel, PC (Jun. 5, 2019) ("Andersen"); Equillium, Inc. (July 22, 2019) ("Equillium"); Evoke Pharma, Inc. (July 17, 2019) ("Evoke"); Gritstone Oncology Inc. (July 24, 2019) ("Gritstone"); Guaranty Federal Bancshares, Inc. (July 23, 2019) ("Guaranty"); Independent Community Bankers of America (July 24, 2019) ("ICBA"); Kezar Life Sciences, Inc. (July 17, 2019) ("Kezar"); Kyle Carver (May 25, 2019) ("Carver"); Marinus Pharmaceuticals, Inc. (July 17, 2019) ("Marinus"); Millendo Therapeutics, Inc. (July 29, 2019) ("Millendo"); MSB Financial Corp. (July 19, 2019) ("MSB"); Nasdaq, Inc. (July 29, 2019) ("Nasdaq"); Organovo, Inc. (July 18, 2019) ("Organovo"); Pieris Pharmaceuticals, Inc. (July 11, 2019) ("Pieris"); Revance Therapeutics, Inc. (July 22, 2019) ("Revance"); SI-BONE, Inc. (July 19, 2019) ("SI-BONE"); South Carolina Bankers Association (July 26, 2019) ("SCBA"); Summit State Bank (May 28, 2019) ("Summit"); Sutro Biopharma, Inc. (July 8, 2019) ("Sutro"); Syros Pharmaceuticals, Inc. (July 22, 2019) ("Syros"); Teligent, Inc. (July 23, 2019) ("Teligent"); Terra Tech Corp. (May 29, 2019) ("Terra Tech"); The Bank of South Carolina (July 26, 2019) ("BSC"); U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (July 29, 2019) ("Chamber"); Xenon Pharmaceuticals Inc. (Jun. 19, 2019) ("Xenon"); and Zynerba Pharmaceuticals, Inc. (July 8, 2019) ("Zynerba").

[8] *See, e.g.*, letters from BDO USA, LLP (July 29, 2019) ("BDO"); Better Markets, Inc. (July 29, 2019) ("Better Markets"); Center for Audit Quality (July 29, 2019) ("CAQ"); CFA Institute, in consultation with its Corporate Disclosure Policy Council (Aug. 22, 2019) ("CFA Inst."); Colleen Honigsberg, Associate Professor of Law, Stanford Law School, *et al.* (July 22, 2019) ("Prof. Honigsberg *et al.*"); Consumer Federation of America (July 29, 2019) ("CFA"); Council of Institutional Investors (July 25, 2019) ("CII"); Crowe LLP (July 29, 2019) ("Crowe"); Deloitte & Touche LLP (July 26, 2019) ("Deloitte"); Grant Thornton LLP (July 17, 2019) ("Grant Thornton"); John Hassell, Indiana University (May 19, 2019) ("Prof. Hassell"); Mary Barth, Stanford University, Wayne Landsman, University of North Carolina, Joseph Schroeder, Indiana University, and Daniel Taylor, University of Pennsylvania (July 11, 2019) ("Prof. Barth *et al.*"); RSM US LLP (July 29, 2019) ("RSM"); and Weili Ge, University of Washington; Allison Koester, Georgetown University; and Sarah McVay, University of Washington (July 26, 2019) ("Prof. Ge *et al.*").

[9] *See* U.S. SEC. AND EXCH. COMM'N SMALL BUS. CAPITAL FORMATION ADVISORY COMM., *Recommendation on the Commission's Proposal to Amend the Accelerated and Large Accelerated Filer Definitions* (Aug. 23, 2019) ("SBCFAC Recommendations"), available at https://www.sec.gov/spotlight/sbcfac/recommendations-rule-3-05-and-accelerated-filer-definition.pdf. Although it supported the proposed amendments, the SBCFAC stated that it "would welcome the Commission to explore additional further amendments" to the accelerated and large accelerated filer definitions and recommended exploring raising the revenue threshold to be a non-accelerated filer to one higher than $100 million, basing the revenue test for an issuer to qualify as a non-accelerated filer

Capital Formation ("SEC Small Business Forum") provided a recommendation on the accelerated filer definition.[10] After taking into consideration these recommendations and the public comments, we are adopting the amendments substantially as proposed. The final amendments are consistent with our historical practice of providing scaled disclosure and other accommodations for smaller issuers and with recent actions by Congress to reduce unnecessary burdens on new and smaller issuers.[11]

II. DISCUSSION OF THE FINAL AMENDMENTS

A. Background

In June 2018, the Commission adopted amendments[12] to the SRC definition[13] to expand the number of issuers that qualify for scaled disclosure accommodations. The amended SRC definition allows an issuer to use either a public float[14] test or the SRC revenue test to determine

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on a three-year rolling average instead of basing it on the revenue in the most recent fiscal year, and looking at whether all SRCs should be non-accelerated filers.

10 *See* U.S. SEC. AND EXCH. COMM'N GOV'T-BUS. FORUM ON SMALL BUS. CAPITAL FORMATION, *Report on the 38th Annual Government-Business Forum on Small Business Capital Formation* (Aug. 14, 2019) ("SEC Small Business Forum"), available at https://www.sec.gov/files/small-business-forum-report-2019.pdf. The SEC Small Business Forum recommended aligning the definition of non-accelerated filer with the definition of SRC to include issuers with a public float less than $250 million or with annual revenues less than $100 million (and either no public float or a public float less than $700 million) .

11 For example, Title I of the Jumpstart Our Business Startups Act of 2012 (''JOBS Act'') amended Section 404(b) of the Sarbanes-Oxley Act ("SOX"), 15 U.S.C. 7262(b), which relates to an issuer's ICFR to exempt emerging growth companies ("EGCs") from the requirement of SOX Section 404(b). In particular, SOX Section 404(b) requires that an issuer's independent auditor attest to, and report on, management's assessment of the effectiveness of the issuer's ICFR ("ICFR auditor attestation"). *See* Public Law 112–106, Sec. 103, 126 Stat. 306 (2012). In addition, Section 72002 of the Fixing America's Surface Transportation Act of 2015 requires the Commission to revise Regulation S-K to further scale or eliminate requirements to reduce the burden on EGCs, accelerated filers, SRCs, and other smaller issuers, while still providing all material information to investors. *See* Pub. L. No. 114-94, 129 Stat. 1312 (2015).

12 *See Smaller Reporting Company Definition*, Release No. 33-10513 (June 28, 2018) [83 FR 31992 (July 10, 2018)] ("SRC Adopting Release").

13 *See* note 6 above.

14 Public float is defined in paragraph (3)(i)(A) of the SRC definition in Rule 12b-2, which states that public float is measured as of the last business day of the issuer's most recently completed second fiscal quarter and computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity. *See also* Item 10(f)

whether it is an SRC. The amendments increased the threshold in the public float test for an issuer to initially qualify as an SRC from less than $75 million to less than $250 million.[15] The Commission also expanded the revenue test to include issuers with annual revenues[16] of less than $100 million if they have no public float or a public float of less than $700 million.[17] The Commission intended the amendments to promote capital formation for smaller issuers by reducing compliance costs for the newly eligible SRCs while maintaining appropriate investor protections.[18]

In conjunction with these amendments, the Commission also revised the accelerated filer and large accelerated filer definitions in Rule 12b-2 to remove the condition that, for an issuer to be an accelerated filer or a large accelerated filer, it must not be eligible to use the SRC accommodations.[19] One result of these amendments is that some issuers now are categorized as both SRCs and accelerated or large accelerated filers.[20] These issuers have some, but not all, of

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(2)(i)(A) and Rule 405. An entity with no public float because, for example, it has equity securities outstanding but is not trading in any public trading market would not be able to qualify on the basis of a public float test alone. That entity must look to the SRC revenue test to determine whether it qualifies as an SRC.

15 To avoid situations where an issuer frequently enters and exits SRC status, each test includes two thresholds—one for initially determining whether an issuer qualifies as an SRC and a subsequent transition threshold that is lower for issuers that did not initially qualify as an SRC, or that no longer qualify as an SRC because they exceeded the initial thresholds.

16 Annual revenues are measured as of the most recently completed fiscal year for which audited financial statements are available. *See* Item 10(f)(2)(i)(B), Rule 405, and Rule 12b-2.

17 *See* Item 10(f)(1), Rule 405, and Rule 12b-2. The prior revenue test included issuers with no public float and annual revenues of less than $50 million. *See* SRC Adopting Release, note 12 above, at 31995. The lower transition thresholds under the revenue test for an issuer that did not initially qualify as an SRC, or that no longer qualifies as an SRC because it exceeded the initial thresholds, were revised from less than $40 million of annual revenues and no public float to less than $80 million of annual revenues and either no public float or a public float of less than $560 million. *See* Item 10(f)(2)(iii)(B), Rule 405, and Rule 12b-2.

18 SRC Adopting Release, note 12 above, at 31992.

19 This amendment, among other things, preserved the existing thresholds in those definitions and did not change the number of issuers subject to the ICFR auditor attestation requirement.

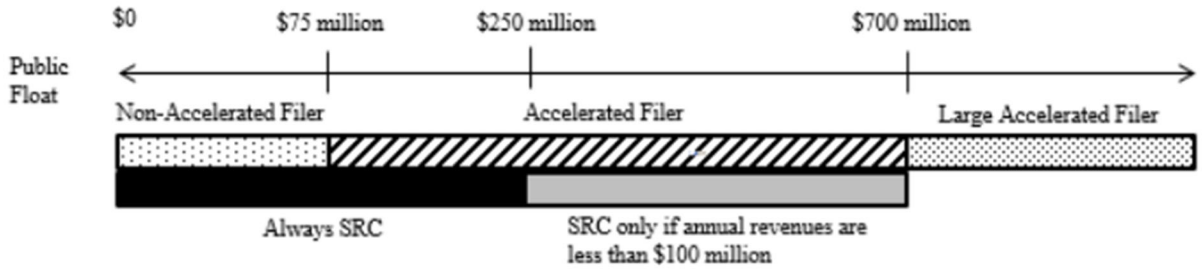
20 Although rare, under our existing rules, some issuers that meet the large accelerated filer definition may be eligible to be an SRC because of the expanded revenue test in the SRC definition. *See* Proposing Release, note 4 above, at 24877, n. 25. As discussed below, in Section II.B.3., we are adopting the proposed amendment to

the benefits of scaled regulation. In particular, issuers that are categorized as both SRCs and accelerated or large accelerated filers must comply with the earlier filing deadlines required of accelerated and large accelerated filers for annual and quarterly reports and the requirement of SOX Section 404(b).[21]

Prior to the SRC amendments, the SRC category of filers generally did not overlap with either the accelerated or large accelerated filer categories.[22] Now, however, as illustrated in Figure 1 of this section, because the public float tests in the SRC and accelerated filer definitions partially overlap, and the accelerated and large accelerated filer definitions no longer specifically exclude an issuer that is eligible to be an SRC, an issuer meeting the accelerated filer definition will be both an SRC and an accelerated filer[23] if it has:

- A public float of $75 million or more, but less than $250 million, regardless of annual revenues; or
- Less than $100 million in annual revenues, and a public float of $250 million or more, but less than $700 million.

Figure 1. Current Definitions of SRC, Accelerated Filer, and Large Accelerated Filer



the "large accelerated filer" definition so that an issuer that is eligible to be an SRC under the SRC revenue test would not also qualify as a large accelerated filer.

21 15 U.S.C. 7262(b).

22 *See* SRC Adopting Release, note 12 above, at 32001.

23 The thresholds provided below are based on the initial thresholds of each definition; however, due to the transition provisions of the accelerated and large accelerated filer definitions, additional issuers may also be both an SRC and an accelerated or large accelerated filer.

B. Amendments to Exclude Low-Revenue SRCs from the Accelerated and Large Accelerated Filer Definitions

1. Proposed Amendments

Under the existing accelerated filer and large accelerated filer definitions in Rule 12b-2, an issuer must satisfy three conditions to be an accelerated filer or large accelerated filer.[24] We proposed to add a new condition to the definitions of accelerated filer and large accelerated filer that would exclude from those definitions an issuer that is eligible to be an SRC and that meets the SRC revenue test. The most notable effect of the proposed amendments[25] would be that an issuer that is eligible to be an SRC and that meets the SRC revenue test would not be subject to the requirement of SOX Section 404(b) that an issuer's independent auditor must attest to, and report on, management's assessment of the effectiveness of the issuer's ICFR.[26] The final amendments do not change an auditor's role in a financial statement audit.[27]

SOX Section 404(a)[28] requires almost all issuers, including SRCs, that file reports

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[24] The three existing conditions for qualifying as an accelerated filer are that an issuer: (1) had an aggregate worldwide public float of $75 million or more, but less than $700 million, as of the last business day of the issuer's most recently completed second fiscal quarter; (2) has been subject to the requirements of 15 U.S.C. 78m (Exchange Act Section 13(a)) or 15 U.S.C. 78o(d) (Exchange Act Section 15(d)) for a period of at least twelve calendar months; and (3) has filed at least one annual report pursuant to those sections. For a large accelerated filer, conditions (2) and (3) are the same, but condition (1) is that an issuer had an aggregate worldwide public float of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter. Also, as discussed in note 20 above, some issuers that meet the "large accelerated filer" definition may be eligible to be an SRC.

[25] The issuer also would not have to abide by the filing deadlines of an accelerated or large accelerated filer, provide the disclosure required by Item 1B of Form 10-K and Item 4A of Form 20-F about unresolved staff comments on its periodic and/or current reports, or provide the disclosure required by Item 101(e)(4) of Regulation S-K about whether it makes filings available on or through its Internet website. *See* 17 CFR 229.101(e)(4).

[26] *See* 17 CFR 240.13a-15(f) and 17 CFR 240.15d-15(f) (defining ICFR).

[27] *See* letter from Deloitte (suggesting that the Commission explain how an auditor's role in a financial statement audit will change as a result of the amendments).

[28] 15 U.S.C. 7262(a).

pursuant to Exchange Act Section 13(a) or 15(d)[29] to establish and maintain ICFR and have their management assess the effectiveness of their ICFR.[30] SOX Section 404(b) subjects certain issuers not otherwise exempted to the ICFR auditor attestation requirement.[31] The most significant exemption from the ICFR auditor attestation requirement is the exemption provided to EGCs pursuant to Title I of the JOBS Act ("JOBS Act Exemption"). Generally, an EGC is a company that has total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year end and that has not sold common equity securities under a registration statement.[32] The JOBS Act Exemption provides EGCs with a five-year exemption from the ICFR auditor attestation requirement. We estimate that the JOBS Act Exemption applies to issuers with an aggregate market capitalization of about $585 billion, compared to about $95 billion in aggregate for the issuers that are newly exempt from the ICFR auditor attestation requirement under the amendments.[33]

2. Comments on the Proposed Amendments

Many commenters supported the portion of the proposed amendments that would exclude

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29 *See* 17 CFR 240.13a-15 and 17 CFR 240.15d-15.

30 Investment companies registered under Section 8 of the Investment Company Act of 1940, 15 U.S.C 80a–8, are specifically exempted from SOX Section 404 by SOX Section 405, 15 U.S.C. 7263. Notwithstanding the exemption pursuant to SOX Section 405, these registered investment companies are subject to other requirements regarding internal controls. *See* Proposing Release, note 4 above, at 24879, n. 44.

31 For example, SOX Section 404(c) exempts from Section 404(b) any issuer that is neither a large accelerated filer nor an accelerated filer. *See* 15 U.S.C. 7262(c).

32 *See* 15 U.S.C. 77(b)(a)(19).

33 These estimates are based on staff analysis of data on market values from Compustat for annual reports in calendar year 2018. *See* note 298 below for details on the identification of the population of different filer types. *See* note 336 below for details on the identification of the population of affected issuers. Out of the 1,430 issuers who qualified as EGCs in 2018, 1,097 are also non-accelerated filers. The remaining EGCs are still exempt from the ICFR auditor attestation requirement solely due to the JOBS Act Exemption, and those issuers are significantly larger in terms of aggregate market capitalization (approximately $145 billion) than the issuers newly exempted under the amendments (approximately $95 billion). This estimate excludes 41 EGCs with an aggregate of approximately $20 billion in market capitalization for which we are unable to determine non-accelerated filer status, the majority of which are Canadian issuers filing on Form 40-F.

an issuer that is eligible to be an SRC and that meets the SRC revenue test from the accelerated and large accelerated filer definitions.[34] Other commenters opposed the proposed amendments or suggested the need for further analysis.[35] Commenters' views on different aspects of the proposal, as well as its effects, are discussed topically, below.

a. Comments on Using Revenue for Determining Accelerated and Large Accelerated Filer Status

A number of commenters stated explicitly that they supported using revenue as a measure to determine whether an issuer should be subject to the ICFR auditor attestation requirement.[36] These commenters suggested that using a revenue measurement is preferable to using a public float measurement[37] because public float is often affected by industry or economic trends not specific to any particular issuer,[38] and that revenue is more predictable,[39] a better indicator of an issuer's complexity,[40] and a better indicator of an issuer's ability to absorb the burdens of the ICFR auditor attestation requirement.[41] Other commenters questioned whether revenue is an appropriate measure for determining whether an issuer should be a non-accelerated filer in all

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[34] *See, e.g.*, letters from Adamas, AdvaMed, AdvaMed *et al.*, Aequor, Andersen, Ardelyx, Ardelyx's slides from its presentation to the SBCFAC Meeting (Aug. 13, 2019) ("Ardelyx Presentation"), ASA, BIO, Broadmark, BSC, Carver, Catalyst, Cerecor, Chamber, Chiasma, CLSA, Concert, Corvus, CSB, CSBA, CymaBay, Daré, Equillium, Evoke, Gritstone, Guaranty, ICBA, Institute of Management Accountants' Financial Reporting and Small Business Committees (July 16, 2019) ("IMA"), Kezar, Marinus, Millendo, MSB, National Association of Manufacturers (July 26, 2019) ("NAM"), Nasdaq, Organovo, Pieris, Revance, SCBA, SI-BONE, Summit, Sutro, Syros, Teligent, Terra Tech, Xenon, and Zynerba.

[35] *See, e.g.*, letters from BDO, Better Markets, CAQ, CFA, CFA Inst., CII, Crowe, Deloitte, Grant Thornton, Prof. Barth *et al.*, Prof. Ge *et al.*, Prof. Hassell, Prof. Honigsberg *et al.*, and RSM.

[36] *See, e.g.*, letters from BIO, Broadmark, Chamber, Concert, Corvus, and MSB.

[37] *See, e.g.*, letters from Broadmark, Chamber, Concert, Corvus, and MSB.

[38] *See* letter from MSB.

[39] *See* letter from Broadmark.

[40] *See, e.g.*, letters from Concert and Corvus.

[41] *See* letter from Broadmark.

cases.[42] One commenter asserted that low-revenue companies may have less sophisticated or experienced accounting functions and some aspects of their business may be associated with accounting complexities.[43] This commenter also suggested that issuers may recognize revenue in ways that could result in them frequently transitioning in and out of non-accelerated filer status.[44] Another commenter indicated that an issuer could have a relatively low amount of revenue but still have a large market capitalization and thus "greater investor exposure."[45]

b. Comments on the Proposed Amendments' Effect on Capital Formation and the Number of Public Issuers

Commenters expressed mixed views on the effect that the proposed amendments would have on capital formation, the cost of capital, and the decisions of companies as to whether to enter the public capital markets. Some commenters agreed with the view expressed in the Proposing Release that, by expanding the JOBS Act Exemption, the proposed amendments would enhance capital formation or allow affected issuers to preserve capital[46] while also maintaining investor protection.[47] One commenter, questioning the benefits, if any, of the ICFR auditor attestation requirement, asserted that there is no correlation between a smaller issuer's compliance with the ICFR auditor attestation requirement and stronger markets in general.[48] Additionally, some commenters suggested that eliminating the ICFR auditor attestation

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42 *See* letter from Ernst & Young LLP (July 29, 2019) ("EY"), Grant Thornton, and National Association of State Boards of Accountancy (July 23, 2019) ("NASBA").

43 *See* letter from EY.

44 *Id.*

45 *See* letter from Grant Thornton.

46 *See, e.g.*, letters from Andersen, CLSA, Concert, ICBA, and NASBA.

47 *See, e.g.*, letters from ICBA and NASBA.

48 *See* letter from BIO.

requirement would encourage certain companies to enter the public markets.[49]

Conversely, other commenters asserted that the proposed amendments would not enhance capital formation, and some indicated they could even reduce capital formation.[50] Two of these commenters expressed the view that eliminating the ICFR auditor attestation requirement could increase the cost of capital for certain issuers because investors would require a premium to invest in issuers due to the heightened risk of ineffective internal controls.[51] In addition, some commenters maintained that the ICFR auditor attestation requirement does not prevent companies from entering the public markets.[52] For example, one commenter suggested that the Proposing Release's statement about the significant decline in the number of issuers listed on major exchanges implied that the cost of compliance with the ICFR auditor attestation requirement has contributed materially to that decline.[53] This commenter and some others asserted that the decline can be attributed to many other factors.[54] Some commenters stated that confidence in the U.S. capital market system, likely stems, at least in part, from financial reporting safeguards, including the ICFR auditor attestation requirement, and contended that the proposed amendments would thereby reduce investor confidence in issuers' financial reporting.[55]

Several commenters indicated that the ICFR auditor attestation requirement is not

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49 *See, e.g.*, letters from AdvaMed, AdvaMed *et al.*, Broadmark, Cerecor, and ICBA.

50 *See, e.g.*, letters from Better Markets, CII, CFA, CFA Inst., and Prof. Ge *et al.*

51 *See* letters from Better Markets and CFA.

52 *See, e.g.*, letters from CFA, CFA Inst., CII, and Crowe.

53 *See* letter from CFA.

54 *See, e.g.*, letters from CII, CFA, CFA Inst., and Crowe. Other factors commenters cited include the expansion of exemptions to registration that increase companies' ability to raise funds privately, *see, e.g.*, letters from CFA, CII, and Crowe; corporate consolidations, *see, e.g.*, letters from CFA and CII; market conditions, *see* letter from CFA; and the general regulatory environment, *see* letter from Crowe.

55 *See, e.g.*, letters from CAQ and CII.

necessary because issuers are permitted to voluntarily obtain an ICFR auditor attestation if they believe it is in their interest to do so.[56] Some instances in which commenters suggested that issuers may choose to voluntarily obtain an ICFR auditor attestation include when their investors demand it,[57] when not obtaining it would have a negative impact on investment analysts' coverage,[58] or when issuers otherwise deem it a good use of their capital resources.[59] In this regard, one commenter suggested clarifying that it is the authority and responsibility of the issuer's audit committee to determine whether the issuer should voluntarily obtain an ICFR auditor attestation.[60]

c. Comments on the Proposed Amendments' Effect on Investor Protection

Commenters' views as to the effect of the proposed amendments on investor protection were also mixed. Many commenters asserted that, even if the ICFR auditor attestation requirement did not apply, other existing requirements would provide investors in these issuers with sufficient protection.[61] Commenters cited a number of these other requirements, including SOX Section 404(a);[62] Nasdaq's listing standards, surveillance, and enforcement;[63] the required management certifications;[64] and the obligation of an independent auditor to consider ICFR

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56 *See, e.g.*, letters from ASA, BIO, Broadmark, Chamber, Guaranty, and Nasdaq.

57 *See, e.g.*, letters from BIO and Guaranty.

58 *See* letter from Guaranty.

59 *Id.*

60 *See* letter from EY.

61 *See, e.g.*, letters from ASA, Broadmark, BSC, Carver, Cerecor, Guaranty, ICBA, MSB, NAM, Nasdaq, Pieris, SCBA, and Xenon.

62 *See, e.g.*, letters from ASA, Broadmark, Carver, ICBA, MSB, Nasdaq, and Xenon.

63 *See* letter from Nasdaq.

64 *See* 17 CFR 229.601(31)(i), 17 CFR 240.13a-14(a), and 17 CFR 240.15d-14(a). *See, e.g.*, letters from MSB, Nasdaq, and Xenon.

when conducting a financial statement audit.[65]

For example, several commenters noted that, when conducting a financial statement audit, the auditor is required to obtain an understanding of each component of ICFR,[66] which a few of these commenters asserted would provide investors with sufficient protection absent the ICFR auditor attestation requirement.[67] Other commenters noted that the requirement that an auditor communicate to the issuer's management and its audit committee any significant deficiencies or material weaknesses related to ICFR in a financial statement audit would provide a certain level of protection for investors in the affected issuers.[68] Some commenters expressed a view that the ICFR auditor attestation requirement is not important or material to investors generally.[69] A few of these commenters asserted that investors rarely ask an issuer that is exempt from the ICFR auditor attestation requirement to voluntarily obtain such an attestation.[70] One commenter[71] cited a study[72] that found no statistically significant market response on

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65 *See, e.g.*, letters from ASA, Carver, Cerecor, MSB, NAM, and Xenon.

66 *See, e.g.*, letters from ASA, CAQ, CFA Inst., Crowe, EY, Grant Thornton, Guaranty, NASBA, Nasdaq, PricewaterhouseCoopers LLP (July 25, 2019) ("PWC"), and RSM.

67 *See, e.g.*, letters from ASA, Guaranty, and Nasdaq.

68 *See* letter from Nasdaq.

69 *See, e.g.*, letters from Adamas; Ardelyx; Ardelyx Presentation, ASA, BIO, Carver, Catalyst, Chiasma, Corvus, CymaBay, Equillium, Evoke, Gritstone, Kezar, Marinus, Millendo, Organovo, Pieris, Revance, SI-BONE, Syros, Teligent, and Zynerba. Some of these commenters and others asserted that the ICFR auditor attestation requirement is not material for, or important to, investors based on the results of a study and their own experience. *See, e.g.*, letters from Adamas, Ardelyx, Catalyst, Chiasma, Corvus, CymaBay, Equillium, Evoke, Gritstone, Kezar, Marinus, Millendo, Organovo, Pieris, Revance, SI-BONE, Syros, Teligent, and Zynerba (citing Craig Lewis and Joshua White, *Science or Compliance: Will Section 404(b) Compliance impede Innovation by Emerging Growth Companies in the Biotech Industry*, (Feb. 2019) ("BIO Study"), available at https://www.bio.org/sites/default/files/BIO_EGC_White_Paper_02_11_2019_FINAL.pdf).

70 *See, e.g.*, letters from Ardelyx Presentation and BIO.

71 *See* letter from BIO.

72 Jacqueline Hammersley, Linda Myers, and Catherina Shakespeare, *Market Reactions to the Disclosure of Internal Control Weaknesses and to the Characteristics of those Weaknesses under Section 302 of the Sarbanes Oxley Act of 2002* (Mar. 2008), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=979538.

average to disclosures of material weaknesses in disclosure controls, which suggests, according to the commenter, that investors do not significantly change their long-term value assessment of an issuer based on these disclosures.

In addition to these broader points, several commenters in the banking sector pointed out that community banks and bank holding companies are subject to extensive supervision and regulation by federal and state banking regulators, which they stated would protect investors in this industry even if the affected issuers were not subject to the ICFR auditor attestation requirement.[73]

Conversely, other commenters asserted that the ICFR auditor attestation requirement is an important investor protection and that eliminating it would undermine such protection.[74] One commenter disputed the contention in the Proposing Release that eliminating the ICFR auditor attestation requirement for low-revenue issuers would not significantly affect the ability of investors to make informed investment decisions.[75] Some commenters stated that the ICFR auditor attestation requirement increases investor confidence generally[76] and that investors view the requirement as beneficial.[77]

Some commenters asserted that the SOX Section 404(a) requirement would not provide investors in low-revenue SRCs with sufficient protection if they were not also subject to the ICFR auditor attestation requirement[78] because, as one commenter stated, the ICFR auditor

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73 *See, e.g.*, letters from BSC, Guaranty, ICBA, and SCBA.

74 *See, e.g.*, letters from Better Markets, Grant Thornton, and Prof. Barth *et al.*

75 *See* letter from Prof. Barth *et al.*

76 *See, e.g.*, letters from Better Markets, CAQ, CFA Inst., and EY.

77 *See, e.g.*, letters from CII, CFA Inst., and EY.

78 *See, e.g.*, letters from Better Markets, CFA Inst., Crowe, Grant Thornton, and Prof. Barth *et al.*

attestation requirement acts as an effective check on SOX Section 404(a).[79] Another commenter asserted that management's assessment is weakened when management knows that it will not be challenged by an ICFR auditor attestation.[80] A third commenter claimed that investors would place undue reliance on management's report when not accompanied by an ICFR auditor attestation.[81]

A few commenters noted that a financial statement audit does not provide the same level of assurance as an integrated audit[82] because a financial statement audit's objective is different from that of an integrated audit as it relates to ICFR.[83] Therefore, some commenters asserted that, without the ICFR auditor attestation requirement, the requirement for auditors to obtain an understanding of each component of ICFR when conducting a financial statement audit would not provide sufficient investor protection.[84] Similarly, other commenters suggested that some testing of ICFR conducted as part of a financial statement audit would not provide sufficient investor protection.[85] One commenter asserted that the control testing performed by a financial statement auditor would not be as extensive as testing performed in an ICFR auditor attestation and that it is more difficult for a financial statement auditor to challenge the design of ICFR.[86] Another commenter noted that, despite the requirement that a financial statement auditor

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79 *See* letter from Better Markets.

80 *See* letter from CFA Inst.

81 *See* letter from Grant Thornton.

82 *See, e.g.*, letters from CFA Inst., Crowe, and EY.

83 *See, e.g.*, letters from CAQ, CFA Inst., and RSM (noting that a financial statement audit's objective is for the auditor to obtain an understanding of the issuer's ICFR that is sufficient to assess the factors that affect the risks of material misstatement and to design further audit procedures, whereas an integrated audit's objective is to test and express an opinion on the effectiveness of the issuer's ICFR).

84 *See, e.g.*, letters from CAQ, CFA Inst. Crowe, EY, and RSM.

85 *See, e.g.*, letters from EY, Grant Thornton, and NASBA.

86 *See* letter from EY.

communicate any significant deficiencies or material weaknesses related to ICFR to the issuer's management and its audit committee, a financial statement audit is not designed to identify such significant deficiencies or material weaknesses.[87]

Some commenters indicated that the ICFR auditor attestation requirement promotes effective ICFR and more accurate disclosures related to ICFR,[88] including the likelihood and timeliness of disclosing ineffective ICFR.[89] Also, a number of commenters noted that, as discussed in the Proposing Release, effective ICFR, generally, and the ICFR auditor attestation requirement, more specifically, enhances transparency;[90] increases the quality and reliability of issuers' financial statements,[91] corporate governance,[92] audits,[93] and analyst forecasts;[94] and reduces the number of issuers' restatements, misstatements,[95] the instances of fraud,[96] and occurrences of insider trading.[97]

A few commenters expressed concern about the effect that the amendments could have on the reliability of key performance indicators and other measures. One commenter indicated that investors in certain issuers that would become non-accelerated filers under the amendments rely on key performance indicators that are derived from their financial statements, such as

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87 *Id*.

88 *See, e.g.*, letters from Better Markets, CFA, CII, Crowe, Grant Thornton, Prof. Barth *et al.*, and PWC.

89 *See, e.g.*, letters from Better Markets, CFA, Crowe, and Prof. Barth *et al.*

90 *See* letter from EY.

91 *See, e.g.*, letters from Better Markets, CAQ, CFA, CII, Deloitte, EY, Grant Thornton, Prof. Barth *et al.*, PWC, and RSM.

92 *See* letter from Deloitte.

93 *See* letter from CAQ.

94 *See* letter from CFA.

95 *See, e.g.*, letters from CAQ, CFA, CFA Inst., Crowe, Deloitte, EY, Grant Thornton, and Prof. Barth *et al.*

96 *See, e.g.*, letters from Better Markets and Deloitte.

97 *See* letter from CFA.

backlog, sales orders, and number of customers, and asserted that eliminating the ICFR auditor attestation requirement could reduce the reliability of those indicators.[98] Another commenter noted that investors in those issuers rely on non-GAAP financial measures, key performance indicators, and other disclosures and stated that the Commission may wish to consider auditor involvement with that information to address potential risks related to completeness and accuracy.[99]

d. Comments on the Disproportionate Costs and Benefits of the ICFR Auditor Attestation Requirement to Small and Low-Revenue Companies

A number of commenters stated that the ICFR auditor attestation requirement is quite costly.[100] One of these commenters indicated that the ICFR auditor attestation requirement "is the most costly aspect of being an [a]ccelerated [f]iler."[101] Several commenters asserted more specifically that the ICFR auditor attestation requirement is disproportionally costly to small and/or low-revenue issuers.[102] Some of these commenters indicated that the reason for the disproportionate costs is that there are fixed costs associated with the ICFR auditor attestation requirement that are not scalable for smaller issuers.[103] Other commenters stated that the benefits of the ICFR auditor attestation requirement do not outweigh the costs,[104] including the

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98 *See* letter from NASBA.

99 *See* letter from CAQ.

100 *See, e.g.*, letters from BIO, Broadmark, Carver, Guaranty, ICBA, MSB, Summit, and Syros.

101 Letter from Guaranty.

102 *See, e.g.*, letters from AdvaMed *et al.*, Andersen, BIO, Broadmark, Chamber, CLSA, CSB, Guaranty, and NAM.

103 *See, e.g.*, letters from Broadmark and Guaranty.

104 *See, e.g.*, letters from ICBA, MSB, and Syros.

costs associated with ICFR auditor attestation fees,[105] issuer personnel time,[106] and outside consultants.[107]

Some commenters asserted that eliminating the ICFR auditor attestation requirement would not substantially reduce costs to issuers.[108] A few of these commenters noted that ICFR auditor attestations have become less expensive and more effective because auditors are more experienced in conducting them.[109] Some commenters stated that potential compliance cost reductions may be negated if there is a loss of investor confidence and protection,[110] if ICFR deficiencies go undetected,[111] if there is an increase in restatements and misstatements,[112] or if there are higher costs of capital.[113]. Additionally, some commenters stated that any cost reductions would vary widely among issuers[114] and would be hard to quantify.[115]

Other commenters asserted that the benefits of the ICFR auditor attestation requirement are not as great for low-revenue and smaller issuers as they are for other issuers.[116] These commenters expressed the view that the issuers that would be exempt from the ICFR auditor attestation requirement under the proposed amendments are less likely to have ineffective ICFR

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105 *See, e.g.*, letters from MSB and Summit.

106 *See, e.g.*, letters from Carver, MSB, and Summit.

107 *See, e.g.*, letters from MSB and Summit.

108 *See, e.g.*, letters from BDO, Better Markets, CFA, CFA Inst., EY, Grant Thornton, and RSM.

109 *See, e.g.*, letters from CFA Inst. and Deloitte.

110 *See, e.g.*, letters from Better Markets and CII.

111 *See* letter from CFA Inst.

112 *See, e.g.*, letters from BDO, CFA, and CFA Inst.

113 *See, e.g.*, letters from CFA and CFA Inst.

114 *See, e.g.*, letters from EY, Grant Thornton, and PWC.

115 *See, e.g.*, letters from Grant Thornton, PWC, and RSM.

116 *See, e.g.*, letters from BIO and Guaranty.

than other issuers. One commenter cited a study that concluded that biotech EGCs are less likely to have ineffective ICFR than other issuers.[117] Another commenter noted that ineffective ICFR is less of a concern for banking issuers because of the "federal and state regulatory oversight and internal control audits of community banks."[118]

Conversely, a number of other commenters contended that the benefits of the ICFR auditor attestation requirement are greater for low-revenue and smaller issuers than for other issuers.[119] Some of the commenters discussed how those issuers are more likely to have ineffective ICFR.[120] Commissioner Robert J. Jackson Jr.'s dissent from the Proposing Release ("Commissioner Jackson's Statement")[121] asserted that investors care most about ICFR auditor attestations at those issuers that would not be subject to the ICFR auditor attestation requirement under the proposed amendments, and that high-growth companies, which potentially would include some of the affected issuers, are those in which the risk and consequences of fraud are the greatest.[122] Some commenters referred to statistics cited in the Proposing Release to argue that issuers not subject to the ICFR auditor attestation requirement have higher levels of

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117 *See* letter from BIO (citing the BIO Study). Note that the BIO Study investigates only the incremental effect of being in the category of biotech EGCs after accounting for the association of ineffective ICFR with the other characteristics of these issuers (such as their size and return on assets). It is unclear from the study whether these issuers have a higher or lower rate of ineffective ICFR on average, when considering all of their characteristics.

118 *See* letter from Guaranty.

119 *See, e.g.*, letters from Better Markets, CAQ, CFA, CFA Inst., CII, Crowe, EY, Grant Thornton, IMA, NASBA, Prof. Barth *et al.*, Prof. Hassell, and RSM.

120 *See, e.g.*, letters from Better Markets, CAQ, CFA, CII, Grant Thornton, IMA, NASBA, Prof. Barth *et al.*, and Prof. Hassell.

121 Commissioner Robert J. Jackson Jr., *Statement on Proposed Amendments to Sarbanes Oxley 404(b) Accelerated Filer Definition* (May 9, 2019), available at https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-accelerated-filer-definition. A few commenters cited Commissioner Jackson's Statement. *See, e.g.*, letters from CFA, CFA Inst., and CII.

122 We address Commissioner Jackson's Statement in the Economic Analysis. *See* Section IV.C.3.c. below.

ineffective ICFR compared with issuers subject to that requirement.[123] Additionally, commenters observed that some low-revenue issuers or smaller companies may still have complex financial statements that require sophisticated accounting.[124]

Finally, some commenters maintained that the risks of fraud[125] and financial statement restatements or misstatements[126] are greater for the issuers that would not be subject to the ICFR auditor attestation requirement under the proposed amendments than they are for other issuers. Other commenters cited research that concludes that, since 2003, non-accelerated U.S. filers accounted for 62 percent of the total U.S. financial statement restatements.[127] Some commenters contended that issuers that would not be subject to the ICFR auditor attestation requirement under the proposed amendments have fewer resources and personnel,[128] which could result in increased misstatements,[129] unidentified material weaknesses,[130] and ineffective ICFR.[131]

e. Comments on the Relationship Between Non-Accelerated Filers and SRCs

A number of commenters discussed the relationship between the non-accelerated

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123 Commenters cited the statistics in the Proposing Release, note 4 above, that over 40 percent of non-accelerated filers that are not subject to the ICFR auditor attestation requirement have ineffective ICFR, compared to less than approximately nine and five percent of accelerated and large accelerated filers, respectively. As noted in the Proposing Release, note 4 above, over 68 percent of non-accelerated filers have reported two consecutive years of ineffective ICFR and over 38 percent have reported four consecutive years of ineffective ICFR in their annual reports. *See, e.g.*, letters from Better Markets and Grant Thornton.

124 *See, e.g.*, letters from BDO and RSM.

125 *See, e.g.*, letters from Better Markets, CFA, CII, and Prof. Barth *et al.*

126 *See, e.g.*, letters from Better Markets, CAQ, EY, Grant Thornton, IMA, Prof. Barth *et al.*, and RSM.

127 *See, e.g.*, letters from CAQ and CFA Inst.

128 *See, e.g.*, letters from CAQ, Crowe, EY, and Grant Thornton.

129 *See, e.g.*, letter from Crowe.

130 *See, e.g.*, letter from EY.

131 *See, e.g.*, letters from CAQ and Grant Thornton.

filer and SRC definitions.[132] Some commenters noted the current relationship is incongruent, which results in complexity.[133] Several commenters indicated that the proposed amendments would reduce some of this complexity by more closely aligning the definitions.[134] In contrast, other commenters asserted that the proposed amendments would increase the complexity of determining filer status.[135]

While supporting the proposed amendments, some commenters recommended that the final amendments completely align the SRC and non-accelerated filer definitions.[136] Additionally, one commenter recommended further extending the relief from the ICFR auditor attestation requirement to issuers with a public float that exceeds $700 million if their annual revenues are less than $100 million.[137]

f. Other Comments

We received a variety of other comments on the Proposing Release. Some commenters noted that it is difficult for investors to easily determine whether an issuer's filing includes an ICFR auditor attestation.[138] These commenters suggested requiring issuers to disclose whether they are exempt from the ICFR auditor attestation requirement[139] and/or have voluntarily

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132 *See, e.g.*, letters from ASA, BDO, BIO, Broadmark, CFA, CFA Inst., Chamber, EY, Grant Thornton, Guaranty, KPMG LLP (July 29, 2019) ("KPMG"), NAM, Nasdaq, PWC, and RSM.

133 *See, e.g.*, letters from BDO, BIO, Broadmark, CFA, and Nasdaq.

134 *See, e.g.*, letters from BIO, Grant Thornton, KPMG, and Nasdaq.

135 *See, e.g.*, letters from BDO, CFA Inst., EY, PWC, and RSM. *See also* SBCFAC Meeting Transcript (Aug. 13, 2019), available at https://www.sec.gov/info/smallbus/acsec/sbcfac-transcript-081319.pdf.

136 *See, e.g.*, letters from ASA, Guaranty, NAM, and Nasdaq.

137 *See* letter from Corvus.

138 *See, e.g.*, letters from CAQ, CFA Inst., and Grant Thornton.

139 *See, e.g.*, letters from CFA Inst., CII, and Grant Thornton.

obtained an ICFR auditor attestation[140] either on a filing's cover page,[141] such as with a check box,[142] or in management's report on ICFR.[143] Two commenters recommended that the Commission engage in a post-implementation review of the impact of the final amendments,[144] with one of these commenters recommending that the final amendments require a review of the impact of the changes on the affected registrants five years after adoption of the amendments.[145] Some commenters requested that we allow sufficient time and notice for auditors and issuers to prepare for compliance with the final amendments,[146] whereas other commenters noted that some issuers may be subject to the ICFR auditor attestation requirement for only a short time[147] and requested the Commission adopt final amendments quickly.[148] One commenter asserted that the measurement date for non-accelerated filer status and the timing of the start of the auditor's attestation of ICFR is burdensome to small biotech registrants.[149]

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140 *See, e.g.*, letters from CFA Inst. and KPMG.

141 *See, e.g.*, letters from CAQ, CFA Inst., CII, and Grant Thornton.

142 *See, e.g.*, letters from CAQ and Grant Thornton.

143 *See* letter from Grant Thornton.

144 *See* letters from IMA and PWC.

145 *See* letter from IMA.

146 *See, e.g.*, letters from BDO, CAQ, Crowe, EY, KPMG, PWC, and RSM.

147 *See, e.g.*, letters from Concert, MSB, Nasdaq, and Xenon.

148 *See, e.g.*, letters from MSB and Summit.

149 *See* letter from Corvus. Public float for both SRC status and accelerated and large accelerated filer status is measured on the last business day of the issuer's most recently completed second fiscal quarter, and revenue for purposes of determining SRC status is measured based on annual revenues for the most recent fiscal year completed before the last business day of the second fiscal quarter. Therefore, an issuer will be aware of any change in SRC status or accelerated or large accelerated filer status as of that date. Although an issuer that determines it will no longer be eligible to be an SRC is permitted to continue to use the SRC accommodations for the Form 10-K for the year in which it fails the measurement test, an issuer that becomes an accelerated or large accelerated filer on that same measurement date would be required to include the ICFR auditor attestation in that Form 10-K. *See* Rule 12b-2, Item 10(f)(2)(i)(C), and Rule 405. Although the transition provisions apply differently, the measurement dates for SRC status and accelerated and large accelerated filer status each provide an issuer with at

Additionally, although we did not propose amendments to the accelerated and large accelerated filer definitions that would specifically address foreign private issuers ("FPI") or business development companies ("BDC"), we solicited comment on these points and a few commenters requested we do so.[150] One commenter asserted that there should be no disparity between an FPI that presents its financial statements in accordance with International Financial Reporting Standards ("IFRS") and a domestic issuer or FPI that presents its financial statements in accordance with U.S. GAAP.[151] The commenter noted that an FPI that presents its financial statements in accordance with IFRS cannot be an SRC, so such an FPI cannot rely on the proposed amendments. Another commenter recommended that the Commission extend the benefits of non-accelerated filer status to BDCs if they have total investment income of less than $80 million in their most recently completed fiscal year for which audited financial statements are available and have either no public float or public float of less than $700 million.[152] The commenter stated that allowing BDCs to qualify as non-accelerated filers under this modified SRC revenue test would reduce regulatory asymmetry between BDCs and operating companies, consistent with recent congressional mandates to allow BDCs to use the same offering rules as operating companies. The commenter also suggested that allowing smaller BDCs to benefit from non-accelerated filer status would ease regulatory costs and burdens, which could encourage more BDCs to enter public markets, creating greater access to capital for small

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least six months to prepare for a change in its status, and we continue to believe that this is an adequate amount of time to prepare for the transition.

150 *See, e.g.*, letters from Dorsey & Whitney LLP (Aug. 16, 2019) ("Dorsey & Whitney") and Proskauer Rose LLP (July 26, 2019) ("Proskauer").

151 *See* letter from Dorsey & Whitney.

152 *See* letter from Proskauer.

operating companies and expanding investment opportunities for retail investors.[153]

3. Final Amendments

After considering the comments, we are adopting the final amendments substantially as proposed. The final amendments add a new condition to the accelerated and large accelerated filer definitions in Rule 12b-2 that excludes an issuer that is eligible to be an SRC and that had annual revenues of less than $100 million in the most recent fiscal year for which audited financial statements are available. The amendments also allow BDCs to qualify for this exclusion if they meet the requirements of the SRC revenue test using their annual investment income as the measure of annual revenue, although BDCs would continue to be ineligible to be SRCs.[154] The final amendments are consistent with our historical practice of providing scaled disclosure and other accommodations for smaller issuers[155] and with recent actions by Congress to reduce burdens on new and smaller issuers.[156] The table below summarizes the conditions required to be considered an accelerated and large accelerated filer under the final amendments to Rule 12b-2.

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153 *Id.*

154 *See* Section II.B.3.f. below.

155 *See, e.g.*, *Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934 (Jan. 4, 2008)]; *Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934 (Jan. 4, 2008)] ("2007 SRC Adopting Release"); and SRC Adopting Release, note 12 above.

156 *See* note 11 above.

Table 1. Accelerated Filer and Large Accelerated Filer Conditions Under the Final Amendments

Final Accelerated Filer Conditions	Final Large Accelerated Filer Conditions
The issuer has a public float of $75 million or more, but less than $700 million, as of the last business day of the issuer's most recently completed second fiscal quarter.	The issuer has a public float of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter.
The issuer has been subject to the requirements of Exchange Act Section 13(a) or 15(d) for a period of at least twelve calendar months.	Same.
The issuer has filed at least one annual report pursuant Exchange Act Section 13(a) or 15(d).	Same.
The issuer is not eligible to use the requirements for SRCs under the revenue test in paragraph (2) or (3)(iii)(B), as applicable, of the "smaller reporting company" definition in Rule 12b-2 or, in the case of a BDC, does not meet the requirements of the revenue test in those paragraphs using annual investment income as the measure of its annual revenues.	Same.

Below we discuss specific aspects of the final amendments about which we received significant public comment and our response to those comments. In many cases, our responses reflect analysis and data that is more comprehensively presented in the Economic Analysis.[157]

a. Using Revenue for Determining Accelerated and Large Accelerated Filer Status

As discussed above,[158] several commenters supported the use of revenue in the proposal, providing a variety of reasons that a revenue measurement is preferable to using a public float

[157] *See* Section IV. below.

[158] *See* Section II.A.2.a. above.

measurement.[159] Others, however, questioned whether revenue is an appropriate measure for determining whether an issuer should be considered a non-accelerated filer.[160] One of these commenters asserted that low-revenue issuers may have less sophisticated or experienced accounting functions and some aspects of their business may be associated with accounting complexities.[161] Also, the commenter suggested that these issuers may recognize revenue in ways that could result in them frequently transitioning in and out of non-accelerated filer status.[162]

As we discuss in more detail below,[163] we continue to believe, as a general matter, that there may be greater costs and relatively lower benefits to including low-revenue issuers, as compared to other issuers, in the accelerated and large accelerated filer definitions. While we recognize that the circumstances of individual issuers and their accounting systems and processes may vary, we believe that low-revenue issuers may, on average, be less susceptible to the risk of certain types of restatements, such as those related to revenue recognition.[164] We also note that the revisions to the transition thresholds included in the final amendments may help minimize the risk of frequent reclassifications of issuer status.[165] For these reasons, we continue to believe that revenue is an appropriate measure for determining whether an issuer should be considered a non-accelerated filer.

b. Effect on Capital Formation and the Number of Public Companies

Under the final amendments, an issuer that is eligible to be an SRC and that meets the

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159 *See, e.g.*, letters from Broadmark, Chamber, Concert, Corvus, and MSB.

160 *See, e.g.*, letters from EY and Grant Thornton, and NASBA.

161 *See* letter from EY.

162 *Id.*

163 *See* Sections II.B.3.d. and Section IV.C.2.d. below.

164 *See* Section IV.C.3. below.

165 *See* Section II.C. below.

SRC revenue test will not be required to comply with accelerated or large accelerated filer requirements and, thereby, will not be subject to the ICFR auditor attestation requirement. Not subjecting these affected issuers to the ICFR auditor attestation requirement should reduce their compliance costs. As discussed in the Economic Analysis,[166] we estimate that, consistent with the proposal, an issuer no longer subject to the ICFR auditor attestation requirement would save approximately $210,000 per year comprised of approximately $110,000 per year reduction in audit fees and an additional reduction in non-audit costs of approximately $100,000.

Some commenters stated that eliminating the ICFR auditor attestation requirement would enhance capital formation or allow those issuers to preserve capital.[167] We note, however, that a number of other commenters asserted that these cost savings would be small,[168] and may not help capital formation.[169] As we discuss in the Economic Analysis,[170] we continue to believe that the expected savings are likely to represent a meaningful cost savings for many of the affected issuers and, therefore, may have a positive effect on capital preservation and formation. Although the average annual cost savings may represent a small percentage of the average affected issuer's revenues and market capitalization, we believe those savings may be meaningful given that affected issuers have, on average, negative net income and negative net cash flows from operations.[171] More generally, low-revenue issuers are likely to face financing constraints because they do not have access to internally generated capital.[172] Therefore, the

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166 *See* Section IV.C.2.b. below.

167 *See, e.g.*, letters from Andersen, CLSA, Concert, ICBA, and NASBA.

168 *See* letters from CFA, CFA Inst., CII, and Prof. Barth *et al*.

169 *See* note 50 above.

170 *See* Section IV.C.2.d. below.

171 *See* note 362 below.

172 This information is based on staff analysis of data from Compustat. *See* Section IV.C.2.d. below.

average savings of $210,000 per year for these issuers may be put to productive use[173] such as developing the company.[174]

As we noted in the Proposing Release,[175] the affected issuers are a type of smaller issuer whose representation in public markets has decreased relative to the years before SOX. Over the past two decades, the number of issuers listed on major exchanges has decreased by about 40 percent,[176] but the decline has been concentrated among smaller size issuers. For example, the number of listed issuers with a market capitalization below $700 million has decreased by about 65 percent,[177] and the number of issuers with less than $100 million in revenue has decreased by about 60 percent.[178] Although factors other than the ICFR auditor attestation requirement may have contributed to the decline,[179] we believe that the described cost reductions associated with the final amendments could be a positive factor in encouraging additional small companies to register their securities offerings or a class of their securities, which would provide an increased

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173 For example, in a survey of issuers in the biotech industry, among 11 biotech EGCs that responded to a question regarding how an extension of the exemption from the ICFR auditor attestation requirement would affect them given the costs associated with the requirement, eight out of the 11 issuers indicated that they expected a positive impact on investments in research and development and six out of the 11 issuers indicated that they expected a positive impact on hiring employees. *See* BIO Study, note 423 above.

174 *See, e.g.*, letters from Adamas, Aequor, Andersen, Ardelyx, Catalyst, Chiasma, CLSA, Concert, Corvus, CymaBay, Daré, Evoke, Equillium, Gritstone, ICBA, Kezar, Marinus, Millendo, NASBA, Organovo, Pieris, Revance, SI-BONE, Sutro, Syros, Teligent, and Zynerba.

175 *See* Section III.C.1. of the Proposing Release, note 4 above. Staff extracted information regarding whether issuers reported having securities registered under Section 12(b) of the Exchange Act from the cover page of annual report filings using a computer program supplemented with hand collection. *See* note 336 below for details on the identification of the population of affected issuers.

176 This estimate is based on staff analysis of data from the Center for Research in Security Prices database for December 1998 versus December 2018. The estimate excludes RICs and issuers of ADRs.

177 *Id.*

178 This estimate is based on staff analysis of data from Standard & Poor's Compustat and Center for Research in Security Prices databases for fiscal year 1998 versus fiscal year 2017. The estimate excludes RICs and issuers of ADRs.

179 *See* note 54 above.

level of transparency and investor protection with respect to those companies.[180]

c. Effect on Investor Protection

We continue to believe that the amendments are not likely to have a significant effect on the overall ability of investors in the affected issuers to make informed investment decisions and note that many commenters agreed with this assessment.[181] As discussed in greater detail in the Proposing Release,[182] issuers have a number of other obligations that we believe will provide sufficient protections for investors in the affected issuers and allow investors in those issuers to make informed investment decisions. These responsibilities derive from the Foreign Corrupt Practices Act ("FCPA") requirements with respect to internal accounting controls[183] as well as a number of different changes to financial reporting that were introduced by SOX.[184]

For example, although a non-accelerated filer that is eligible to be an SRC and that meets the SRC revenue test will not be subject to the ICFR auditor attestation requirement, it will remain subject to the SOX Section 404(a) requirement to state in its annual report the responsibility of management for establishing and maintaining an adequate control structure and procedures for financial reporting, and for that report to contain an assessment of the effectiveness of that structure and its procedures. In addition, affected issuers are required to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial

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180 *See, e.g.*, letters from AdvaMed, AdvaMed *et al.*, Broadmark, Cerecor, and ICBA.

181 *See* note 61 to 68 above and accompanying text.

182 *See* Section II.B. of the Proposing Release, note 4 above.

183 The FCPA added Section 13(b)(2)(B) to the Exchange Act, 15 U.S.C 78m(b)(2)(B) (referring to "internal accounting controls" rather than ICFR).

184 *See, e.g.*, SOX Sections 302, 15 U.S.C. 7241, and 404(a) and related rules. *See* 17 CFR 229.308, 17 CFR 240.13a-15, 17 CFR 240.15d-15, Form 20-F, Form 40-F, 17 CFR 270.30a-2, and 17 CFR 270.30a-3.

statements in conformity with GAAP.[185] Also, the principal executive and financial officers of certain issuers are required to certify that, among other things, they are responsible for establishing and maintaining ICFR, have designed disclosure controls and procedures to ensure material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, and have evaluated and reported on the effectiveness of the issuer's disclosure controls and procedures.[186]

Furthermore, the issuers that are subject to the final amendments will remain subject to a financial statement audit by an independent auditor, which will help maintain appropriate investor protections. Even without an ICFR auditor attestation requirement, an independent auditor is required to consider ICFR in the performance of a financial statement audit.[187] We acknowledge, as stated by some commenters,[188] that the objective of a financial statement audit and the level of control testing performed is different from an ICFR audit. However, we believe that the requirements of a financial statement audit, among other requirements, provide some additional protections and that, for low-revenue SRCs, this and the other protections and factors associated with these issuers described above sufficiently mitigate the risk that the final amendments will adversely affect the ability of investors to make informed investment decisions.[189]

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185 15 U.S.C. 78m(b)(2)(B).

186 *See* 17 CFR 240.13a-14 or 17 CFR 240.15d-14 (requiring certification) and 17 CFR 229.601(b)(31) (prescribing certification content). These rules were adopted pursuant to SOX Section 302. *See* 15 U.S.C. 7241.

187 *See* Public Company Accounting Oversight Board ("PCAOB") Accounting Standard ("AS") 2110, *Identifying and Assessing Risks of Material Misstatement*, paragraphs .18 through.40 ("PCAOB AS 2110"), paragraphs .18 through .40.

188 *See* note 83 above.

189 *See* Section IV.C.3.b. below (stating that, in the Proposing Release, note 4 above, we noted that low-revenue issuers may be less likely than other issuers to fail to detect and disclose material weaknesses in the absence of an ICFR auditor attestation, perhaps because they have less complex financial systems and controls).

For example, the auditor in a financial statement audit is required to identify and assess the risks of material misstatements, which is similar to the risk assessment evaluation required in an ICFR auditor attestation. Additionally, the auditor engaged in a financial statement audit often may test the operating effectiveness of certain internal controls even if not performing an integrated audit to reduce the extent of substantive testing required to issue an opinion on the financial statements. Moreover, even if an auditor decides not to rely on internal controls to reduce the extent of substantive testing, the auditor may still identify internal control deficiencies during such substantive testing in a financial statement audit.

Under PCAOB standards, the evaluation and communication of significant deficiencies and material weaknesses in ICFR to management and the issuer's audit committee is required in both a financial statement audit and an ICFR auditor attestation.[190] The evaluation of the severity of a control deficiency identified by the auditor is the same for a financial statement audit and an ICFR auditor attestation. Further, a financial statement auditor has the responsibility to review management's disclosure for any misstatement of facts, such as a statement that ICFR is effective when there is a known material weakness.[191] Therefore, we continue to believe significant deficiencies and material weaknesses that an ICFR auditor attestation may uncover also may be uncovered as a part of the financial statement audit of a low-revenue SRC. As discussed above,[192] because of these requirements, a number of commenters agreed that an auditor of the financial statements of a low-revenue issuer that would be exempt from the ICFR auditor attestation requirement under the final amendments would still be required to consider ICFR and therefore this process would provide sufficient investor

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[190] *See* Section II.C. of the Proposing Release, note 4 above.

[191] *Id.*

[192] *See* notes 61 to 68 above and accompanying text.

protection.

Other developments may serve to reinforce these existing investor protections. In 2010, the PCAOB adopted enhanced auditing standards related to the auditor's assessment of, and response to, risk that, in part, clarify and augment the extent to which internal controls are to be considered in a financial statement audit.[193] In particular, these risk assessment standards require auditors in both an integrated and financial statement audit to evaluate the design of certain controls.[194] The PCAOB has expressed concern about the number and significance of deficiencies in auditing firm compliance with these risk assessment auditing standards, but it has also noted promising improvements in their application.[195]

Additionally, recent settled charges against four public companies for failing to maintain effective ICFR for seven to 10 consecutive annual reporting periods[196] may have a deterrent effect on issuers failing to remediate material weaknesses, which could reduce the overall rate of persistence of material weaknesses in ICFR. Also, if management elects to obtain and use automated controls testing and process automation,[197] this may result in improvements in ICFR

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193 *See Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards*, PCAOB Release No. 2010-004 (Aug. 5, 2010) ("PCAOB Release No. 2010-004"). *See also Public Company Accounting Oversight Board; Order Approving Proposed Rules on Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards*, Release No. 34-63606, File No. PCAOB 2010-01 (Dec. 23, 2010) [75 FR 82417 (Dec. 30, 2010)] ("PCAOB Release No. 2010-01"). These auditing standards are discussed in further detail in the Economic Analysis. *See* Section IV.B.1. below.

194 *See* AS 2110, paragraphs .18 through.40, note 187 above.

195 *See Inspection Observations Related to PCAOB "Risk Assessment" Auditing Standards (No. 8 through No.15)*, PCAOB Release No. 2015-007 i through iii (Oct. 15, 2015) ("PCAOB Release No. 2015-007").

196 *See SEC Charges Four Public Companies with Longstanding ICFR Failures*, press release (Jan. 29,2019) ("SEC Press Release"), available at https://www.sec.gov/news/press-release/2019-6.

197 *See, e.g.*, Kevin Moffitt, Andrea Rozario, & Miklos Vasarhelyi (2018), *Robotic Process Automation for Auditing*, Journal of Emerging Technologies, 15(1) ACCT. 1 ("Robotic Process Automation") (describing how, for example, a robotic process automation program can be "set up to automatically match purchase orders, invoices, and shipping documents [and] can check that the price and quantity on each of the documents match [to] help auditors validate the effectiveness of preventive internal controls….").

regardless of the ICFR auditor attestation requirement if their increased application results in more robust financial reporting with fewer opportunities for ICFR deficiencies and/or in an increase by management in their testing and related improvements of controls. In Section IV.C.3.b.5, we note, as an example, that issuers may have made investments in systems, procedures, or training to explain how control improvements may persist for certain affected issuers. Finally, we note that auditors have had many years of experience with the 2010 risk assessment standards, and therefore auditors may be more likely to test ICFR, even if an ICFR auditor attestation is not required, as a means of enhancing auditing efficiency.[198]

We recognize that some commenters disagreed with this assessment and asserted that investor protections other than the ICFR auditor attestation requirement would not be sufficient because, among other reasons, a financial statement audit has a different objective than an integrated audit,[199] testing of ICFR in a financial statement audit is not as extensive,[200] it is more difficult for a financial statement auditor to challenge the design of ICFR,[201] and a financial statement audit is not designed to identify significant ICFR deficiencies or material weaknesses.[202] As discussed in the Economic Analysis, we acknowledge that the amendments may be associated with some adverse effects on the effectiveness of ICFR and the reliability of

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198 *See Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 For Issuers With Public Float Between $75 and $250 Million* at 106 (Apr. 2011) ("2011 SEC Staff Study"), available at https://www.sec.gov/news/studies/2011/404bfloat-study.pdf (stating that "…once effective controls are in place at the issuer, the auditor is more likely to continue to test them even if [it is] not issuing an auditor attestation during a particular year in order to rely on them for purposes of reducing substantive testing in the audit of the financial statements, particularly for issuers that are larger and more complex").

199 *See, e.g.*, letters from CAQ, CFA Inst., and RSM.

200 *See* letter from EY.

201 *Id*.

202 *Id*.

financial statements for the affected issuers.[203] However, the Proposing Release presented evidence that suggests that these effects and their impact on investor protection are likely to be mitigated in the case of the affected issuers as compared to other accelerated filers. The Economic Analysis provides further related analysis in response to commenter feedback and does not find evidence that leads us to alter this view.[204]

One commenter indicated that a low-revenue issuer could have a large market capitalization and thus "greater investor exposure."[205] As discussed in the Economic Analysis,[206] we agree that, as capitalization increases, there is more investor capital at risk. We note, however, that relative to higher-revenue issuers, on average, risk among these issuers is likely more associated with their future prospects than their current financial statements.[207] Therefore, exempting low-revenue issuers from the ICFR auditor attestation requirement is less likely to affect investor protections with respect to those issuers.

One commenter noted its concern that certain issuers that would no longer be subject to the ICFR auditor attestation requirement are conducting large initial public offerings ("IPOs") based on key performance indicators that are derived from financial systems, and that eliminating the ICFR auditor attestation requirement could result in potentially less robust internal controls and unreliable data.[208] To the extent the commenter is primarily concerned with the information

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203 *See* Section IV.A. below.

204 *Id.*

205 *See* letter from Grant Thornton.

206 *See* Section IV.C.3.d. below.

207 Also, the affected parties are limited to issuers with no more than $700 million in public float. Further, as discussed in Section IV.C.3.d below, we estimate that in aggregate the affected issuers that will be newly exempt from all ICFR auditor attestation requirements represent 0.2 percent of the total equity market capitalization of issuers.

208 *See* letter from NASBA.

available to investors at the time of an IPO, we note that the affected issuers that would be newly exempt from the ICFR auditor attestation requirement are generally more mature firms that are not within five years of their IPO.

Also, we believe the risk for those low-revenue issuers for which key performance indicators are material to investors and that are derived from financial systems is mitigated by the requirement to maintain, evaluate, and disclose effectiveness of disclosure controls and procedures[209] on a quarterly basis.[210] Key performance indicators or non-GAAP measures disclosed within a report filed or submitted to the Commission generally are within the scope of disclosure controls and procedures. The financial systems from which an issuer derives the key performance indicator or non-GAAP measure would normally be included in ICFR and, therefore, within the scope of management's assessments as well. Further, the Commission recently issued disclosure guidance on key performance indicators and metrics and reminded issuers of the importance of effective controls and procedures when disclosing material key performance indicators or metrics that are derived from their own information.[211]

d. Disproportionate Costs and Benefits of the ICFR Auditor Attestation for Small and Low-Revenue Companies

Not only is the ICFR auditor attestation requirement costly in general, as discussed above, a number of commenters asserted that the ICFR auditor attestation requirement is disproportionally costly to small and low-revenue issuers.[212] We agree that the costs of the ICFR

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209 Although there is substantial overlap between an issuer's disclosure controls and procedures and ICFR, there are elements of each that are not subsumed by the other. *See* 17 CFR 240.13a-15 and 17 CFR 240.15d-15.

210 *See* 17 CFR 240.13a-14 and 17 CFR 240.15d-14.

211 *See* Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations, Release No. 34-88094 (Jan. 30, 2020).

212 *See* note 102 above and accompanying text.

auditor attestation requirement may be particularly burdensome for these issuers because they include fixed costs that are not scalable for smaller issuers, as also noted by several commenters.[213] Further, low-revenue issuers have limited access to internally generated capital, and so the costs may more directly impact their ability to spend on investments or hiring.[214] We therefore expect that reducing these costs would have a more beneficial impact on small and low-revenue issuers than it would for other issuers. Some commenters similarly expressed the view that the amendments would enhance these issuers' ability to preserve capital without significantly affecting the ability of investors to make informed investment decisions based on the financial reporting of those issuers.[215]

As discussed above, other commenters claimed that eliminating the ICFR auditor attestation requirement would not substantially reduce costs to issuers[216] and that there would be other negative impacts of this change.[217] We acknowledge that the magnitude of these cost savings likely will vary among issuers depending upon their particular facts and circumstances[218] and, as some commenters asserted,[219] ICFR auditor attestations have become less expensive over time because auditors are more experienced in conducting them. However, based on the comments received and our own analysis of available data,[220] we believe the cost reductions from not being subject to the ICFR auditor attestation requirement could be substantial for

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213 *See* letters from ASA, Broadmark, Chamber, and Guaranty.

214 *See, e.g.,* letters from Daré, Summit and Xenon.

215 *See* letters from Andersen, CLSA, Concert, ICBA, and NASBA.

216 *See* note 108 above and accompanying text.

217 *See* notes 110 to 113 above and accompanying text.

218 *See, e.g.*, letters from EY, Grant Thornton, and PWC.

219 *See, e.g.*, letters from CFA Inst. and Deloitte.

220 *See* Section IV.C.2.d.

affected issuers.

We believe the benefits of the ICFR auditor attestation requirement likely are fewer for low-revenue SRCs than for other issuers, an assessment supported by some commenters.[221] As a result, obtaining the ICFR auditor attestation is likely, on average, to be less meaningful for these issuers, and not obtaining one should have less of an impact on investor protection than for other types of issuers. First, we note that low-revenue SRCs may be less susceptible to the risk of certain kinds of misstatements, such as those related to revenue recognition. As discuss in the Economic Analysis,[222] 10 to 20 percent of restatements and about 60 percent of financial disclosure fraud cases in recent times have been associated with improper revenue recognition,[223] which is less of a risk, for example, for issuers that currently have little to no revenue.

Second, as we noted in Table 14 of the Proposing Release,[224] issuers with revenues of less than $100 million have, on average, restatement rates that are three to nine percentage points lower than those for higher-revenue issuers. Moreover, certain low-revenue SRCs likely have less complex financial systems and controls and, therefore, may be less likely than other issuers to fail to detect and disclose material weaknesses in the absence of an ICFR auditor attestation.

Third, we believe that those issuers' financial statements may be less critical to assessing their valuation given, for example, the relative importance of their future prospects. We recognize that other commenters disagreed and asserted that benefits of the ICFR auditor

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221 *See* notes 116 to 118 above and accompanying text.

222 *See* Section IV.C.3. below.

223 *See* Audit Analytics, *2017 Financial Restatements: A Seventeen Year Comparison*, (May 2018), and Committee of Sponsoring Organizations of the Treadway Commission, ("COSO"), *Fraudulent Financial Reporting 1998-2007: An Analysis of U.S. Public Companies* (2010).) ("COSO 2010 Fraud Study"), available at http://www.coso.org/documents/COSO-Fraud-Study-2010-001.pdf.

224 *See* Section III.C.4.b. of the Proposing Release, note 4 above.

attestation requirement are greater for lower-revenue and smaller issuers than for other issuers.[225] We carefully considered these comments and, as discussed in the Economic Analysis, investigated the claims by conducting supplemental analysis, but we did not find evidence that led us to alter our views.[226]

e. Relationship Between Non-Accelerated Filers and SRCs

Under the final amendments, some, but not all, SRCs would become non-accelerated filers. We are not adopting an alternative suggested by some commenters of fully aligning the SRC and non-accelerated filer definitions. As we note in the Economic Analysis,[227] although full alignment of the two definitions could provide several benefits, including greater regulatory simplicity, reducing any frictions or confusion associated with issuers' determination of their filer status or reporting regime, and expanding the number of issuers that qualify as non-accelerated filers, fully aligning the two definitions also could result in costs that are greater than those for the amendments we are adopting. For example, the mitigating factors associated with exempting low-revenue issuers, such as a potential lower susceptibility to the risks of certain kinds of misstatements and a greater role of future prospects relative to current financial statements in driving market valuations for these issuers as compared to other issuers,[228] may not be present or may be more limited, for other types of SRCs.

As a result, fully aligning the SRC and non-accelerated filer thresholds could have adverse effects on the reliability of the financial statements of the issuers with higher revenues

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225 *See* notes 119 to 124 above and accompanying text.

226 *See* Section IV.C.3.a. below.

227 *See* Section IV.C.5.a. below.

228 *See* Section IV.C.3. below.

and the ability of investors to make informed investment decisions about those issuers.[229] Therefore, we do not believe it would be appropriate at this time to increase the public float threshold for non-accelerated filers to align that definition with the SRC definition. Additionally, we note that many non-accelerated filers remain eligible for the JOBS Act Exemption for their first five years as a public company. The table below summarizes the relationships between SRCs and non-accelerated and accelerated filers under the final amendments.

Table 2. Relationships between SRCs and Non-Accelerated, Accelerated, and Large Accelerated Filers under the Final Amendments

Relationships between SRCs and Non-Accelerated, Accelerated, and Large Accelerated Filers under the Final Amendments		
Status	**Public Float**	**Annual Revenues**
SRC and Non-Accelerated Filer	Less than $75 million	N/A
	$75 million to less than $700 million	Less than $100 million
SRC and Accelerated Filer	$75 million to less than $250 million	$100 million or more
Accelerated Filer (not SRC)	$250 million to less than $700 million	$100 million or more
Large Accelerated Filer (not SRC)	$700 million or more	N/A

f. Effect on Business Development Companies

In a change from the proposal, the final amendments also exclude BDCs from the accelerated and large accelerated filer definitions under circumstances that are analogous to the

[229] *Id.*

exclusions for other issuers under the amendments. The amendments include a specific provision applicable to BDCs, because BDCs are not eligible to be SRCs and to provide a definition of "revenue" for BDCs to use for this purpose.[230] Specifically, a BDC will be excluded from the accelerated and large accelerated filer definitions in Rule 12b-2 if the BDC: (1) has a public float of $75 million or more, but less than $700 million; and (2) has investment income of less than $100 million.[231] The amendments to Rule 12b-2 provide that, for this purpose, a BDC's revenue is the BDC's investment income, as defined in Rule 6-07.1 of Regulation S-X.[232] BDCs are subject to the same transition provisions for accelerated filer and large accelerated status that apply to other issuers under the amendments, except that the amendments' BDC-specific "revenue" definition will apply to these transition provisions as well.[233]

Although the Commission did not propose to exclude BDCs from the accelerated and large accelerated filer definitions using the SRC revenue test, the Commission did solicit comment on such an approach and discussed the relative costs and benefits of this alternative in the Proposing Release.[234] In response, one commenter urged that we adopt such an approach, stating that, among other reasons, the policy reasons that support providing regulatory relief to smaller reporting companies should apply equally to smaller BDCs.[235] This commenter

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230 Although a BDC is considered to be eligible to use the requirements for SRCs under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in Rule 12b-2 for purposes of the amended accelerated filer and large accelerated filer definitions, BDCs will continue to be ineligible to be SRCs under the final amendments.

231 *See* paragraphs (1)(iv), (2)(iv), and (4) of the amended definitions of accelerated filer and large accelerated filer in Rule 12b-2. Consistent with the current definitions of these terms, a BDC with public float of less than $75 million is already a non-accelerated filer, regardless of the amount of its annual investment income.

232 *See* 17 CFR 210.6-07.1.

233 *See* Section II.C. below (discussing the amended transition provisions more generally).

234 *See* Sections II.C., II.E., and III.C.6. of the Proposing Release, note 4 above.

235 *See* letter from Proskauer.

suggested that the Commission expand the proposed amendment to the definition of accelerated filer and large accelerated filer to exclude BDCs with total investment income of less than $80 million in the most recently completed fiscal year for which audited financial statements are available and either no public float or public float of less than $700 million.

Although we observed in the Proposing Release that the SRC revenue test would not be meaningful for BDCs because BDCs prepare financial statements under Article 6 of Regulation S-X and generally do not report revenue, the final amendments' definition of "revenue" for purposes of the BDC-specific provisions incorporate information that BDCs report in their financial statements. A BDC's investment income includes income from dividends, interest on securities, and other income.[236] We recognize, as stated in the Proposing Release, that investors in BDCs generally may place greater significance on the financial reporting of BDCs relative to low-revenue non-investment company issuers and BDC financial statements will continue to be audited by an independent auditor. As the commenter supporting this approach observed, however, the policy considerations supporting the final amendments generally apply to BDCs.[237] Moreover, BDCs that are excluded from the accelerated and large accelerated filer definitions will remain obligated, among other things, to establish and maintain internal control over financial reporting and have management assess the effectiveness of internal control over financial reporting. The final amendments also are consistent with other rulemaking initiatives in which we have sought to provide BDCs parity with other reporting companies in appropriate

[236] A BDC's annual investment income is equivalent to annual revenues solely for purposes of the accelerated filer and large accelerated filer definitions. These amendments do not affect the meaning of "revenue" or "investment income" in other Commission rules or provisions of the securities laws.

[237] *See* letter from Proskauer.

circumstances.[238]

g. Effect on Foreign Private Issuers

Under the proposed amendments, an FPI would be excluded from the accelerated and large accelerated filer definitions if it qualifies as an SRC[239] under the SRC revenue test in Exchange Act Rule 12b-2. One commenter asserted that the final amendments should permit an FPI that presents its financial statements using IFRS to qualify for the exemption based on the low-revenue test.[240] We note that foreign issuers that qualify as FPIs or SRCs are permitted to avail themselves of special accommodations unique to each reporting regime, but must select one reporting regime or the other. The final amendments provide an exemption from the ICFR auditor attestation requirement for low-revenue SRCs. Issuers that qualify as FPIs and elect to use the FPI reporting regime have other accommodations available to them, such as the ability to disclose material changes in their ICFR and effectiveness of disclosure controls and procedures on an annual basis, as compared to the quarterly basis required of U.S. issuers, including SRCs.[241]

h. Requiring ICFR Auditor Attestation Less Frequently than Annually

The final amendments do not revise our rules to require an ICFR auditor attestation

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238 *See Securities Offering Reform for Closed-End Investment Companies*, Release No. 33427 (Mar. 20, 2019) [84 FR 14448 (Apr. 10, 2019)].

239 *See* 2007 SRC Adopting Release, note 155 above, Section II, and *Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP*, Release No. 33-8879 (Dec. 21, 2007) [73 FR 985 (Jan. 4, 2008)], Section III.E.4. (stating that an FPI is not an SRC unless it makes its filings on forms available to U.S. domestic issuers and otherwise qualifies to use the SRC scaled disclosure accommodations). We are adding instructions to the SRC definitions in Item 10(f), Rule 405, and Rule 12b-2 clarifying our position that an FPI is not eligible to use the requirements for SRCs unless it uses the forms and rules designated for domestic issuers and provides financial statements prepared in accordance with U.S. GAAP.

240 *See* letter from Dorsey & Whitney.

241 *See* Rule 13a-15(d), Rule 15d-15(d), Item 15(d) of Form 20-F, and General Instruction B(6)(e) of Form 40-F.

requirement less frequently than annually. Issuers that are accelerated or large accelerated filers will be required to obtain an ICFR auditor attestation every year, unless they qualify as EGCs, as under our current rules. We did not propose to revise this requirement, but requested comment on this matter, and every commenter that discussed the subject[242] asserted that issuers that are subject to the ICFR auditor attestation requirement should obtain one annually. A few of these commenters asserted that requiring the ICFR auditor attestation only once every three years would not decrease costs significantly because auditors consider prior year audit results when planning and performing the current year audit, so performing an audit of ICFR every three years would reduce efficiencies gained from performing audits annually and add complexity and costs.[243] Also, one commenter indicated that auditors in many instances may continue to test internal controls in the financial statement audit, which potentially limits any resulting cost reduction.[244]

i. Check Box Indicating Whether an ICFR Auditor Attestation is Included in a Filing

Although we did not propose a requirement that issuers report whether they have obtained an ICFR auditor attestation, we requested comment on whether we should do so. As discussed above,[245] some commenters recommended that the final rule include a requirement for an issuer to prominently disclose in its filing whether an ICFR auditor attestation is included. This type of disclosure was also recommended by the Government Accountability Office

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242 *See, e.g.*, letters from Crowe, KPMG, and NASBA.

243 *See, e.g.*, letters from Crowe and KPMG.

244 *See* letter from KPMG.

245 *See* notes 138 to 143 above and the accompanying text.

("GAO") in a 2013 study of internal controls requirements.[246] No commenters opposed such a requirement. Disclosure of the ICFR auditor attestation is currently required within the auditor's report on the financial statements and management's annual report on ICFR.[247] After reviewing these comments, we are persuaded to add a check box to the cover pages of Forms 10-K, 20-F, and 40-F to indicate whether an ICFR auditor attestation is included in the filing because we agree that more prominent and easily accessible disclosure of this information would be useful to investors and market participants while imposing only minimal burdens on issuers.

Under the new rule, issuers will be required to include the check box on their cover pages in any annual report filed on or after the final amendments' effective date. Once issuers are required to tag the cover page disclosure data using Inline eXtensible Business Reporting Language ("Inline XBRL"), they will also be required to tag this cover page check box disclosure in Inline XBRL because Item 406 of Regulation S-T ("Item 406"),[248] Item 601(b)(104),[249] paragraph 104 to "Instructions as to Exhibits" of Form 20-F, and paragraph B.17 under the "General Instructions" of Form 40-F require those issuers to tag every data point on the cover pages of Form 10-K, Form 20-F, and Form 40-F.[250] We do not expect the incremental compliance burden associated with tagging the additional cover page information to be significant, given that registrants already are being required on a phased-in basis to tag other

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246 *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-582, *Internal Controls: SEC Should Consider Requiring Companies to Disclose Whether They Obtained an Auditor Attestation* (July 2013) ("2013 GAO Study").

247 *See* Item 308 of Regulation S-K and PCAOB AS 3101.

248 17 CFR 232.406.

249 17 CFR 229.601(b)(4).

250 Item 406 mandates that companies required to tag their financial statements in Inline XBRL must also tag their cover page data in Inline XBRL. Operating companies are required to tag their financial statements in Inline XBRL on a phase-in basis. *See Inline XBRL Filing of Tagged Data*, Release No. 33-10514 (June 28, 2018) [83 FR 40846 (July 10, 2018)] and 17 CFR 232.405.

cover page information as well as information in their financial statements.[251]

C. Amendments to Increase the Public Float Transition Thresholds from $50 million to $60 million and $500 million to $560 million and to Add the SRC Revenue Test to the Transition Threshold

1. Proposed Amendments

An issuer initially becomes an accelerated filer after it first meets certain conditions as of the end of its fiscal year, including that it had a public float of $75 million or more but less than $700 million as of the last business day of its most recently completed second fiscal quarter. An issuer initially becomes a large accelerated filer in a similar manner, including that it had a public float of $700 million or more as of the last business day of its most recently completed second fiscal quarter. Once the issuer becomes an accelerated filer, it will not become a non-accelerated filer unless it determines at the end of a fiscal year that its public float had fallen below $50 million on the last business day of its most recently completed second fiscal quarter. Similarly, a large accelerated filer will remain one unless its public float had fallen below $500 million on the last business day of its most recently completed second fiscal quarter. If the large accelerated filer's public float falls below $500 million but is $50 million or more, it becomes an accelerated filer. Alternatively, if the issuer's public float falls below $50 million, it becomes a non-accelerated filer.[252] The purpose of these transition thresholds is to avoid situations in which

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[251] Electronic Data Gathering, Analysis and Retrieval System ("EDGAR") filers that are required by Item 406 to provide cover page Inline XBRL data tagging will be required to tag the ICFR data element only after a revised Document Entity Identifier taxonomy has been posted to SEC.gov and the Commission has adopted a new EDGAR Filer Manual that reflects appropriate changes to the submission of Forms 10-K, 20-F and 40-F.

[252] For example, under the rules prior to these amendments, if an issuer that is a non-accelerated filer determines at the end of its fiscal year that it had a public float of $75 million or more, but less than $700 million, on the last business day of its most recently completed second fiscal quarter, it will become an accelerated filer. On the last business day of its next fiscal year, the issuer must re-determine its public float to re-evaluate its filer status. If the accelerated filer's public float fell to $70 million on the last business day of its most recently completed second fiscal quarter, it would remain an accelerated filer because its public float did not fall below the $50 million transition threshold. Alternatively, if the issuer's public float fell to $49 million, it would then become a non-accelerated filer because its newly determined public float is below $50 million. As another example, an

an issuer frequently enters and exits accelerated and large accelerated filer status due to small fluctuations in its public float.

In the SRC Adopting Release,[253] we amended the SRC rules so that the SRC transition thresholds were set at 80 percent of the corresponding initial qualification thresholds. In the Proposing Release, we proposed to revise the accelerated and large accelerated filer transition thresholds to be 80 percent of the corresponding initial qualification thresholds to align the transition thresholds across the SRC, accelerated filer, and large accelerated filer definitions. Additionally, we indicated that revising these thresholds would limit the cases in which an issuer could be both an accelerated filer and an SRC or a large accelerated filer and an SRC, thereby reducing regulatory complexity.

We proposed to revise the transition threshold for becoming a non-accelerated filer from $50 million to $60 million and the transition threshold for leaving the large accelerated filer status from $500 million to $560 million. We also proposed to add the SRC revenue test to the public float transition thresholds for accelerated and large accelerated filers. If the SRC revenue test were not added to the accelerated filer and large accelerated filer transition provisions, an issuer's annual revenues would never factor into determining whether an accelerated filer could become a non-accelerated filer, or whether a large accelerated filer could become an accelerated or non-accelerated filer. We proposed that an issuer that is already an accelerated filer would

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issuer that has not been a large accelerated filer but had a public float of $700 million or more on the last business day of its most recently completed second fiscal quarter would then become a large accelerated filer at the end of its fiscal year. If, on the last business day of its subsequently completed second fiscal quarter, the issuer's public float fell to $600 million, it would remain a large accelerated filer because its public float did not fall below $500 million. If, however, the issuer's public float fell to $490 million at the end of its most recently completed second fiscal quarter, it would become an accelerated filer at the end of the fiscal year because its public float fell below $500 million. Similarly, if the issuer's public float fell to $49 million, the issuer would become a non-accelerated filer.

[253] *See* note 12 above.

remain one unless either its public float falls below $60 million or it becomes eligible to use the SRC accommodations under the revenue test in paragraph (2) or (3)(iii)(B) of the SRC definition,[254] as applicable.[255] Therefore, under the proposed amendments, an accelerated filer would remain an accelerated filer until its public float falls below $60 million or its annual revenues fall below the applicable revenue threshold ($80 million or $100 million), at which point it would become a non-accelerated filer.

Similarly, we proposed conforming amendments to the large accelerated filer transition provisions for when an issuer that is already a large accelerated filer transitions to either accelerated or non-accelerated filer status. To transition out of large accelerated filer status at the end of the issuer's fiscal year, an issuer would need to have a public float below $560 million as of the last business day of its most recently completed second fiscal quarter or meet the revenue test in paragraph (2) or (3)(iii)(B), as applicable, of the SRC definition. A large accelerated filer would become an accelerated filer at the end of its fiscal year if its public float fell to $60 million or more but less than $560 million as of the last business day of its most recently completed second fiscal quarter and its annual revenues are not below the applicable revenue threshold ($80 million or $100 million). The large accelerated filer would become a non-accelerated filer if its public float fell below $60 million as of the last business day of its most recently completed second fiscal quarter or its annual revenues fell below the applicable revenue threshold ($80

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[254] Paragraph (2) of the SRC definition states that an issuer qualifies as an SRC if its annual revenues are less than $100 million and it has no public float or a public float of less than $700 million. Paragraph (3)(iii)(B) of the SRC definition states, among other things, that an issuer that initially determines it does not qualify as an SRC because its annual revenues are $100 million or more cannot become an SRC until its annual revenues fall below $80 million.

[255] An issuer that is initially applying the SRC definition or previously qualified as an SRC would apply paragraph (2) of the SRC definition. Once an issuer determines that it does not qualify for SRC status, it would apply paragraph (3)(iii)(B) of the SRC definition at its next annual determination.

million or $100 million).[256]

2. Comments

We received very few comments regarding the proposed changes to the transition thresholds. The commenters who discussed the proposed amendments to increase the public float transition thresholds supported them.[257] One commenter also suggested that the Commission consider indexing the thresholds to inflation in a manner similar to the indexing that applies to the EGC definition.[258] Only two commenters addressed the proposed amendments to add the SRC revenue test to the transition thresholds, and these commenters supported that proposal.[259]

3. Final Amendments

After considering the comments, we are adopting the final amendments as proposed. As discussed in greater detail in the Economic Analysis,[260] transition thresholds in Rule 12b-2 are lower than entry thresholds to keep issuers from frequently needing to reclassify their filer status. The frequent reclassifications that would result without the transition thresholds may cause confusion for issuers and investors as to the issuer's status. Also, such frequent reclassifications may increase issuers' costs because they would frequently need to revise their disclosure schedules and

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256 One exception to this requirement is that an issuer that was a large accelerated filer whose public float had fallen below $700 million (but remained $560 million or more) but became eligible to be an SRC under the SRC revenue test in the first year the SRC amendments became effective would become a non-accelerated filer even though its public float remained at or above $560 million. *See* SRC Adopting Release, note 12 above, at n. 31 ("For purposes of the first fiscal year ending after effectiveness of the amendments, a registrant will qualify as a SRC if it meets one of the initial qualification thresholds in the revised definition as of the date it is required to measure its public float or revenues (the 'measurement date'), even if such registrant previously did not qualify as a SRC.").

257 *See, e.g.*, letters from CLSA, Nasdaq, and RSM.

258 *See* letter from RSM.

259 *See* letters from CLSA and Nasdaq.

260 *See* Section IV.C.4.c below.

continually consider the impact of whether they are subject to the ICFR auditor attestation requirement from one year to the next, and may increase investors' incremental costs of evaluating the reliability of the issuer's financial disclosures. Therefore, we believe a transition threshold is appropriate. However, we recognize that providing a transition threshold results in some issuers remaining in their filer status even though their public float or revenues are below that filer status's entry threshold.

The final amendments revise the public float transition threshold for accelerated and large accelerated filers to become a non-accelerated filer from $50 million to $60 million and revise the public float transition threshold for a large accelerated filer to lose its large accelerated filer status from $500 million to $560 million. Prior to the final amendments, the public float threshold for an accelerated and large accelerated filer to become a non-accelerated filer was $50 million and the public float transition threshold for a large accelerated filer to lose its large accelerated filer status was $500 million. We believe these threshold amounts are too low and result in more issuers than intended being classified as an accelerated or large accelerated filer. However, we believe there should be some transition threshold so as to avoid some volatility. The amendments would make the public float transition thresholds 80 percent of the initial thresholds, which is consistent with the percentage used in the transition thresholds for SRC eligibility. We believe this approach appropriately balances the risk of frequent reclassifications resulting from a higher percentage threshold against the risk of delaying appropriate transitions due to a lower threshold. The table below summarizes how an issuer's filer status will change based on its subsequent public float determination.

Table 3. Subsequent Determination of Filer Status Based on Public Float under Final Amendments

Final Amendments to the Public Float Thresholds			
Initial Public Float Determination	**Resulting Filer Status**	**Subsequent Public Float Determination**	**Resulting Filer Status**
$700 million or more	Large Accelerated Filer	$560 million or more	Large Accelerated Filer
		Less than $560 million but $60 million or more	Accelerated Filer
		Less than $60 million	Non-Accelerated Filer
Less than $700 million but $75 million or more	Accelerated Filer	Less than $700 million but $60 million or more	Accelerated Filer
		Less than $60 million	Non-Accelerated Filer

The final amendments also add the SRC revenue test to the transition threshold for accelerated and large accelerated filers. As we noted in the Proposing Release, if we do not add the SRC revenue test to the accelerated filer and large accelerated filer transition provisions, an issuer's annual revenues would never factor into determining whether an accelerated filer could become a non-accelerated filer, or whether a large accelerated filer could become an accelerated or non-accelerated filer. We note that one commenter stated that the manner in which issuers may recognize revenue could cause them to frequently lose and gain non-accelerated filer status.[261] We believe that providing transition thresholds should mitigate any such concern.

Under the final amendments, an accelerated filer with revenues of $100 million or more that is eligible to be an SRC based on the public float test contained in paragraphs (1) and

[261] *See* letter from EY.

(3)(iii)(A) of the SRC definition can transition to non-accelerated filer status in a subsequent year if it has revenues of less than $100 million. For example, an issuer with a December 31 fiscal year end that did not exceed the public float threshold in the prior year and that has a public float, as of June 30, 2020, of $230 million and annual revenues for the fiscal year ended December 31, 2019 of $101 million will be eligible to be an SRC under the public float test; however, because the issuer would not be eligible to be an SRC under the SRC revenue test, it will be an accelerated filer (assuming the other conditions described in Table 1 are also met). At the next determination date (June 30, 2021), if its public float, as of June 30, 2020, remains at $230 million and its annual revenues for the fiscal year ended December 31, 2019 are less than $100 million, the issuer will be eligible to be an SRC under the SRC revenue test (in addition to the public float test) and thus it will become a non-accelerated filer.

On the other hand, an issuer with a December 31 fiscal year end that has a public float, as of June 30, 2020, of $400 million and annual revenues for the fiscal year ended December 31, 2019 of $101 million will not be eligible to be an SRC under either the public float test or the SRC revenue test and will be an accelerated filer (assuming the other conditions described in Table 1 also are met). At the next determination date (June 30, 2021), if its public float, as of June 30, 2021, remains at $400 million, that issuer will not be eligible to be an SRC under the SRC revenue test unless its annual revenues for the fiscal year ended December 31, 2020 are less than $80 million, at which point it will be eligible to be an SRC under the SRC revenue test and to become a non-accelerated filer.

D. Transition Issues

The final amendments will become effective 30 days after they are published in the Federal Register. The final amendments will apply to an annual report filing due on or after the effective date. Even if that annual report is for a fiscal year ending before the effective date, the

issuer may apply the final amendments to determine its status as a non-accelerated, accelerated, or large accelerated filer. For example, an issuer that has a March 31, 2020 fiscal year end and that is due to file its annual report after the effective date of the amendments may apply the final amendments to determine its filing status even though its fiscal year end date precedes the effective date. An issuer that determines it is eligible to be a non-accelerated filer under the final amendments will not be subject to the ICFR auditor attestation requirement for its annual report due and submitted after the effective date of the amendments and may comply with the filing deadlines that apply, and other accommodations available, to non-accelerated filers.

III. OTHER MATTERS

If any of the provisions of these amendments, or the application of these provisions to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application. Pursuant to the Congressional Review Act,[262] the Office of Information and Regulatory Affairs has designated these amendments as not "a major rule," as defined by 5 U.S.C. 804(2).

IV. ECONOMIC ANALYSIS

We are mindful of the costs and benefits of the amendments. The discussion below addresses the economic effects of the amendments, including their anticipated costs and benefits, as well as the likely effects of the amendments on efficiency, competition, and capital formation.[263] We also analyze the potential costs and benefits of reasonable alternatives to the

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[262] 5 U.S.C. 801 *et seq*.

[263] Section 2(b), 15 U.S.C. 77b(b), and Section 3(f) of the Exchange Act, 15 U.S.C. 78c(f), directs the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Further, Section 23(a)(2) of the Exchange Act, 15

amendments. Where practicable, we have attempted to quantify the economic effects of the amendments; however, in certain cases, we are unable to do so because either the necessary data are unavailable or certain effects are not quantifiable. In these cases, we provide a qualitative assessment of the likely economic effects.

A. Introduction

As discussed above, we are adopting amendments to the definitions of "accelerated filer" and "large accelerated filer" that will generally extend non-accelerated filer status to issuers with up to $700 million in public float if they are eligible to be SRCs and their revenues are less than $100 million. As non-accelerated filers, among other things, these issuers will not be required to obtain an ICFR auditor attestation pursuant to SOX Section 404(b). The amendments are intended to reduce compliance costs for these issuers while maintaining investor protections by more appropriately tailoring the types of issuers that are included in the categories of accelerated and large accelerated filers.

In the Proposing Release, we presented evidence that the imposition of the ICFR auditor attestation requirement has been associated with benefits to issuers and investors, such as reduced rates of ineffective ICFR and more reliable financial statements.[264] However, as explained in the Proposing Release, the affected issuers may find the costs of this requirement to be particularly burdensome given certain fixed costs that may not scale with size. Importantly, because these issuers have limited access to internally-generated capital, savings on compliance costs may be more likely to be applied to additional investment, research, or hiring.

U.S.C. 78w(a)(2), requires the Commission, when making rules under the Exchange Act, to consider the impact that the rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

[264] *See* Section III.C.4.a. of the Proposing Release, note 4 above,. *See also* Section IV.C.3.a. below.

We acknowledged, in the Proposing Release, that exempting these low-revenue issuers from the ICFR auditor attestation requirement may result in adverse effects such as an increased prevalence of ineffective ICFR and restatements, and we estimated the potential effects on the rates of such issues among the affected issuers. At the same time, we provided evidence in support of two mitigating factors specific to the affected issuers.[265] First, we documented that low-revenue issuers have relatively low rates of restatement, which could mean that the affected issuers may, on average, be less susceptible to the risk of certain kinds of misstatements. Next, we provided evidence that the market value of the low-revenue issuers was not as associated with contemporary financial statements as for higher-revenue issuers, which could imply that their valuations are driven to a greater degree by their future prospects.

Commenters raised a number of concerns with our analysis and conclusions in the Proposing Release. We carefully reviewed all of the comments received and in a few instances, conducted supplemental analysis in response to the issues and questions raised by those comments. Overall, based on our analysis of the available evidence and data, our primary conclusions have not substantively changed. While we address the comments in detail in the body of the Economic Analysis below, we highlight certain of our findings in relation to some commenter concerns here.

One concern raised by commenters is that rather than targeting issuers where there may be relatively fewer benefits of the ICFR auditor attestation requirement, the amendments will remove this requirement for exactly those issuers where the benefits may be greatest.[266] These

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[265] We also noted in the Proposing Release, note 4 above, that issuers exempted from this requirement may choose to voluntarily obtain an ICFR auditor attestation if investors demand it or the issuers otherwise deem it, from their perspective, to be the best use of their resources.

[266] *See, e.g.,* letters from CFA, CFA Inst., and CII. *See also* Commissioner Jackson's Statement.

commenters supported this assertion by, for example, claiming that investors react more strongly to news of restatements or material weaknesses in ICFR—and thus care more about the benefits of an ICFR auditor attestation—at small or low-revenue issuers as compared to other issuers.[267] In response to these comments, we have conducted additional analyses of the investor response to ICFR disclosures and restatement announcements. We do not find any evidence that investors react more negatively to restatements or to auditors reporting material weaknesses in ICFR at low-revenue issuers than at higher-revenue issuers. Further, based on the suggestions of a commenter,[268] we have refined our analysis of the extent to which financial statement variables are associated with the valuation of different types of issuers. We continue to find that financial statement variables explain a greater amount of the variation in stock prices and returns for higher-revenue issuers than for low-revenue issuers, even when we focus on more seasoned issuers similar to those that would be affected by the amendments or when we expand the set of variables that we consider. Overall, our analysis does not provide support for the assertion that investors care more about the information produced by the ICFR auditor attestation requirement at low-revenue issuers than at other issuers.

A few commenters asserted that the costs of the amendments will significantly outweigh any benefits.[269] We have conducted supplemental analysis and quantification of the potential costs of the amendments and do not find evidence to support the views of these commenters. We carefully considered the cost estimates provided by commenters and found them useful in refining our own analysis. However, we found some of these estimates to be overstated. For

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[267] *Id*.

[268] *See* letter from Crowe.

[269] *See, e.g.,* letters from Better Markets and Prof. Barth *et al*.

example, some estimates applied costs associated with a small fraction of issuers to all of the affected issuers or implicitly compared aggregate estimates of costs over multiple years to the estimated savings for a single year.[270] Others identified investor harms that occurred despite the ICFR auditor attestation requirement being in place, which may demonstrate the limitations of the ICFR auditor attestation requirement rather than informing us of the risks of removing the requirement.[271]

Some commenters stated that the Proposing Release did not provide sufficient quantification of the costs of the amendments.[272] In response to those comments, as additional context for our consideration of the possible effects of the final amendments, we conducted supplemental analysis of the expected frequency, type, and magnitude of potential adverse effects. We consider effects resulting from potential misreporting about the effectiveness of ICFR as well as those driven by potential changes in the actual effectiveness of ICFR. Where possible, we estimate dollar costs as well as dollar transfers across shareholders, which represent costs to some shareholders and benefits to other shareholders. We note that these cost estimates do not fully adjust for the mitigating factors that we find to be associated with low-revenue issuers and may therefore be inflated. Also, we caution against attempts to over-interpret the relation between our quantitative estimates of monetized benefits and monetized costs because we are not able to place dollar values on all of the potential costs and benefits of the amendments.

Several commenters argued that the expected cost savings are too small to be

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[270] *See* letter from Prof. Barth *et al.* (with respect to quantified benefits of ICFR audit for the average company).

[271] *See* letters from Better Markets and Prof. Barth *et al.* (with respect to estimates of income and stock market impact of restatements).

[272] *See, e.g.,* letters from Better Markets, CFA Inst., CII, Prof. Barth *et al*., and Prof. Ge *et al*.

economically meaningful,[273] and that the amendments are unlikely to have capital formation benefits.[274] We acknowledge that, while the amendments could be a positive factor in the decision of additional companies to enter public markets, it may not be the decisive factor, and the direct impact of the amendments on the number of public companies may be limited to the extent that companies may be more focused on other factors associated with the decision to go public. However, we continue to believe that the expected savings is likely, in many cases, to represent a meaningful cost savings for the affected issuers.[275] In particular, while the average annual cost savings may represent a small percentage of the average affected issuers' revenues and market capitalizations, it is still likely to be meaningful given that the net income and operating cash flows of the affected issuers are typically negative.[276] These savings may thus have beneficial economic effects on net capital formation through the productive use of this preserved capital towards, for example, new investments.

Some commenters indicated that the Proposing Release did not adequately consider the risk of fraud,[277] or that the risks of fraudulent financial reporting may be particularly high for low-revenue issuers.[278] We acknowledge the argument that incentives to engage in misconduct could be different for low-revenue issuers and, in response to these comments, we conducted

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[273] *See, e.g.,* letters from CFA, CFA Inst., CII, and Prof. Barth *et al*.

[274] *See, e.g.,* letters from Better Markets, CII, CFA, CFA Inst., and Prof. Ge *et al.*

[275] One commenter requested that we replicate, with recent data, the analysis in a previous study that found a "bunching" of firms below the public float threshold for entering accelerated filer status, in order to explore whether the costs of the ICFR auditor attestation requirement remain as high as previously documented. *See* letter from Prof. Honigsberg, *et al*. *See also* Commissioner Jackson's Statement. As discussed in more detail below, we provide this analysis and find that there may be some such "bunching," but we note that our conclusion that the cost savings may be meaningful to the affected issuers does not rely on this analysis or the related study.

[276] *See* note 362 below.

[277] *See, e.g.,* letters from CFA Inst., CII, and Prof. Barth *et al*.

[278] *See, e.g.,* letter from CFA, CFA Inst., CII and Prof. Barth *et al.*

supplemental analysis concerning the risk of fraud. In particular, we conducted an analysis to investigate this risk and did not find evidence based on the available data that low-revenue issuers that, like the affected issuers, are not within five years of their IPO ("seasoned" issuers), are more highly represented in the set of seasoned issuers associated with financial misconduct or financial reporting fraud than they are in the overall population of seasoned issuers. We also estimated the extent to which expanding the exemption from the ICFR auditor attestation requirement could affect the likelihood of the affected issuers engaging in such activities and include a quantification of the associated costs of this risk in our overall assessment of the potential costs of the amendments. Overall, this supplemental analysis does not cause us to change our primary conclusions regarding the potential effects of the amendments.

The economic analysis also considers other changes associated with the amendments. For example, the affected issuers will be permitted an additional 15 days and five days, respectively, after the end of each period to file their annual and quarterly reports, relative to the deadlines that apply to accelerated filers.[279] The amendments also revise the transition provisions for accelerated and large accelerated filer status, including increasing the public float thresholds to exit accelerated and large accelerated filer status from $50 million and $500 million in public float to $60 million and $560 million in public float. Additionally, the amendments introduce a new check-box disclosure on the cover page of annual reports on Forms 10-K, 20-F, and 40-F to indicate whether an ICFR auditor attestation is included in the filing.

The discussion that follows examines the potential benefits and costs of the amendments in detail. As part of our analysis, we consider both the comments received on the Proposing

[279] Non-accelerated filers also are not required to provide disclosure required by Item 1B of Form 10-K and Item 4A of Form 20-F about unresolved staff comments on their periodic and/or current reports or disclosure required by Item 101(e)(4) of Regulation S-K about whether they make filings available on or through their Internet websites.

Release and the likelihood that the effects of the ICFR auditor attestation have changed over time with changes in auditing standards and other market conditions.

B. Baseline

To assess the economic impact of the amendments, we are using as our baseline the current state of the market under the existing definition of "accelerated filer." This section discusses the current regulatory requirements and market practices. It also provides statistics characterizing accelerated filers, the timing of filings, disclosures about ineffective ICFR, and restatement rates under the baseline.

1. Regulatory Baseline

Our baseline includes existing statutes and Commission rules that govern the responsibilities of issuers with respect to financial reporting, as well as PCAOB auditing standards and market standards related to the implementation of these responsibilities.

In particular, accelerated and large accelerated filers are subject to accelerated filing deadlines for their periodic reports relative to non-accelerated filers. These deadlines are summarized in Table 4 below. All registrants can file Form 12b-25 ("Form NT") to avail themselves of an additional 15 calendar days to file an annual report, or an additional five calendar days to file a quarterly report, and still have their report deemed to have been timely filed.

Table 4. Filing Deadlines for Periodic Reports

	Calendar Days after Period End	
Category of Filer	Annual	Quarterly
Non-Accelerated Filer	90 days	45 days
Accelerated Filer	75 days	40 days
Large Accelerated Filer	60 days	40 days

The Proposing Release discusses in detail the issuer and auditor responsibilities with respect to disclosure controls and procedures and ICFR for issuers of different filer types.[280] These responsibilities derive from the FCPA requirements with respect to internal accounting controls as well as a number of different changes to financial reporting that were introduced by SOX.

In particular, all issuers[281] are required to devise and maintain an adequate system of internal accounting controls[282] and to have their corporate officers assess the effectiveness of the issuer's disclosure controls and procedures[283] and disclose the conclusions of their assessments, typically on a quarterly basis.[284] In addition, all issuers are required to have their corporate officers certify in each of their periodic reports that the information in the report fairly presents, in all material respects, the issuer's financial condition and results of operations.[285] All issuers

[280] See Sections II.B. and III.B.1. of the Proposing Release, note 4 above.

[281] Specifically, the requirements apply to all issuers that file reports pursuant to Section 13(a) or 15(d) of the Exchange Act.

[282] *See* Section 13(b)(2)(B) of the Exchange Act.

[283] *See* note 209 above.

[284] *See* note 210 above.

[285] *See* 17 CFR 240.13a-14(b) and 17 CFR 240.15d-14(b).

other than RICs and asset-backed securities ("ABS") issuers[286] are also required to include management's assessment of the effectiveness of their ICFR in their annual reports.[287] Further, all issuers are required to have the financial statements in their annual reports examined and reported on by an independent auditor, who, even if not engaged to provide an ICFR auditor attestation, is responsible for considering ICFR in the performance of the financial statement audit.[288] Also, an auditor engaged in a financial statement only audit may test the operating effectiveness of some internal controls in order to reduce the extent of substantive testing performed in the audit. Importantly, all of these responsibilities with respect to financial reporting and ICFR apply equally to non-accelerated as well as accelerated and large accelerated filers. Finally, all issuers listed on national exchanges are required to have an audit committee that is composed solely of independent directors and is directly responsible for the appointment, compensation, retention and oversight of the issuer's independent auditors.[289] The amendments do not change any of these requirements, including the requirements of a financial statement audit.

Beyond these requirements, accelerated filers and large accelerated filers other than

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286 *See* 17 CFR 240.13a-15 and 17 CFR 240.15d-15. A newly public issuer is also not required to provide a SOX Section 404(a) management report on ICFR until its second annual report filed with the Commission. *See* Instructions to Item 308 of Regulation S-K.

287 *See Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*, Release No. 33-8238 (June 5, 2003) [68 FR 36635 (June 18, 2003)]. These evaluations of ICFR, as well as any associated ICFR auditor attestations, should be based on a suitable, recognized control framework. The most widely used framework for this purpose is the one set forth in a report of the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

288 *See* PCAOB AS 2110, note 187 above. *See also* the discussion below in this section about this auditing standard.

289 *See* 17 CFR 240.10A-3. In the absence of an ICFR auditor attestation requirement, we note that the audit committee is responsible for approving whether to voluntarily obtain an ICFR auditor attestation, and would be alerted by the auditor engaged in a financial statement only audit if the auditor becomes aware of a significant deficiency or material weakness in ICFR.

EGCs, RICs, and ABS issuers are required under SOX Section 404(b) and related rules to include an ICFR auditor attestation in their annual reports. In addition, certain banks, even if they are non-accelerated filers, are required under Federal Deposit Insurance Corporation ("FDIC") rules to have their auditor attest to, and report on, management's assessment of the effectiveness of the bank's ICFR (the "FDIC auditor attestation requirement").[290]

One commenter raised questions about the nature of the FDIC auditor attestation requirement and how it compares to the ICFR auditor attestation requirement.[291] For banks that are subject to the ICFR auditor attestation requirement, the FDIC regulations require ICFR attestation engagements to be performed according to the same standards as the ICFR auditor attestation requirement under SOX Section 404(b) (*i.e.*, AS 2201,[292] as discussed below).[293] For other banks, the FDIC allows ICFR attestations to be performed either according to AS 2201 or according to the American Institute of Certified Public Accountants ("AICPA") attestation standard.[294] In 2015, the Auditing Standards Board of the AICPA issued Statement on Auditing Standards ("SAS") No. 130, revising their attestation standard with the intention of adhering as closely as possible to AS 2201 while aligning with their generally accepted auditing standards and avoiding unintended consequences in practice.[295] The FDIC also requires that the attestation

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290 Part 363 of the FDIC regulations requires that the auditor of an insured depository institution with consolidated total assets of $1 billion or more (as of the beginning of the fiscal year) examine, attest to, and report separately on the assertion of management concerning the effectiveness of the institution's internal control structure and procedures for financial reporting.

291 *See* letter from CFA Inst.

292 *See* AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* ("AS 2201").

293 *See* Section 18A of Appendix A to Part 363 of the FDIC regulations.

294 *Id*.

295 *See* Executive Summary to SAS 130 (October 2015), available at https://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/SAS_130_Summary.pdf.

reports be made available for public inspection (at the bank's main and branch offices or, alternatively, by mail to anyone who requests it).[296] Per Section IV.B.4 below, material weaknesses reported in SOX Section 404(a) reports and the corresponding SOX Section 404(b) reports typically mirror each other, so material weaknesses identified by the FDIC auditor attestation may also become publicly known via corresponding SOX Section 404(a) management reports. Finally, we note that FDIC and Federal Reserve examiners may also independently review and assess the adequacy of ICFR of banks.

Some issuers that are not required to comply with SOX Section 404(b) voluntarily obtain an ICFR auditor attestation.[297] Estimates of the number of issuers of each filer type are provided in Table 5 below.[298]

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[296] *See* Section 363.4 of Part 363 of the FDIC regulations.

[297] Up to about seven percent of exempt issuers voluntarily provided an ICFR auditor attestation from 2005 through 2011. *See* 2013 GAO Study, note 246 above. We find similar results when examining data for non-accelerated filers and EGCs in calendar years 2014 through 2018 from Ives Group Audit Analytics to identify, among issuers of these types that have a SOX Section 404(a) management report, how many also have an ICFR auditor attestation report available in the database. *See* note 298 below regarding the identification of filer types.

[298] The estimates in this table are based on staff analysis of self-identified filer status for issuers filing annual reports on Forms 10-K, 20-F, or 40-F in calendar year 2018, excluding any such filings that pertain to fiscal years prior to 2017. Staff extracted filer status from filings using a computer program supplemented with hand collection and compared the results for robustness with data from XBRL filings, Ives Group Audit Analytics, and Calcbench. FPIs represent those filing on Forms 20-F or 40-F and do not include FPIs that choose to file on Form 10-K. EGC issuers are identified by using data from Ives Group Audit Analytics and/or by using a computer program to search issuer filings, including filings other than annual reports, for a statement regarding EGC status. The estimates generally exclude RICs because these issuers do not file on the annual report types considered. This table also excludes 143 issuers, mostly Canadian MJDS issuers filing on Form 40-F (which does not require disclosure of filer status or public float), for which filer type is unavailable.

Table 5. Filer Status for Issuers Filing Annual Reports in 2018

	Non-Accelerated*	Accelerated	Large Accelerated
FPI	265	137	264
EGC	1,097	333	0
Total	3,900	1,416	2,266

* The estimated number of non-accelerated filers includes approximately 621 ABS issuers, which are not required to comply with SOX Section 404. Staff estimates that very few, if any, ABS issuers are accelerated or large accelerated filers. ABS issuers are identified as issuers that made distributions reported via Form 10-D.

Audits of ICFR and the associated ICFR auditor attestation reports are made in accordance with AS 2201,[299] previously known as Auditing Standard Number 5 ("AS No. 5").[300] This standard, which replaced Auditing Standard Number 2 ("AS No. 2") in 2007, was intended to focus auditors on the most important matters in the audit of ICFR and eliminate procedures that the PCAOB believed were unnecessary to an effective audit of ICFR.[301] Among other things, the 2007 standard facilitates the scaling of the evaluation of ICFR for smaller, less complex issuers by, for example, encouraging auditors to use top-down risk-based approaches and to use the work of others in the attestation process.[302] It was accompanied by Commission guidance similarly facilitating the scaling of SOX Section 404(a) management evaluations of

299 *See* note 292 above.

300 AS No. 5 was renumbered as AS 2201, note 292 above, effective Dec. 31, 2016. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015).

301 *See Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements, and Related Independence Rule and Conforming Amendments*, PCAOB Release No. 2007-005A (June 12, 2007). *See also Public Company Accounting Oversight Board; Order Approving Proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, a Related Independence Rule, and Conforming Amendments*, Release No. 34-56152, File No. PCAOB 2007-02 (July 27, 2007) [72 FR 42141 (Aug. 1, 2007)].

302 *Id.*

ICFR.[303]

The adoption of AS 2201 in 2007 has been found to have lowered audit fees.[304] However, several studies have provided evidence that, at least initially, after the adoption of AS 2201, the quality of ICFR of issuers subject to the ICFR auditor attestation requirement decreased relative to that of other issuers.[305] Around 2010, PCAOB inspections of auditors began to include a heightened focus on whether auditing firms had obtained sufficient evidence to support their opinions on the effectiveness of ICFR.[306] There is some evidence that these inspections have led to an improvement in the reliability of ICFR auditor attestations,[307] but also concerns that audit fees also increased around the same time.[308]

In 2010, the PCAOB adopted enhanced auditing standards related to the auditor's

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303 *See Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934*, Release No. 33-8810 (June 20, 2007) [72 FR 35323 (June 27, 2007)]. *See also Amendments to Rules Regarding Management's Report on Internal Control Over Financial Reporting*, Release No. 33-8810 (June 20, 2007) [72 FR 35309 (June 27, 2007)].

304 *See, e.g.*, *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements* (Sept. 2009) ("2009 SEC Staff Study"), available at https://www.sec.gov/news/studies/2009/sox-404_study.pdf; Rajib Doogar, Padmakumar Sivadasan, & Ira Solomon, 48(4) J. OF ACCT. RES. 795 (2010).

305 *See*, *e.g.*, Joseph Schroeder & Marcy Shepardson, *Do SOX 404 Control Audits and Management Assessments Improve Overall Internal Control System Quality?*, 91(5) ACCT. REV. 1513 (2016) ("Schroeder and Shepardson 2016 Study"); Lori Bhaskar, Joseph Schroeder, & Marcy Shepardson, *Integration of Internal Control and Financial Statement Audits: Are Two Audits Better than One?* ACCT. REV. (forthcoming 2018) ("Bhaskar *et al.* 2018 Study"), available at http://aaajournals.org/doi/abs/10.2308/accr-52197. *See* Section IV.C.3.a. and notes 464 and 474 below for more information on these studies.

306 *See* Jeanette Franzel, Board Member, PCAOB, Speech by PCAOB board member at the American Accounting Association Annual Meeting, *Current Issues, Trends, and Open Questions in Audits of Internal Control over Financial Reporting* (2015), available at https://pcaobus.org//News/Speech/Pages/08102015_Franzel.aspx.

307 *See* Mark Defond & Clive Lennox, *Do PCAOB Inspections Improve the Quality of Internal Control Audits?*, 55(3) J. OF ACCT. RES. 591 (2017) ("Defond and Lennox 2017 Study").

308 *See, e.g.*, Tammy Whitehouse, *Audit Inspections: Improvement? Maybe. Costs? Yes*, Compliance Week (April 14, 2015), available at https://www.complianceweek.com/news/news-article/audit-inspections-improvement-maybe-costs-yes#.W5LW7mlpCEd; and Jennifer McCallen, Roy Schmardebeck, Jonathan Shipman, & Robert Whited, *Have the Costs and Benefits of SOX Section 404(b) Compliance Changed Over Time?*, Working Paper (Nov. 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3420787 ("McCallen *et al.* 2019 study").

assessment of and response to risk.[309] The enhanced risk assessment standards have likely reduced, to some extent, the degree of difference between a financial statement only audit and an integrated audit (which includes an audit of ICFR) because the standards clarify and augment the extent to which internal controls are to be considered even in a financial statement only audit. In particular, the risk assessment standards applying to both types of audits require auditors, in either case, to evaluate the design of certain controls, including whether the controls are implemented.[310]

Based on the results of inspections in the several years after the adoption of the new risk assessment auditing standards, the PCAOB expressed concern about the number and significance of deficiencies in auditing firm compliance with these standards, but also noted promising improvements in the application of these standards.[311] While the risk assessment standards may reduce the degree of difference between a financial statement only audit and an integrated audit, there remain important differences in the requirements of these audits as they relate to controls. For example, in an integrated audit, but not a financial statement only audit, the auditor is required to identify likely sources of misstatements in considering the evaluation of ICFR.[312] Also, the extent of the procedures necessary to obtain the required understanding of controls generally will be greater in an integrated audit due to the different objectives of such an audit as

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309 *See* PCAOB Release No. 2010-004 and PCAOB Release No. 2010-01, note 193 above.

310 *See* AS 2110, paragraphs .18-.40, note 187 above.

311 *See* PCAOB Release No. 2015-007, note 195 above.

312 *See* PCAOB Release No. 2010-004, note 309 above, at 7 and A10-41. As discussed above, even in a financial statement only audit, if the auditor becomes aware of a significant deficiency or material weakness in ICFR, it is required to inform management and the audit committee of this finding and has the responsibility to review management's disclosure for any misstatement of facts, such as a statement that ICFR is effective when there is a known material weakness. *See* notes 190 to 191 above and the accompanying text.

compared to a financial statement only audit.[313]

The Commission recently settled charges against four public companies for failing to maintain effective ICFR for seven to 10 consecutive annual reporting periods.[314] These enforcement cases may have a deterrent effect among issuers failing to remediate material weaknesses, which might reduce the overall rate of persistence of material weaknesses in ICFR.

We also note that there have been some recent changes in accounting and auditing that are part of our baseline and could increase the uncertainty of our analysis due to their effects on factors such as audit fees, restatements, and ICFR. For example, three new reporting standards have been issued recently by FASB, on the topics of revenue recognition, leases, and credit losses, which could temporarily increase audit fees as issuers and auditors adjust to the new standards.[315] Recent changes in technology, such as the potential for management to use automated controls testing and process automation,[316] may result in improvements in ICFR regardless of the ICFR auditor attestation requirement if their increased application results in more robust financial reporting processes with fewer opportunities for deficiencies and/or in an increase by management in control testing and related improvements. Such automation could also reduce audit fees, including the costs of an audit of ICFR, but at least one report suggests that the uptake of these technologies has been slow.[317] Finally, auditors have had many years of experience with integrated audits, as well as risk assessment standards that require the

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313 *See Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Conforming Amendments to PCAOB Standards*, PCAOB Release No. 2008-006 A9-8 (Oct. 21, 2008).

314 *See* SEC Press Release, note 196 above.

315 Information on these and other FASB Accounting Standards updates is available at https://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498.

316 *See, e.g.*, Robotic Process Automation, note 197 above.

317 *See, e.g.*, Protiviti survey results, *Benchmarking SOX Costs, Hours and Controls* (2018) ("Protiviti 2018 Report").

consideration of ICFR even in the absence of an ICFR auditor attestation. This experience may affect their execution of financial statement only audits of issuers for whom the ICFR auditor attestation requirement is eliminated. For example, given their experience, auditors may be more likely to detect control deficiencies or to increase their auditing efficiency by reducing substantive testing in favor of testing some related controls even when an ICFR auditor attestation is not required.[318]

2. Characteristics of Accelerated Filer Population

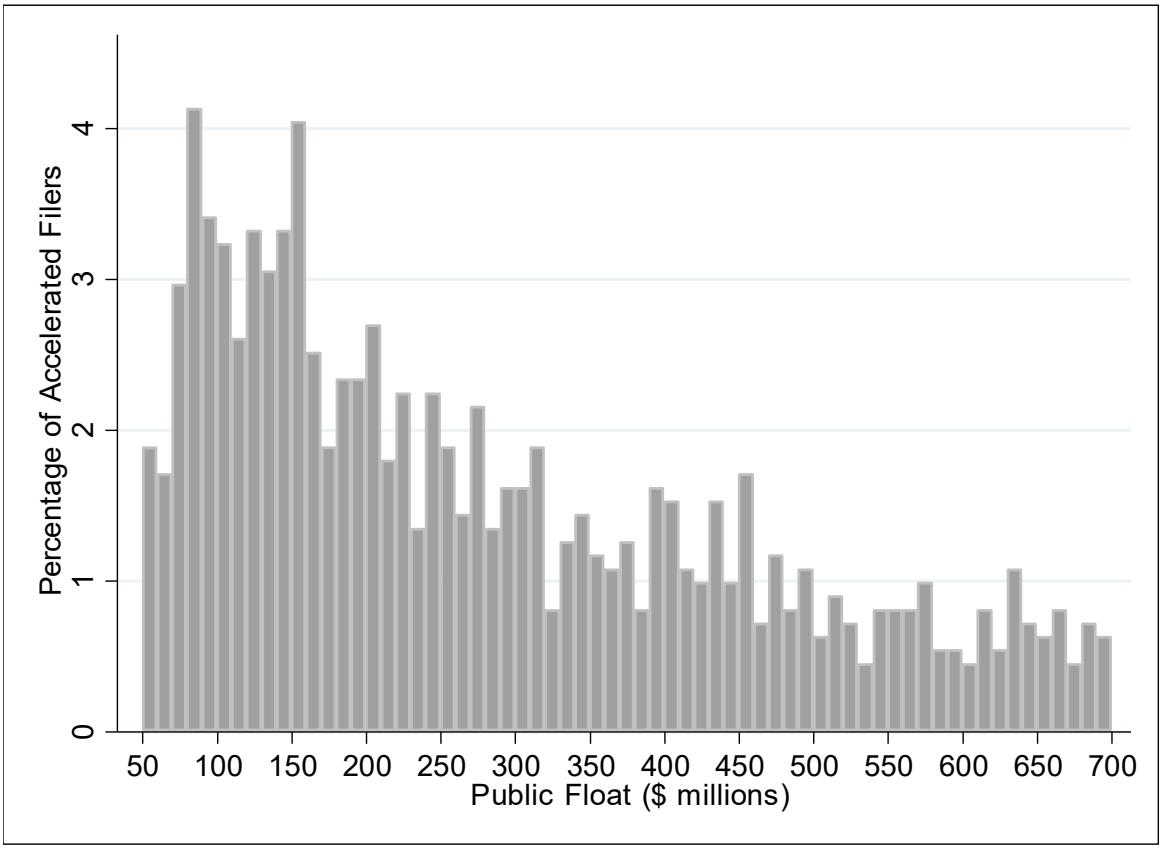
Per Table 5, there were approximately 1,400 accelerated filers in total in 2018. Figure 2[319] presents the distribution of public float across these issuers.[320]

[318] 2011 SEC Staff Study, note 198 above, (stating that "…once effective controls are in place at the issuer, the auditor is more likely to continue to test them even if [it is] not issuing an auditor attestation during a particular year in order to rely on them for purposes of reducing substantive testing in the audit of the financial statements, particularly for issuers that are larger and more complex").

[319] The estimates in the figure are based on staff analysis of data from XBRL filings. *See* note 298 above for details on the identification of the population of accelerated filers.

[320] Because of the accelerated filer transition provisions, some accelerated filers have float below $75 million. The public float of these issuers would previously have exceeded $75 million, causing them to enter accelerated filer status, but has not dropped below the $50 million public float level required to exit accelerated filer status.

Figure 2. Distribution of public float of accelerated filers in 2018

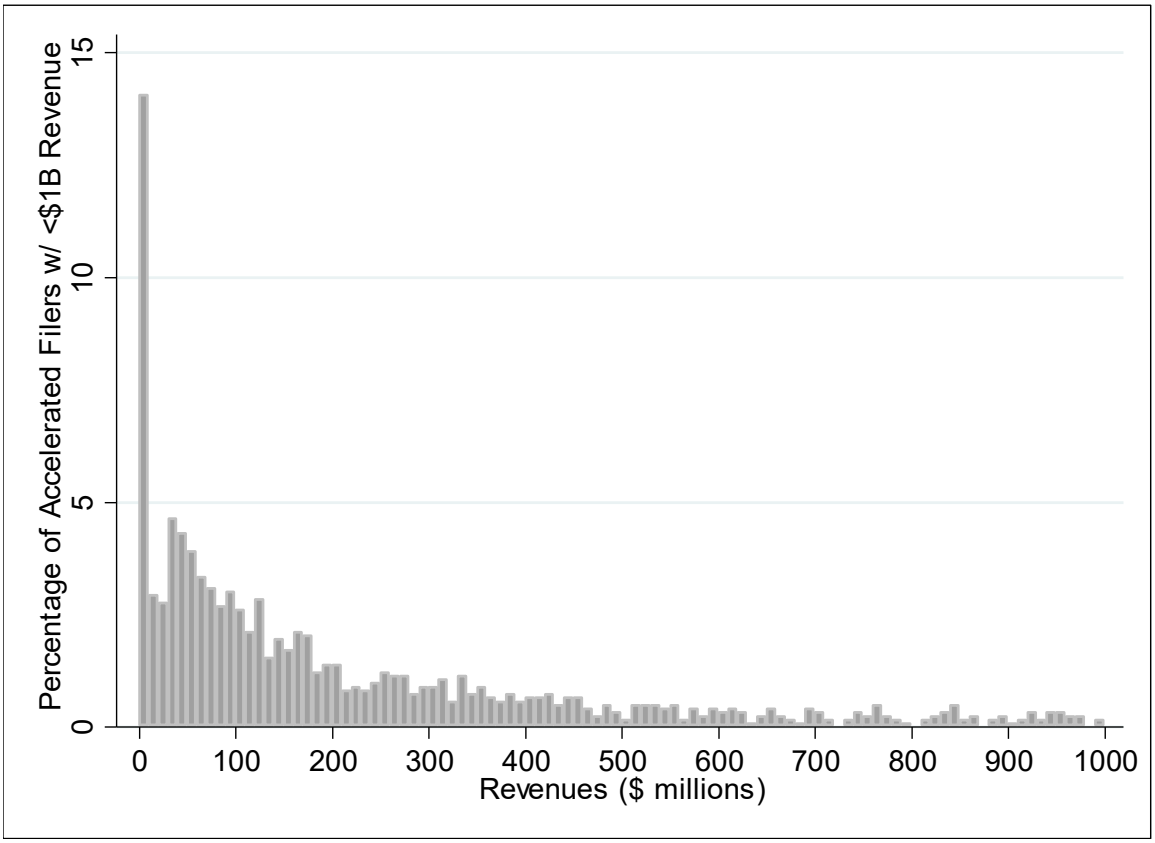


The distribution of public float among accelerated filers is skewed towards lower levels of float, but higher levels of float are also significantly represented.

Figure 3[321] presents the distribution of revenues across those accelerated filers that have less than $1 billion in revenues. While the full population of accelerated filers has revenues of up to over $20 billion, about 90 percent of accelerated filers have less than $1 billion in revenues. We restrict the figure to this subset in order to more clearly display the distribution in this range.

[321] The estimates of revenues are based on staff analysis of data from XBRL filings, Compustat, and Calcbench. The revenue data used is from the last fiscal year prior to the annual report in calendar year 2018, because the SRC revenue test is based on the prior year's revenues. *See* note 298 above for details on the identification of the population of accelerated filers.

Figure 3. Distribution of prior fiscal year revenues of accelerated filers in 2018, amongst those with less than $1 billion in such revenues



The distribution of revenues for accelerated filers is heavily skewed towards lower levels of revenue, with roughly three-quarters of accelerated filers having revenues of less than $500 million and more than a third having revenues of less than $100 million. Other than a clustering of issuers with zero or near zero revenues, there are no obvious breaks in the distribution.

While a large range of industries are represented among accelerated filers, a small number of industries account for the majority of these issuers. The "Banking" industry accounts for about 14.1 percent of accelerated filers, followed by "Pharmaceutical Products" (13.9 percent) "Financial Trading" (8.0 percent), "Business Services" (5.7 percent), "Petroleum and Natural Gas" (4.8 percent), "Computer Software" (4.4 percent), "Retail" (4.4 percent),

"Transportation" (4.2 percent), and "Electronic Equipment" (4.1 percent).[322]

3. Timing of Filings

As discussed above, non-accelerated, accelerated, and large accelerated filers face different filing deadlines for their periodic reports. In Table 6, we present the timing in recent years of annual report filings by these different groups of issuers relative to their corresponding deadlines.[323]

Table 6. Filing timing for annual reports in years 2014 through 2018, by filer status

	Non-Accelerated	Accelerated	Large Accelerated
Annual report filing deadline	90 days	75 days	60 days
Average days to file	101 days	70 days	56 days
Percentage filed:			
By deadline	72%	91%	94%
Over 5 days early	44%	63%	61%
After deadline	28%	9%	6%
Over 15 days after deadline	13%	5%	4%

Table 6 documents that accelerated and large accelerated filers file their annual reports, on average, four or five days before the applicable deadline. Nine percent and six percent, respectively, of accelerated and large accelerated filers submit their annual reports after the

[322] These estimates are based on staff analysis of data including SIC codes from XBRL filings and Ives Group Audit Analytics, using the Fama-French 49-industry classification system. *See* http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/det_49_ind_port.html. *See* note 298 above for details on identification of population of accelerated filers.

[323] The estimates in this table are based on staff analysis of EDGAR filings. These statistics include all annual reports on Forms 10-K, 20-F, and 40-F filed in calendar years 2014 through 2018 other than amendments. If multiple annual reports (excluding amendments) are filed in the same calendar year, the analysis considers only the latest such filing. Given the effect of weekends and holidays, filings are considered to be on time if within two calendar days after the original deadline. The "5 days early" and "over 15 days after" categories are similarly adjusted to account for the possible effect of weekends and holidays. *See* note 298 above for details on the identification of filer type.

initial deadline, with roughly half of these filers surpassing the 15-day grace period that is obtained by filing Form NT. Non-accelerated filers are less likely to meet their initial deadline or extended deadline, with the average non-accelerated filer submitting its annual report 11 days after the initial deadline and 13 percent of non-accelerated filers filing after the 15-day grace period obtained by filing Form NT.

4. Internal Controls and Restatements

We next consider the current rates of ineffective ICFR and restatements[324] among issuers that are accelerated filers under the baseline relative to other filer types. The data for all years of the analysis has been updated relative to the analysis in the Proposing Release.[325] Throughout our analysis, we use the term restatement to refer to a restatement that is associated with some type of misstatement. As discussed above, non-accelerated filers and EGCs are statutorily exempted from the ICFR auditor attestation requirement. Table 7 presents the percentage of issuers reporting ineffective ICFR in recent years by filer type.[326]

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[324] Unless otherwise specified, statistics and analysis regarding restatements are not restricted to those restatements requiring Form 8-K Item 4.02 disclosure.

[325] Previous years of data may be revised due to, for example, newly disclosed restatements that reflect misstatements in these earlier years, restated internal control reports that relate to previous fiscal years, previously incomplete data that was later populated, or other updates or database changes.

[326] The estimates in this table are based on staff analysis of Ives Group Audit Analytics data. ICFR effectiveness is based on the last amended management or auditor attestation report for the fiscal year. Percentages are computed out of all issuers of a given filer type with the specified type of report available in the Ives Group Audit Analytics database. *See* note 298 above for details on the identification of filer type.

Table 7. Percentage of issuers reporting ineffective ICFR

Ineffective ICFR Year Reported In:	Non-Accelerated	Accelerated	Large Accelerated
Management Report			
2014	40.1%	7.8%	3.2%
2015	41.2%	9.2%	3.8%
2016	38.3%	9.5%	4.6%
2017	40.2%	9.2%	5.0%
2018	40.3%	8.9%	3.8%
Average / year	*40.0%*	*8.9%*	*4.1%*
Auditor Attestation			
2014	n/a	8.0%	3.3%
2015	n/a	9.1%	3.8%
2016	n/a	9.0%	4.6%
2017	n/a	9.4%	4.9%
2018	n/a	8.7%	3.8%
Average / year	*n/a*	*8.8%*	*4.1%*

Based on management's SOX Section 404(a) reports on ICFR from recent years, on average, about nine percent of accelerated filers reported at least one material weakness in ICFR in a given year.[327] This represents a moderately higher rate than that among large accelerated filers, approximately four percent, on average, of which reported ineffective ICFR,[328] and a substantially lower rate than that among non-accelerated filers, more than a third of which

[327] Per the second column of the first panel of Table 7, the rate of ineffective ICFR among accelerated filers has ranged from 7.8 to 9.5 percent for the years 2014 through 2018, for an average per year of 8.9 percent.

[328] Per the third column of the first panel of Table 7, the rate of ineffective ICFR among large accelerated filers has ranged from 3.2 to 5.0 percent for the years 2014 through 2018, for an average per year of 4.1 percent.

reported ineffective ICFR each year.[329] For issuers subject to the ICFR auditor attestation requirement, the rates of ineffective ICFR reported by management and by auditors are similar.[330] This may not be surprising, as management will be made aware of any material weaknesses discovered by the auditor and vice versa.

We next consider the persistence of material weaknesses across these issuer categories. Table 8[331] presents the percentage of issuers that reported two, three, or four consecutive years of ineffective ICFR culminating in 2018, by filer type.[332]

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329 Per the first column of the first panel of Table 7, the rate of ineffective ICFR among non-accelerated filers has ranged from 38.3 to 41.2 percent for the years 2014 through 2018, for an average per year of 40.0 percent.

330 Per the second column of Table 7, the average rate of ineffective ICFR for accelerated filers across years 2014 through 2018 was 8.9 percent as reported in management reports and 8.8 percent as reported in auditor reports. Similarly, per the third column of Table 7, the average rate of ineffective ICFR for large accelerated filers across years 2014 through 2018 was 4.1 percent as reported in management reports and 4.1 percent as reported in auditor reports.

331 The estimates in this table are based on staff analysis of Ives Group Audit Analytics data. ICFR effectiveness is based on the last amended management report for the fiscal year. Percentages in the first panel are computed out of all issuers of a given filer type in 2018 with SOX Section 404(a) management reports available in Ives Group Audit Analytics database, while percentages in the second panel are computed out of issuers of a given filer type reporting ineffective ICFR in their SOX Section 404(a) management report for 2018. *See* fourth row of Table 7 and note 298 above for details on the identification of filer type.

332 One commenter noted that the Proposing Release, note 4 above, indicated that over 68 percent of non-accelerated filers have reported two consecutive years of ineffective ICFR and over 38 percent have reported four consecutive years of ineffective ICFR in their annual reports. *See* letter from Better Markets. To clarify, we note that these statistics, like those reported in the second panel of Table 8 below, reflect percentages out of the issuers in each category that maintained ineffective ICFR in the last year of the analysis, not percentages of all issuers in each category.

Table 8. Percentage of issuers reporting consecutive years of ineffective ICFR in management report, by 2018 filer status

Ineffective ICFR Years:	Non-Accelerated	Accelerated	Large Accelerated
Issuers with persistent ineffective ICFR / All issuers			
2017-2018 (at least 2 years)	28.4%	3.5%	1.4%
2016-2018 (at least 3 years)	20.8%	2.0%	0.5%
2015-2018 (4 years)	16.1%	1.0%	0.3%
Issuers with persistent ineffective ICFR / Issuers with 2018 ineffective ICFR			
2017-2018 (at least 2 years)	70.4%	39.2%	36.4%
2016-2018 (at least 3 years)	51.6%	22.4%	14.1%
2015-2018 (4 years)	39.9%	11.3%	7.2%

The first panel of Table 8 is intended to demonstrate the overall rate of persistently ineffective ICFR among issuers of different types, while the second panel is intended to demonstrate the degree of persistence of ineffective ICFR among the subset of issuers of each type that report ineffective ICFR in 2018. Compared to non-accelerated filers, we find that a smaller percentage of accelerated and large accelerated filers report material weaknesses that persist for multiple years, with about one percent of accelerated filers and about 0.3 percent of large accelerated filers reporting ineffective ICFR for four consecutive years (per the third row of the table), representing about 11 percent of the accelerated filers and about seven percent of the large accelerated filers that reported ineffective ICFR in 2018 (per the last row of the table). A larger percentage of non-accelerated filers persistently report material weaknesses, with about 16 percent of these issuers (per the third row of the table), or about 40 percent of those reporting ineffective ICFR in 2018 (per the last row of the table), having reported material weaknesses for four consecutive years. As discussed above, it is possible that recent Commission enforcement actions might lead to a reduction in the persistence of material weaknesses in ICFR to the extent that they change issuers' awareness of the risks of longstanding ICFR failures.

Table 9 presents the rate of restatements among each of these filer types, excluding EGCs, and for EGCs separately. For each year, we consider the percentage of issuers that eventually restated the financial statements for that year. The reporting lag before restatements are filed results in a lower observed rate in the later years of our sample, particularly for 2017 (and even more so for 2018, which we do not report for this reason), as issuers may yet restate their results from recent years.[333]

Table 9. Percentage of issuers issuing restatements by year of restated data

Restated:	Non-Accelerated (ex. EGCs)	Accelerated (ex. EGCs)	Large Accelerated	EGC
Total Restatements				
2014	10.9%	11.9%	14.5%	17.7%
2015	9.2%	12.5%	12.7%	16.0%
2016	6.8%	9.6%	8.9%	9.3%
2017	6.9%	7.5%	6.3%	8.3%
Average / year	*8.5%*	*10.4%*	*10.6%*	*12.8%*
8-K Item 4.02 Restatements				
2014	3.9%	3.6%	2.4%	5.0%
2015	3.1%	3.6%	1.8%	4.7%
2016	2.4%	2.7%	1.3%	3.0%
2017	2.3%	2.0%	0.7%	3.1%
Average / year	*2.9%*	*2.9%*	*1.6%*	*3.9%*

The first panel of Table 9 presents the percentage of issuers that make at least one restatement, of any type, while the second panel presents those that make at least one restatement

[333] The estimates in this table are based on staff analysis of Ives Group Audit Analytics data. Percentages are computed out of all issuers of a given filer type with a SOX Section 404(a) management report available in the Ives Group Audit Analytics database. Accelerated and non-accelerated categories exclude EGCs that are in these filer categories. *See* note 298 above for details on the identification of filer type.

requiring Form 8-K Item 4.02 disclosure. The latter type of restatement ("Item 4.02 restatements") reflects material misstatements, while other restatements deal with misstatements that are considered immaterial. We find that EGCs, which are not subject to the ICFR auditor attestation requirement and generally are also younger issuers than those in the other groups, restate their financial statements at higher rates than other issuers, whether we consider all restatements or only Item 4.02 restatements. For non-accelerated filers, which also are not subject to the ICFR auditor attestation requirement, we find that the percentage of issuers reporting Item 4.02 restatements is similar to, and the rate of all restatements slightly lower than, that for accelerated filers who are subject to the ICFR auditor attestation requirement. We note that there is a greater proportion of low-revenue issuers in the non-accelerated filer category than in other categories, and that, in the Proposing Release, we found such issuers to have lower rates of restatement than other issuers.[334] When, in the Proposing Release, we separately considered issuers with revenues below $100 million, we found that the accelerated filers in this category are less likely to restate their financial statements than non-accelerated filers in the same revenue category.[335]

C. Discussion of Economic Effects

The costs and benefits of the amendments, including impacts on efficiency, competition, and capital formation, are discussed below. We first address the population and characteristics of issuers that will newly qualify as non-accelerated filers under the amendments, and then introduce certain categories of issuers that are used for comparison purposes. We next discuss the anticipated costs and benefits associated with the proposed change in applicability of the

[334] *See* Table 14 in the Proposing Release, note 4 above.

[335] *Id*.

ICFR auditor attestation requirement. Following this discussion, we consider the costs and benefits associated with the proposed changes with respect to filing deadlines, exit thresholds, and other required disclosures. Finally, we consider the relative benefits and costs of the principal reasonable alternatives to the amendments.

1. Affected Issuers

We estimate that the amendments will result in 527 additional issuers being classified as non-accelerated filers, and therefore no longer subject to the filing deadlines and ICFR auditor attestation requirement applicable to accelerated filers.[336] Of these, an estimated 154 issuers are EGCs and are thereby already exempt from the ICFR auditor attestation requirement.[337] Among the total 527 affected issuers, an estimated 492 issuers are accelerated filers (or large accelerated filers that have public float of less than $560 million) that will be newly classified as non-accelerated filers because they have annual revenues of less than $100 million and are eligible to be SRCs.[338] An additional 28 issuers are BDCs that will be newly classified as non-accelerated filers because they are currently accelerated filers (and therefore have public float of less than

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[336] The number of affected issuers is based on staff estimates of: (i) the number of accelerated filers in 2018 that have prior fiscal year revenues of less than $100 million and are eligible to be SRCs (*i.e.*, excluding ABS issuers, RICs, BDCs, subsidiaries of non-SRCs, and FPIs filing on foreign forms or using IFRS) or are BDCs with prior year investment income of less than $100 million; (ii) the number of large accelerated filers in 2018 that have a public float of less than $560 million and prior fiscal year revenues of less than $100 million and are eligible to be SRCs; and (iii) the number of accelerated filers in 2018 that have a public float of at least $50 million but less than $60 million. The estimate of the number of affected issuers does not include large accelerated filers that have a public float of at least $560 million but less than $700 million even though such issuers could become non-accelerated filers under the amendments if they became eligible to be SRCs under the SRC revenue test in the first year the SRC amendments became effective due to the limited horizon of this accommodation. *See* note 252above (describing the accommodation provided in the SRC Adopting Release). Revenue data is sourced from XBRL filings, Compustat, and Calcbench. Public float data is from XBRL. *See* note 298 above for details on the identification of the population of accelerated and large accelerated filers and other filer types.

[337] *Id.*

[338] *Id*.

$700 million) and have annual investment income of less than $100 million.[339] The remaining seven affected issuers are accelerated filers that will be newly classified as non-accelerated filers despite having revenues of at least $100 million because they have a public float of at least $50 million but less than $60 million.[340] Our estimate of the number of affected issuers excludes issuers for which we were unable to determine filer classification or revenues, which could represent up to approximately an additional 30 affected issuers.

Our estimate of the number of affected issuers does not include any FPIs. We estimate that there are no FPIs that file on domestic forms and present their financial statements pursuant to U.S. GAAP, and that also meet the required thresholds and other qualifications to be an affected issuer under the amendments. However, there are an estimated 31 FPIs that file on foreign forms, but otherwise meet the required thresholds and other qualifications. There are also FPIs filing on foreign forms for which we were unable to determine filer classification or revenues, which could represent up to approximately an additional 90 FPIs that file on foreign forms but that may meet the required thresholds and other qualifications.[341] While we do not include these issuers in our counts of the number of affected issuers,[342] some of these 30 to 120 additional issuers might choose to file on domestic forms using U.S. GAAP in order to benefit from the amendments if these benefits, together with other benefits of such a choice (such as the ability to rely on the scaled disclosure accommodations available to SRCs) outweigh the costs of

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339 *Id*.

340 *Id*.

341 The majority of these potential additional issuers are Canadian MJDS filers that are not required to disclose filer type or public float. *See* note 298 above.

342 In the Proposing Release, , note 4 above, we included FPIs that file on foreign forms, but otherwise meet the required thresholds and other qualifications, in the number of affected issuers. While these issuers could become subject to the amendments by changing their reporting regime, it is difficult to predict how many would do so and therefore, to be conservative, we do not include them in the number of affected issuers in this release.

changing their disclosure regime. However, many factors are involved in the choice of a reporting regime, and it is difficult to predict how many of these issuers are likely to change their reporting practices due to the amendments.

As noted above, the total number of affected issuers includes an estimated 154 EGCs (including 152 EGCs with annual revenues or, in the case of BDCs, investment income of less than $100 million and two EGCs that will be affected because they have a public float of at least $50 million but less than $60 million).[343] It also includes an estimated 78 banks with $1 billion or more in total assets that are not EGCs.[344] The estimated 154 EGCs are not required to comply with the ICFR auditor attestation requirement under SOX Section 404(b). We estimate that the remaining 373 affected issuers will, including 21 BDCs, be newly exempt from this requirement.[345] Two commenters provided estimates of 382 affected issuers and 385 affected issuers, respectively, as the number of issuers that would be newly exempt from the ICFR auditor attestation requirement under the proposal.[346] While these estimates are largely consistent with our estimate, we note that the commenters' estimates apply some simplifications and use different underlying data sources than our estimate.[347]

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343 *See* note 336 above.

344 Banks are identified as issuers with SIC codes of 6020 (commercial banks), 6021 (national commercial banks), 6022 (state commercial banks), 6029 (NEC commercial banks), 6035 (savings institutions, federally-chartered) or 6036 (savings institutions, not federally-chartered).

345 Of these 373 issuers, 368 had less than $100 million in revenues (or, in the case of BDCs, investment income) in their last fiscal year, while the remaining five would be affected despite having greater revenues because of the revised transition provisions (i.e., because their public float is at least $50 million but less than $60 million).

346 *See* letters from CFA Inst. and Prof. Barth *et al.* *See also* letter from Nasdaq, estimating that at least 399 Nasdaq-listed companies may be affected by the amendments.

347 For example, neither commenter excludes from its estimate issuers that are not eligible to be SRCs or adjusts for the effect of the revised transition thresholds as described in note 336 above and note 151 of the Proposing Release, note 4 above. The letter from CFA Inst. appears to rely on a footnote in the Proposing Release that, while citing to the correct definitions of EGC in our rules, incorrectly stated that an EGC is an issuer that has total annual gross revenues of "less than $1.07 million" during its most recently completed fiscal year (rather than the correct threshold of "less than $1.07 billion") and did not identify the other requirements to be an EGC

Of the 373 issuers that will be newly exempt from the ICFR auditor attestation requirement, we estimate that the 78 banks identified above will be subject to the FDIC auditor attestation requirement,[348] while the remaining 295 issuers will not be subject to any such auditor attestation requirement.[349] For the banks that will be newly exempt from the ICFR auditor attestation requirement but will remain subject to the FDIC auditor attestation requirement, the benefits and costs of expanding the exemption from the ICFR auditor attestation requirement are both expected to be limited. As discussed in Section IV.B.1. above, the FDIC auditor attestation requirement is substantively similar to the ICFR auditor attestation requirement, and is thus expected to require similar expenditures and have similar financial reporting benefits as the ICFR auditor attestation.

We estimate that approximately 90 percent of the affected issuers (whether including or excluding EGCs) have securities that are listed on national exchanges.[350] The representation in

(such as not having reached the last day of the fiscal year following the fifth anniversary of the date of the first sale of common equity securities of the issuer under an effective Securities Act registration statement as an EGC). *See* footnote 47 of the Proposing Release, note 4 above. The estimate in the letter from CFA Inst. also excluded all 10-K filers with the SIC code 6200 ("Security & Commodity Brokers, Dealers, Exchanges & Services"), which we do not believe is appropriate. While the letter correctly indicates that the ICFR auditor attestation requirement does not apply to audits of brokers and dealers performed pursuant to SEC Rule 17a-5, these audits apply to the reports required by Rule 17a-5, which are distinct from a Form 10-K filing. Issuers filing Form 10-Ks that have a subsidiary that is a broker or dealer are not treated differently from other issuers with respect to the ICFR auditor attestation requirement.

348 If these banks are no longer subject to the SOX Section 404(b) auditor attestation requirement, their auditors may follow the AICPA's auditing standards in lieu of the PCAOB's auditing standards for the FDIC auditor attestation. *See* Section 18A of Appendix A to FDIC Rule 363 and the AICPA's AU-C Section 940. *See also* Section III.B.1. above.

349 Of these 274 issuers, 269 are accelerated filers (or large accelerated filers that have public float of less than $560 million) that will be newly classified as non-accelerated filers because they have annual revenues of less than $100 million and are eligible to be SRCs, while the remaining five will be newly classified as non-accelerated filers despite having revenues of at least $100 million because they have a public float of at least $50 million but less than $60 million.

350 Staff extracted information regarding whether issuers reported having securities registered under Section 12(b) of the Exchange Act from the cover page of annual report filings using a computer program supplemented with hand collection. *See* note 336 above for details on the identification of the population of affected issuers.

public markets of issuers similar to the affected issuers has decreased relative to the years before SOX. In particular, over the past two decades, the number of issuers listed on major exchanges has decreased by about 40 percent,[351] but the decline has been concentrated among smaller size issuers. Specifically, the number of listed issuers with market capitalization below $700 million has decreased by about 65 percent,[352] and the number of listed issuers with less than $100 million in revenue has decreased by about 60 percent.[353] One commenter noted that these statistics do not establish that the costs of the ICFR auditor attestation materially contributed to the decline in listed issuers, and that there are a number of other factors that are likely implicated in the decline of listings.[354] We cite these statistics to characterize the affected issuers, not to attribute the decline in listings to any particular cause. As noted below, the amendments could be a positive factor in the decision of additional companies to enter public markets, but it may not be the decisive factor, and the direct impact of the amendments on the number of public companies may be limited to the extent that companies may be more focused on other factors associated with the decision to go public.[355]

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[351] This estimate is based on staff analysis of data from the Center for Research in Security Prices database for December 1998 versus December 2018. The estimate excludes RICs and issuers of ADRs.

[352] *Id.*

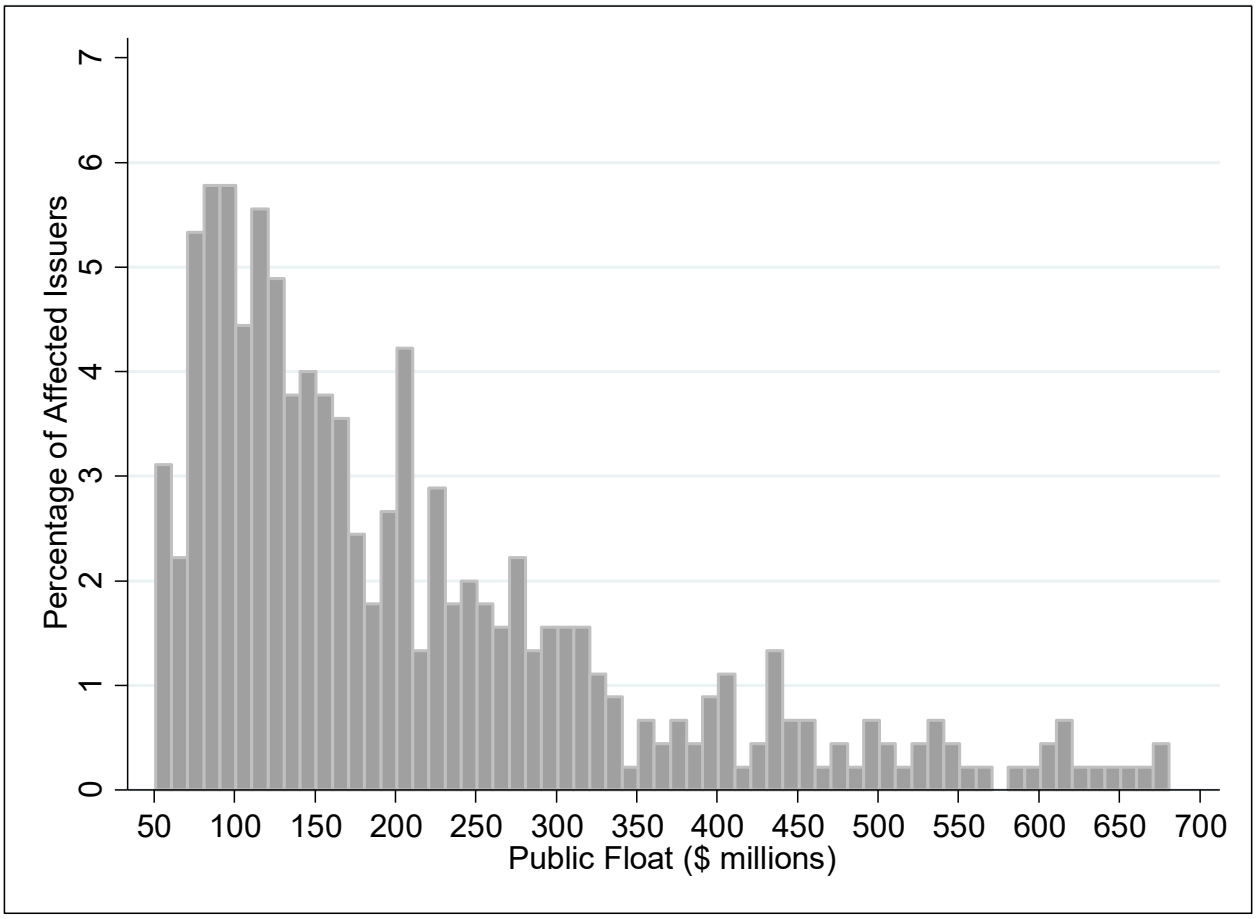
[353] This estimate is based on staff analysis of data from Standard & Poor's Compustat and Center for Research in Security Prices databases for fiscal year 1998 versus fiscal year 2017. The estimate excludes RICs and issuers of ADRs.

[354] *See* letter from CFA.

[355] *See* Section IV.C.2.d. below.

Figure 4[356] presents the distribution of public float across the full sample of affected issuers.[357]

Figure 4. Distribution of public float of affected issuers based on classification in 2018



Relative to the distribution for all accelerated filers presented in Figure 2, the sample of affected issuers is more strongly skewed toward lower levels of public float, with higher levels of public float only thinly represented. However, some of the affected issuers do have public float

[356] The estimates in this figure are based on staff analysis of data from XBRL filings. We corrected the public float data based on hand-collection from Form 10-K filings for five affected issuers whose public float reported in XBRL format was 1,000 times the public float reported on the cover page of the corresponding Form 10-K filing, resulting in values of over $50 billion in public float reported in XBRL. *See* note 336 above for details on the identification of the population of affected issuers.

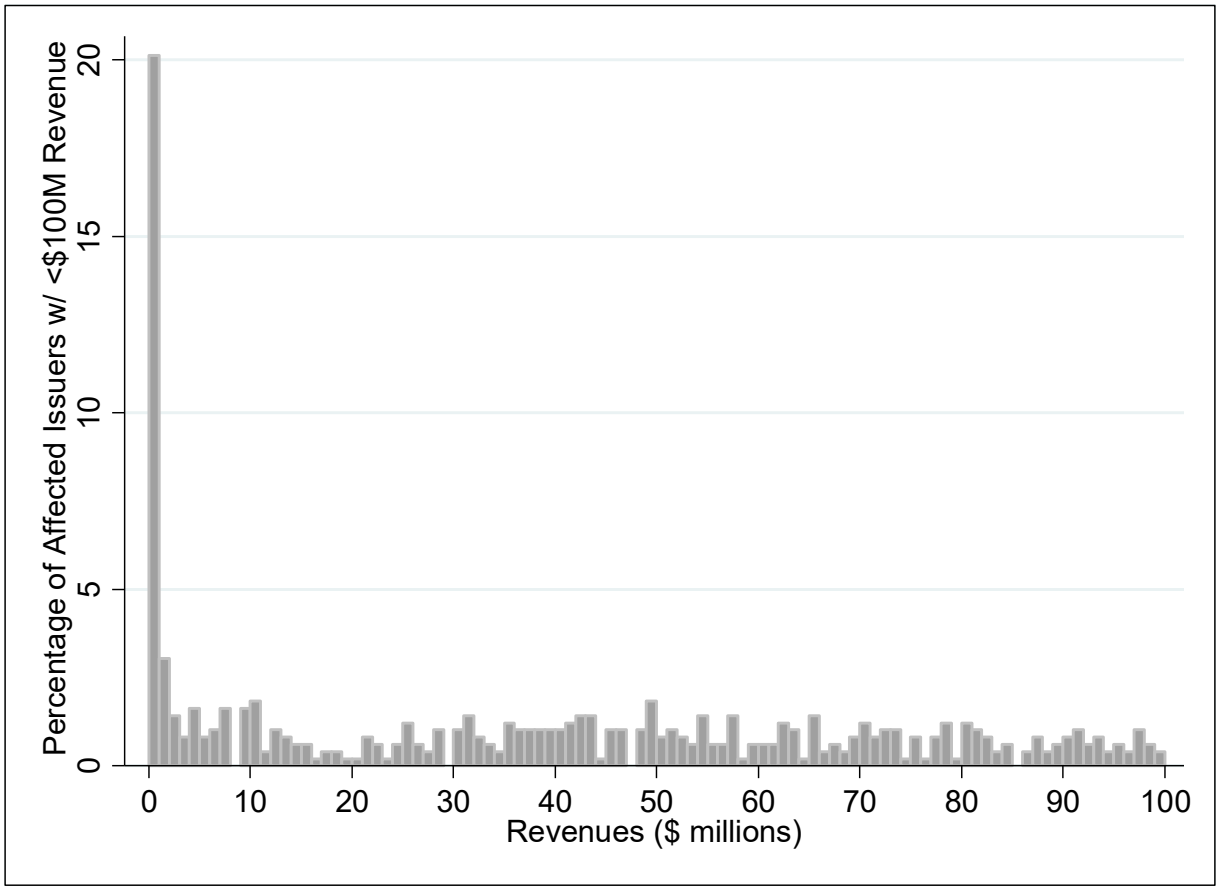
[357] Because of the accelerated filer transition provisions, some of the affected issuers have public float of at least $50 million but below $75 million. *See* note 320 above.

approaching the top of the range for accelerated filers.

Figure 5 presents the distribution of revenues across the 520 accelerated filers (or large accelerated filers with public float of less than $560 million) that will be newly classified as non-accelerated filers because they have revenues (or, in the case of BDCs, investment income) of less than $100 million.[358]

[358] The estimates in this figure are based on staff analysis of data from XBRL filings, Compustat, and Calcbench. The revenue data used is from the last fiscal year prior to the annual report in calendar year 2018, because the SRC revenue test is based on the prior year's revenues. *See* note 336 above for details on the identification of the population of affected issuers.

Figure 5. Distribution of prior fiscal year revenues for affected issuers based on classification in 2018, amongst those with less than $100 million in revenues



Other than a concentration of issuers with zero or near zero revenues,[359] these affected issuers are fairly evenly distributed over different levels of revenue up to $100 million in revenues. The additional seven affected issuers with revenues of at least $100 million but a public float of less than $60 million have revenues ranging from $119 million to $2.1 billion, with a mean of about $770 million in revenues.

The affected issuers are estimated to have median total assets of about $185 million, a

[359] Approximately 13 percent of the estimated 520 affected issuers with revenues of less than $100 million and approximately 11 percent of the estimated 290 affected issuers with revenues of less than $100 million that would be newly exempt from all ICFR auditor attestation requirements (*i.e.*, those that are not EGCs and are not banks subject to the FDIC auditor attestation requirement) have zero revenues.

median number of employees of about 115, and a median age of about 12 years.[360] For those issuers that will be newly exempt from all ICFR auditor attestation requirements (i.e., those that are not EGCs and are not banks subject to the FDIC auditor attestation requirement), the median total assets and median number of employees are somewhat lower at about $125 million and 85 employees, and the median issuer age is slightly higher at about 19 years.[361] The majority of the affected issuers have negative net income and negative net cash flows from operations.[362]

The affected issuers are heavily concentrated, based on the number of issuers, in the "Pharmaceutical Products" (29.1 percent), "Banking" (22.4 percent),[363] "Financial Trading" (16.0 percent), "Medical Equipment" (4.4 percent), and "Electronic Equipment" (3.8 percent) industries.[364] If the distribution of eligible issuers does not change over time, the amendments could lead to a noticeable decrease in the presence of "Pharmaceutical Products" and "Banking" issuers in the pool of accelerated filers.

One commenter noted they sought to understand the industry concentration of the

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360 These estimates are based on staff analysis of data from Compustat. *See* note 336 above for details on the identification of the population of affected issuers.

361 *Id.*

362 *Id.* For the 295 affected issuers that would be newly exempt from all ICFR auditor attestation requirements (*i.e.*, those that are not EGCs and are not banks subject to the FDIC auditor attestation requirement), the median net income is approximately negative $6 million and the median net cash flows from operations is approximately negative $6 million.

363 For the 295 affected issuers that would be newly exempt from all ICFR auditor attestation requirements (*i.e.*, those that are not EGCs and are not banks subject to the FDIC auditor attestation requirement), the proportion of "Banking" issuers drops to 7.8 percent. By contrast, the proportion in other industries does not change by more than a few percentage points.

364 These estimates are based on staff analysis of data including SIC codes from XBRL filings and Ives Group Audit Analytics, using the Fama-French 49-industry classification system. BDCs are manually-classified as members of the "Financial Trading" industry under this system as SIC codes were unavailable from our sources for the vast majority of these issuers. *See* http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/Data_Library/det_49_ind_port.html. *See* note 336 above for details on the identification of the population of affected issuers.

affected issuers based on measures such as their public float, revenues, and total assets.[365] Based on their public float relative to the aggregate public float of the affected issuers, the affected issuers are heavily concentrated in the "Pharmaceutical Products" (33.5 percent), "Banking" (20.0 percent), "Financial Trading" (17.0 percent), and "Medical Equipment" (5.0 percent) industries.[366] Because revenues and total assets may be less comparable across industries of different types, we do not present the fraction of the aggregate revenue and assets of the affected issuers represented by each industry. As an alternative that we believe may be more informative, we present, in Table 10, the estimated proportion of all of the accelerated filers in each industry that will be affected by the amendments (*i.e.*, become non-accelerated), calculated based on several different measures of the size of the affected issuer pool in a given industry.[367] We focus this table on non-EGCs, and present affected issuers in the "Banking" industry both including and excluding those that will remain subject to the FDIC auditor attestation requirement, in order to highlight the disproportionate effects by industry in terms of the issuers that will newly be exempt from the ICFR auditor attestation requirement.

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365 *See* letter from CFA Inst.

366 These estimates are based on staff analysis of data including SIC codes from XBRL filings and Ives Group Audit Analytics, using the Fama-French 49-industry classification system. *See* note 364 above for more details. We corrected the public float data based on hand-collection from Form 10-K filings for five affected issuers whose public float reported in XBRL format was 1,000 times the public float reported on the cover page of the corresponding Form 10-K filing, resulting in values of over $50 billion in public float reported in XBRL. For the 295 affected issuers that would be newly exempt from all ICFR auditor attestation requirements (*i.e.*, those that are not EGCs and are not banks subject to the FDIC auditor attestation requirement), the proportions are "Pharmaceutical Products" (27.9 percent), "Financial Trading" (22.5 percent), "Real Estate" (7.6 percent), "Medical Equipment" (7.5 percent), and "Banking" (5.4 percent) .

367 The estimates in Table 10 are based on staff analysis of data including data on total assets from Compustat and SIC codes from XBRL filings and Ives Group Audit Analytics, using the Fama-French 49-industry classification system. See note 364 above for more details. Both the numerators (related to the affected issuers) and denominators (related to accelerated filers) exclude EGCs. We corrected the public float data based on hand-collection from Form 10-K filings for five affected issuers and six unaffected issuers whose public float reported in XBRL format was about 1,000 times (in one case, about 1,000,000 times) the public float reported on the cover page of the corresponding Form 10-K filing, resulting in values of over $50 billion in public float reported in XBRL. *See* note 336 above for details on the source of revenue and public float data and on the identification of the affected issuers. *See* note 298 above for details on the identification of filer type.

Table 10. Percentage of accelerated filers in each industry that will be affected issuers, excluding EGCs

	Percentage of Accelerated Filers (ex. EGCs) that are Affected (ex. EGCs), calculated based on:			
Industry*	Number of Issuers	Total Assets	Revenue	Public Float
Pharmaceutical Products	77.9%	54.4%	36.8%	78.7%
Banking	63.5%	37.6%	33.2%	43.1%
Banking (ex. issuers subject to FDIC att. requirement)	*14.5%*	*5.2%*	*10.9%*	*17.5%*
Medical Equipment	59.3%	28.9%	22.4%	60.9%
Financial Trading	58.5%	22.5%	5.0%	61.6%
Electronic Equipment	32.7%	7.4%	4.3%	33.1%
Other	16.0%	4.0%	1.8%	11.8%

* Excluding EGCs, we estimate that there are 74 affected issuers in the "Pharmaceutical Products" industry, 101 in "Banking" (23 after excluding issuers that would be subject to the FDIC attestation requirement), 62 in "Financial Trading," 16 in "Medical Equipment," and 16 in "Electronic Equipment." The table excludes two affected issuers for which an industry classification was unavailable.

Amongst the industries in which the affected issuers are most greatly concentrated, issuers in the "Pharmaceutical Products" industry are the most disproportionately affected based on the number, total assets, revenues, and public float of the affected issuers (other than EGCs) relative to the representation of this industry among accelerated filers (other than EGCs). While a substantial fraction of accelerated filers other than EGCs in the "Banking" industry are also affected issuers, consistent with one commenter's finding that "Banking" is the industry most affected by the amendments,[368] the proportion of this industry that is affected is significantly reduced once we exclude banks that would be subject to the FDIC auditor attestation requirement and are therefore expected to experience limited benefits and costs as a result of the amendments.

[368] *See* letter from CFA Inst.

2. Potential Benefits of Expanding the Exemption from the ICFR Auditor Attestation Requirement for Affected Issuers

The ICFR auditor attestation requirement has been associated with increased audit fees and other compliance costs. Exempting the affected issuers from this requirement therefore is likely to have the benefit of reducing compliance costs for these issuers. Given the disproportionate burden that the fixed component of compliance costs imposes on smaller issuers, as well as the likelihood that many of the affected issuers face financing constraints, these costs savings may enhance capital formation and competition. The discussion below explores the anticipated cost savings and their potential implications in detail. This discussion is focused on affected issuers that are not expected to be subject to the FDIC auditor attestation requirement.

We begin by summarizing evidence on the indirect costs and net costs of the ICFR auditor attestation requirement. We then estimate the anticipated effects on audit fees and on other compliance costs of expanding the exemption from this requirement for the affected issuers, using reported audit fees, survey data, and existing studies. Finally, we discuss the implications of the cost savings and other potential benefits.

a. Evidence on possible indirect costs of the ICFR auditor attestation requirement

The ICFR auditor attestation requirement may impose costs on issuers and investors beyond the direct costs of compliance. For example, an increased focus on ICFR as a result of the ICFR auditor attestation requirement could have negative effects on issuer performance, if it creates a distraction from operational matters or reduces investment or risk-taking.[369] One issuer

[369] *See* John Coates & Suraj Srinivasan, *SOX after Ten Years: A Multidisciplinary Review*, 28(3) ACCT. HORIZONS 627 at 643-645 (2014) ("Coates and Srinivasan 2014 Study") (discussing these possible effects and summarizing related studies).

noted in its comments that its managers' attention was diverted away from its operating performance in its first year complying with the ICFR auditor attestation requirement, and that, without this requirement, its managers' time could have been more productively spent focusing on opportunities to grow the company.[370] Broader evidence of the indirect costs of the ICFR auditor attestation requirement is inconclusive. Studies have documented a decrease in investment and risk-taking by U.S. companies compared to companies in other countries around the passage of SOX.[371] However, others have demonstrated that these findings are merely the continuation of a trend that began many years before the passage of SOX[372] and that they do not appear to be driven by the applicability of the ICFR auditor attestation or SOX Section 404(a) management ICFR reporting requirements.[373] Another study associates the SOX Section 404 requirements with a decrease in patents and patent citations, but the findings are limited to the early years of implementation of these requirements and the study is not able to distinguish to what extent the effects are attributable to the SOX Section 404(a) management ICFR reporting requirements versus the SOX Section 404(b) ICFR auditor attestation requirement.[374] We are unable to quantify the potential indirect cost savings resulting from the amendments due to the lack of reliable evidence and data that would allow us to quantitatively identify such effects.

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370 *See* letter from Guaranty.

371 *See* Coates and Srinivasan 2014 Study, note 369 above (summarizing these studies).

372 *Id.*

373 *See* Ana Albuquerque & Julie Zhu (2018), *Has Section 404 of the Sarbanes-Oxley Act Discouraged Corporate Risk-Taking? New Evidence from a Natural Experiment*, MGMT. SCI. (forthcoming) (using the staggered implementation of SOX Section 404 to better identify its effects on smaller issuers, with public float of less than $150 million, and finding no evidence of a decrease in the investment and risk-taking activities for issuers that were subject to SOX Section 404 versus those that were not), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049232.

374 *See* Huasheng Gao & Jin Zhang, *SOX Section 404 and Corporate Innovation*," J. OF FIN. AND QUANTITATIVE ANALYSIS (2018) (forthcoming), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3130588.

b. Evidence on net costs of the ICFR auditor attestation requirement

While we are unable to quantify the extent to which the expected cost savings exceed any loss of benefits associated with the ICFR auditor attestation requirement,[375] we note that certain studies have attempted to estimate such "net costs" of the requirement in specific contexts.

i. Studies involving avoidance behavior

Some studies have provided evidence that non-accelerated filers may seek to avoid crossing the $75 million public float threshold and becoming accelerated filers.[376] Related studies have also found that issuers near or below this threshold are more likely than comparable issuers to take actions that may reduce or avoid an increase in their public float, such as disclosing more negative news in the second fiscal quarter (when public float is measured), increasing payouts to shareholders, reducing investment in property, plant, equipment, intangibles and acquisitions, and increasing the number of shares held by insiders.[377] One study uses this avoidance behavior to estimate the net costs of compliance with the ICFR auditor attestation requirement for issuers close to the $75 million public float threshold.[378] The study

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375 While we quantify both anticipated costs and benefits of the amendments, there are many costs and benefits that we cannot quantify, so we are unable to quantify the net benefit or net cost of the amendments. See Section IV.C.3.d. for further discussion of this point.

376 *See, e.g.*, Peter Iliev, *The Effect of SOX Section 404: Costs, Earnings Quality, and Stock Prices*, 45 J. OF FIN. 1163 (2010) ("Iliev 2010 Study") (finding that a disproportionate number of issuers had a public float of just under $75 million in 2004, when ICFR auditor attestations and management ICFR reports were first required for accelerated filers, but not in earlier years); Dhammika Dharmapala, *Estimating the Compliance Costs of Securities Regulation: A Bunching Analysis of Sarbanes-Oxley Section 404(b)*, Working Paper (2016), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2885849 ("Dharmapala 2016 study"); and McCallen *et al.* 2019 study, note 308 above.

377 *See* F. Gao, J.S. Wu & J. Zimmerman, *Unintended Consequences of Granting Small Firms Exemptions from Securities Regulation: Evidence from the Sarbanes-Oxley Act*, 47(2) J. OF ACCT. RES. 459 (2009) and M. E. Nondorf, Z. Singer, & H. You, *A Study of Firms Surrounding the Threshold of Sarbanes–Oxley Section 404 Compliance*, 28(1) ADVANCES IN ACCT. 96 (2012). *See also* F. Gao, *To Comply or Not to Comply: Understanding the Discretion in Reporting Public Float and SEC Regulations*, 33(3) CONTEMPORARY ACCT. RES. 1075 (2016) (presenting evidence that companies that expected higher compliance costs may have used discretion in defining affiliates in order to report lower float).

378 *See* Dharmapala 2016 study, note 376 above.

concludes that the overall costs, net of any benefits, of the ICFR auditor attestation requirement for these issuers is roughly $1 million to $2 million per year, but we note that the methodology used to translate the avoidance behavior into a dollar cost may be unreliable.[379]

Avoidance of the $75 million public float threshold would be consistent with smaller issuers finding the net costs associated with the ICFR auditor attestation requirement to be significant, though there could be other reasons for avoiding the threshold. For example, as one commenter argued, such avoidance may reflect managers who would like to avoid the scrutiny of an audit of ICFR because they are engaging in opportunistic behavior,[380] although we are unaware of direct evidence supporting this hypothesis. One commenter, representing 48 accounting and law professors, requested that we confirm whether the "bunching" of companies below the $75 million public float threshold remains present in today's markets.[381] The commenter noted that such an analysis could help provide confidence that the costs of the ICFR auditor attestation requirement remain as high as previously documented.[382] In response to this comment, our staff conducted supplemental analysis, presented in Figure 6.[383] However, as

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379 *Id.* This paper estimates a net cost of compliance for companies near the threshold of $4 million to $6 million for a few years of compliance (*i.e.*, $1 million to $2 million per year). The analysis leading to this estimate relies on the relation between public float and market capitalization for other companies to approximate the stock market value forgone by those that are estimated to be manipulating their public float downwards. However, we note that the ratio of market capitalization to public float for other companies may simply reflect their propensity towards having affiliated ownership rather than being a reliable basis with which to measure the cost incurred by manipulating public float.

380 *See* letter from Prof. Barth *et al*.

381 *See* letter from Prof. Honigsberg *et al.*

382 *Id.*

383 The estimates in this figure are based on staff analysis of data from XBRL filings associated with annual reports filed in calendar year 2018. The figure includes all issuers with an annual report on Form 10-K, 20-F or 40-F in calendar year 2018 and with public float data available in XBRL, excluding banks, ABS issuers, and RICs (although we note there were no instances of the latter two types of issuers in this sample before these filters were applied). Banks are identified as issuers with SIC codes of 6020 (commercial banks), 6021 (national commercial banks), 6022 (state commercial banks), 6029 (NEC commercial banks), 6035 (savings institutions, federally-chartered) or 6036 (savings institutions, not federally-chartered).

discussed below, the conclusions in this Economic Analysis do not rely on this analysis.

Figure 6. Distribution of public float of issuers (excluding banks, ABS issuers, and RICs) in 2018

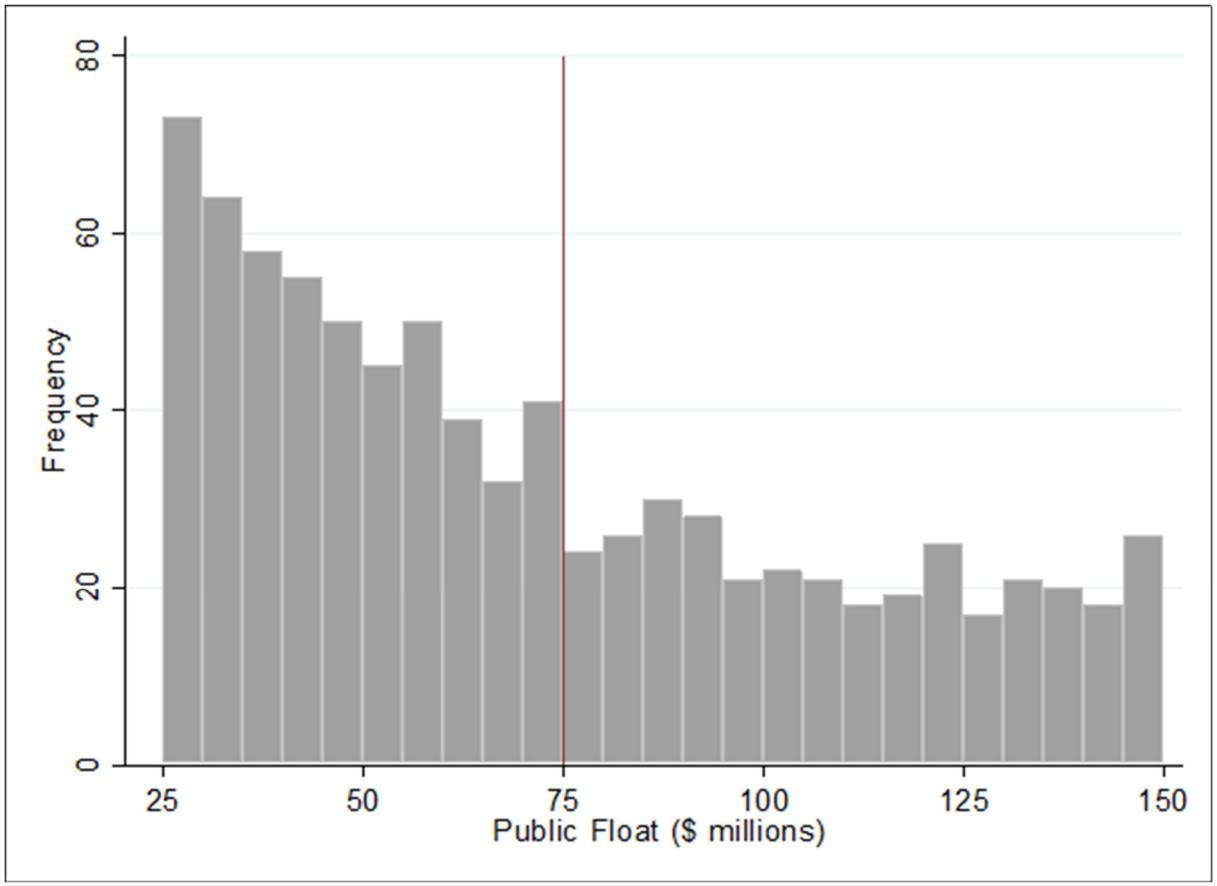

Figure 6 presents the distribution of public float across issuers other than banks, ABS issuers, and RICs. We exclude ABS issuers and RICs because they are unlikely to be sensitive to the public float threshold as they would not be subject to the ICFR auditor attestation requirement (or able to avail themselves of the disclosure accommodations for SRCs) regardless of their public float. We exclude banks because they may be subject to the FDIC auditor attestation requirement, which, as discussed above, is comparable to the ICFR auditor attestation requirement, regardless of their public float. While EGCs would not be subject to the ICFR auditor attestation requirement regardless of their public float, we nevertheless include them in Figure 6 because it is a temporary exemption and such issuers may already consider the

implications of their public float in advance of graduating from this status. However, we obtain similar results when we include or exclude any of these categories of issuers.

The pattern in Figure 6 demonstrates that there may be some "bunching" of public floats below the $75 million threshold in 2018. The pattern is similar to that presented in two recent studies that find a discontinuity in public float at the $75 million threshold when considering data across the 12 or 13 year period ending in 2015.[384] Our findings for 2018 also are consistent with a year-by-year analysis in one of these studies that suggests that this behavior does not appear to change significantly over the time period studied.[385]

Our findings are less consistent with another analysis of public float, which failed to find evidence of "bunching" in 2017.[386] This analysis was cited in a submission to the comment file.[387] When we examine the data underlying this analysis,[388] we find that, although we obtain public float data from different sources,[389] our public float values are over 90 percent correlated with those used in tthis analysis. We note, however, that the analysis applies sample selection filters that exclude, among other issuers, issuers that would become newly subject to an ICFR auditor attestation requirement (and, during this time period, lose the disclosure accommodations for SRCs) upon crossing the $75 million public float threshold. The exclusions result in a

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384 *See* McCallen *et al.* 2019 study, note 308 above, and Dharmapala 2016 study, note 376 above.

385 *See* McCallen *et al. 20*19 study, note 308 above.

386 *See* Commissioner Jackson's Statement. While we provide results for 2018 in Figure 6 in order to present the most recent and reliable available data, we obtain very similar results when running the same analysis for 2017.

387 *See* letter from Prof. Barth *et al.*, citing an analysis in Commissioner Jackson's Statement that finds no evidence of bunching in 2017.

388 *See* "Public Float Data (2017)" available at https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-accelerated-filer-definition.

389 The data underlying the analysis cited by a commenter is generated by using a computer program to extract text from annual reports, applying computer algorithms and filters to isolate public float numbers, and then manually checking the results. *See* Commissioner Jackson's Statement. The data underlying our analysis is based on XBRL filings.

sample size that is approximately half as large as that in our analysis.[390] For example, we understand that the other analysis excludes all financial institutions and issuers with a market capitalization of greater than $150 million.[391] This difference, we find, accounts for the bulk of the difference in our figures. Thus, our analysis reflects a significantly larger and more representative sample of issuers and may therefore be more reliable.

As discussed above, if issuers seek to avoid crossing the $75 million public float threshold, such behavior could reflect a high net cost of the ICFR auditor attestation requirement but could also reflect a self-serving desire to avoid scrutiny. Any such behavior could also be influenced by other requirements associated with this public float threshold during this time period, such as the loss of scaled disclosure accommodations available to SRCs.[392] Thus, though we have considered the studies, evidence, and comments received regarding this avoidance behavior, the conclusions in this Economic Analysis do not rely on these findings.

ii. Studies based on comparative analysis or market reactions

We have also considered studies that have used other methodologies to attempt to quantify the net costs or benefits of the ICFR auditor attestation requirement. One study attempts to quantify and compare certain costs and benefits of exempting non-accelerated filers from the ICFR auditor attestation requirement, focusing on those costs and benefits that the study deems to be measurable, and finds that the cost savings associated with exempting these issuers

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390 The figure in the other analysis reflects 388 issuers, compared to 731, or almost twice as many issuers, in our analysis.

391 Financial institutions are issuers with SIC codes between 6000 and 6999 and include issuers that are not banks. Other filters applied in that analysis include requiring that market capitalization data be available and that the reported public float be at least 10%, but no more than three times, the market capitalization.

392 The analysis presented in Figure 6 is based on annual reports filed in calendar year 2018, which generally pertain to 2017 fiscal years. The amendments to the SRC definition were effective on September 10, 2018. *See* SRC Adopting Release, note 12 above.

(an estimated $388 million in aggregate audit fee savings) have been less than the lost benefits (e.g., an aggregate $719 million in lower earnings) in aggregate present value terms.[393] Studies have also used stock market reactions to changes in the applicability of the ICFR auditor attestation requirement to estimate its net costs or benefits, because the stock market valuation should incorporate both expected costs and expected benefits from a shareholder's perspective. We focus on studies that consider events that allow the effects of the ICFR auditor attestation requirement to be isolated from those of the other requirements that were imposed by SOX, as many early studies did not isolate the effects of the ICFR auditor attestation requirement from other changes required by the same legislation, such as the audit committee requirements of SOX Section 301[394] and the certifications required pursuant to SOX Section 302. Regardless, the results of the studies we focus on have been mixed, perhaps due in part to changes over time in how the ICFR auditor attestation requirement has been implemented. For example, a study analyzing the response to announcements of initial delays in the application of the requirements to some issuers in order to identify the stock market reaction associated with the ICFR auditor attestation requirement found that this requirement was associated with a net reduction in stock

[393] We note that the estimates in this study rely on a number of critical assumptions and estimations. *See* Weili Ge, Allison Koester, & Sarah McVay, *Benefits and Costs of Sarbanes-Oxley Section 404(b) Exemption: Evidence from Small Firms' Internal Control Disclosures*, 63 J. OF ACCT. AND ECON. 358 (2017) ("Ge *et al.* 2017 Study") (estimating the effect on audit fees by comparing the audit fees of non-accelerated filers to those of accelerated filers with market capitalization of $300 million or less; and estimating the effect on earnings by estimating the percentage of non-accelerated filers that may newly disclose ineffective ICFR upon entering an ICFR auditor attestation requirement, based on changes in the rate of disclosure of ineffective ICFR by issuers that transition into accelerated filer status, and applying to this estimate a further estimate of the difference in return on assets that could be associated with such disclosure and any related remediation, based on the results of a multivariate regression relating issuers' change in return on assets to a number of factors, including whether or not they disclosed and remediated ineffective ICFR). This study also estimates a delay over three years in the timing of a market value decline (that would otherwise have occurred at the beginning of this three year period) of $935 million associated with the exemption from the ICFR auditor attestation requirement.

[394] 15 U.S.C. 78j-1.

market valuation for foreign issuers.[395] On the other hand, a study of the response to the later permanent exemption from the ICFR auditor attestation requirement for some issuers found that this requirement was associated with a net increase in stock market valuation for smaller issuers.[396] The latter finding is consistent with studies that conclude that the requirement is value-enhancing based on a negative stock market reaction to issuers excluding acquired operations from management's assessment of ICFR and the ICFR auditor attestation, though these studies do not determine the extent to which this effect is attributable to the ICFR auditor attestation.[397] Similarly, a study of smaller issuers that switched regimes over time found that being subject to the ICFR auditor attestation requirement was associated with an increase in stock market valuation for these issuers.[398]

iii. Other evidence on net costs

The rate of exempt issuers voluntarily obtaining an ICFR auditor attestation has generally been low.[399] Consistent with this finding, a commenter indicated that small biotechnology

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395 *See* Iliev 2010 Study, note 376 above. This study also finds a net reduction in value for small domestic issuers from the SOX Section 404 requirements, but is not able, for these issuers, to isolate the effect attributable to the ICFR auditor attestation requirement versus the SOX Section 404(a) management ICFR reporting requirement.

396 *See* Kareen Brown, Fayez Elayan, Jingyu Li, Emad Mohammad, Parunchana Pacharn, & Zhefeng Frank Liu, *To Exempt or not to Exempt Non-Accelerated Filers from Compliance with the Auditor Attestation Requirement of Section 404(b) of the Sarbanes-Oxley Act*, 28(2) RES. IN ACCT. REG. 86 (2016) ("Brown *et al.* 2016 Study"). *See also* Christina Leuz & Peter Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, 54(2) J. OF ACCT. RES. 525 at 566-569 (2016) ("Leuz and Wysocki 2016 Study") (summarizing mixed evidence from earlier event studies related to SOX that were unable to differentiate the effects of the ICFR auditor attestation requirement from other requirements imposed by SOX).

397 *See, e.g.,* Robert Carnes, Dane Christensen, & Phillip Lamoreaux, *Investor Demand for Internal Control Audits of Large U.S. Companies: Evidence from a Regulatory Exemption for M&A Transactions*, 94(1) THE ACCT. REV. 71 (2019) ("Carnes *et al.* 2019 Study").

398 *See* Hongmei Jia, Hong Xie, & David Ziebart, *An Analysis of the Costs and Benefits of Auditor Attestation of Internal Control over Financial Reporting*, Working Paper (2014) ("Jia *et al.* 2014 study"), available at https://www.lsu.edu/business/accounting/files/researchseries/20141027JXZ.PDF.

399 *See* note 297 above.

companies are rarely asked by investors to voluntarily obtain an ICFR auditor attestation.[400] This may indicate that exempt issuers, when considering their own net cost or benefit of compliance, including how investors would react to their decisions, have typically deemed it to be more beneficial to expend these resources on other uses. However, as discussed in Section IV.C.3.d. below, it is probably not the case that issuers would voluntarily obtain an ICFR auditor attestation in every case in which, from the market or an investor's perspective, the total benefits of doing so would exceed the total costs.

When considering the net tradeoff between costs and benefits for accelerated filers with low revenues in particular, we also re-examined data from the SEC-sponsored survey of financial executives conducted during December 2008 and January 2009 ("2008–09 Survey").[401] While the results of this survey might not be directly applicable a decade later, particularly given the changes over time discussed in Section IV.B.1. above, they provide some suggestive evidence that low-revenue issuers are more likely than other accelerated filers to believe that the costs of complying with SOX Section 404 substantially outweigh the benefits. In particular, when asked about the net costs or benefits of complying with SOX Section 404, 30 percent of respondents at an accelerated filer with revenues below $100 million indicated that the costs far outweighed the benefits, in contrast to 14 percent of respondents at an accelerated filer with greater revenues.[402]

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400 *See* letter from BIO. *See also* letter from Ardelyx Presentation, referencing similar statements in the BIO Study, note 69 above, (which states that "the low rate of voluntary compliance by [biotechnology EGCs] suggests that investors do not demand or value costly Section 404(b) auditor attestations").

401 *See* 2009 SEC Staff Study, note 304 above, and Cindy Alexander, Scott Bauguess, Gennaro Bernile, Alex Lee, & Jennifer Marietta-Westberg, *The Economic Effects of SOX Section 404 Compliance: A Corporate Insider Perspective*, 56 J. OF ACCT AND ECON. 267 (2013) ("Alexander *et al.* 2013 Study").

402 These estimates are based on staff analysis of data from the 2008–09 Survey. The analysis considers responses pertaining to the most recent year for which a given respondent provided a response. We note that the rate of responses to the question about net benefits was lower than for other questions. *See* the 2009 SEC Staff Study, note 304 above, and Alexander *et al.* 2013 Study, note 401 above, for details on the survey and analysis methodology.

However, as noted by a commenter, these survey findings represent the views of issuers and may not be reflective of the views of investors.[403]

c. Potential reduction in audit fees

While issuers disclose their total audit fees, they are not required to disclose the portion of these fees that is attributable to the ICFR auditor attestation requirement. Studies of the initial implementation of the ICFR auditor attestation requirement found that it was associated with a roughly 100 percent increase in audit fees for small accelerated filers.[404] However, these early estimates likely include some initial start-up costs, which were found to diminish over time.[405] Further, these estimates do not incorporate the effect of later developments such as the adoption of AS 2201, which was expected to reduce compliance costs for smaller issuers, and the adoption of the new risk assessment auditing standards, which may reduce the incremental cost of an integrated audit over a financial-statement only audit.

In the Proposing Release, we presented an analysis of audit fees from 2014-2017 for low-revenue issuers that are subject to the ICFR auditor attestation requirement compared to low-revenue issuers not subject to this requirement.[406] In particular, we compared audit fees in these

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403 *See* letter from Crowe.

404 *See, e.g.*, William Kinney & Marcy Shepardson, *Do Control Effectiveness Disclosures Require SOX 404(b) Internal Control Audits? A Natural Experiment with Small U.S. Public Companies*, 49(2) J. OF ACCT. RES. 413 (2011) ("Kinney and Shepardson 2011 Study") (considering those accelerated filers that have newly crossed the $75 million public float threshold in a given year); Iliev 2010 Study, note 376 above (considering those accelerated filers with between $75 million and $100 million in public float); Michael Ettredge, Matthew Sherwood, & Lili Sun, *Effects of SOX 404(b) Implementation on Audit Fees by SEC Filer Size Category*, 37 (1) J. OF ACCT. AND PUB. POL'Y 21 (2017) (considering accelerated filers as a category, as opposed to large accelerated filers, but also finding a contemporaneous 42.7 percent increase in audit fees for non-accelerated filers even though were not subject to the ICFR auditor attestation requirement); and Susan Elridge & Burch Kealey, *SOX Costs: Auditor Attestation under Section 404*, Working Paper (2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=743285 (considering accelerated filers in the lowest quintile of total assets).

405 *See, e.g.*, Alexander *et al.* 2013 Study, note 401 above.

406 *See* Section III.C.3.b. of the Proposing Release, note 4 above.

recent years for accelerated filers that are subject to the ICFR auditor attestation requirement and have revenues of less than $100 million, relative to the audit fees of issuers in our comparison populations (non-accelerated filers, other than EGCs, and EGCs, neither of which is required to comply with the ICFR auditor attestation requirement)[407] that also have revenues of less than $100 million. Based on this analysis, and with consideration for the difference in size of the affected issuers versus the comparison sample, we derived a percentage estimate of 25 percent of total audit fees, and a dollar estimate of about $110,000 per year, that would be saved by issuers newly exempt from the ICFR auditor attestation requirement.[408] As discussed in more detail in the Proposing Release, the percentage estimate is generally consistent with the estimates, ranging from approximately five to 35 percent of total audit fees, from a variety of other analyses using data from after the 2007 change in the ICFR auditing standard.

Several commenters indicated that the expected cost savings are difficult to accurately quantify.[409] We acknowledge that, as discussed in more detail in the Proposing Release, our estimate is subject to significant uncertainty.[410] However, these commenters did not provide alternative methodologies or data for obtaining an estimate of the average savings. One recent study focusing on low public float issuers separately considered the subset of issuers with less than $100 million in revenues in their sample and estimated that an exemption from the ICFR auditor attestation requirement would result in an audit fee savings of $135,000 per year for these

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407 The Proposing Release, note 4 above, provides more information on why we rely on these comparison populations, how they compare to the affected issuers, and how differences between the comparison populations and the affected issuers could affect our inference. *See* Section III.C.2. of the Proposing Release, note 4 above.

408 *See* Section III.C.3.b. of the Proposing Release, note 4 above.

409 *See, e.g.,* letters from EY, Grant Thornton, and RSM.

410 *See* Section III.C.3.b. of the Proposing Release, note 4 above.

issuers.[411] While this analysis was focused on lower float issuers, it is generally supportive of the order of magnitude of our estimate. One commenter questioned whether our estimate considers the incremental costs associated with an audit approach that does not have the benefit of a related audit of ICFR.[412] We note that our analysis is intended to capture this effect, as the issuers in the comparison samples which we use to derive our estimate generally require this type of an audit approach because they are not subject to the ICFR auditor attestation requirement.

We therefore maintain, without change, our estimate of $110,000 in average audit fee savings per year per affected issuer that would be newly exempt from the ICFR auditor attestation requirement. As noted in the Proposing Release, the audit fee savings are expected to vary across the affected issuers, with some experiencing smaller savings and some experiencing much larger savings depending on their individual circumstances. In line with this expectation, several commenters insisted that any reductions in audit fees resulting from the amendments would depend on facts and circumstances and vary widely among issuers.[413] Consistent with these costs savings being highly varied, a number of commenters to the Proposing Release provided estimates of costs that specific issuers had incurred or expected to save ranging from $40,000 per year to costs of over $2 million dollars, though most of these estimates include costs other than audit fees (which are discussed below), some include one-time start-up costs as well as ongoing annual costs, and the largest estimate includes costs attributable to SOX Section 404(a) and other SOX requirements.[414] Similarly, a few of the commenters to the SRC

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411 *See* McCallen *et al. 20*19 study, note 308 above.

412 *See* letter from BDO.

413 *See, e.g.,* letters from EY, Grant Thornton, and PWC.

414 *See* letters from Cerecor (estimating a total of $1 million in expected savings for 2020 associated with an exemption from the ICFR auditor attestation requirement), Concert (estimating expected audit fees associated with the ICFR auditor attestation requirement to represent approximately 45 percent of its total audit fees),

Proposing Release cited costs of $400,000 to over $1 million associated with the ICFR auditor attestation requirement (though it is possible that these estimates also include costs other than audit fees).[415]

One commenter noted that the requirement to implement scaled, risk-based audits of ICFR should already result in an appropriately reduced cost of the ICFR auditor attestation requirement for many affected issuers.[416] We note that our quantitative methodology is intended to reflect the current cost of the ICFR auditor attestation requirement, including the benefits of scaling. Also, while the adoption of AS 2201 in 2007, which facilitated the scaling of audits of ICFR, was found to have initially led to lower audit fees, there is evidence that these costs began to increase again around the year 2010.[417]

Finally, we note that some issuers may voluntarily choose to continue to make these expenditures if they deem the benefits of the ICFR auditor attestation to exceed the cost, and that the extent of savings may be affected if auditors continue to test the operating effectiveness of some controls as part of their financial statement audit. In such cases, the audit fee savings may be reduced, but we would expect the potential costs of expanding the exemption from the ICFR

Guaranty (estimating future annual costs of $40,000 in personnel and external audit costs associated with ongoing compliance with the ICFR auditor attestation requirement, as well as a higher estimate of costs expended for their first year of compliance in 2018 of $167,745 in audit fees as well as $72,000 and 2,340 labor hours expended across the issuer's accounting, information technology and risk management offices), Pieris (estimating that their first year of compliance with the ICFR auditor attestation requirement would be associated with a total of $1.5 million in costs), Syros (estimating that its expected additional costs for compliance with the ICFR auditor attestation requirement would range from $250,000 to $400,000 per year, including incremental external auditor fees, consultant fees, and an increased burden on employee resources), and Terra Tech (estimating over $2 million in costs expended in 2018 for meeting all of its SOX compliance requirements, including but not limited to the ICFR auditor attestation requirement, representing costs to build a new information technology infrastructure, to hire new staff and consultants, and to pay auditing fees).

415 *See* note 208 of the Proposing Release, note 4 above.

416 *See* letter from CFA.

417 *See* Section IV.B.1. above.

auditor attestation requirement to be correspondingly lower as well.

d. Additional potential compliance cost savings

The ICFR auditor attestation requirement is associated with other compliance costs beyond audit fees, including outside vendor costs and internal labor costs.[418] However, these costs are difficult to measure because they are not required to be reported. Practitioner studies based on surveys of issuers often report non-audit costs of the internal control assessment and reporting requirements of SOX Section 404 in particular or of SOX in general, but the costs attributable to the ICFR auditor attestation requirement versus the SOX Section 404(a) management ICFR reporting requirements or other requirements are generally not broken out separately.[419]

The Proposing Release presented an analysis of data from the 2008–09 Survey on the non-audit costs of SOX Section 404 in general, such as outside vendor costs, labor, and non-labor costs (such as software, hardware and travel costs), as well as the percentage of the outside vendor costs and labor hours that were attributable to the ICFR auditor attestation requirement. Based on this analysis, we estimated that the average non-audit costs attributable to the ICFR auditor attestation requirement at the time of the survey were approximately $125,000 per year.[420] Adjusting this historical cost downward slightly to account for the fact that some of these expenditures may now be required even in the case of a financial statement only audit (due

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418 *See, e.g.*, Leuz and Wysocki 2016 Study, note 396 above.

419 *See, e.g.*, Protiviti 2018 Report, note 317 above (finding, for example, total internal costs associated with all aspects of SOX compliance to be $282,900 for 2018 for respondents with less than $100 million in revenues) and SOX & Internal Controls Professionals Group, Moss Adams LLP, and Workiva (2017), "2017 State of the SOX/Internal Controls Market Survey" ("2017 SICPG Survey Report"), available at www.mossadams.com/landingpages/2017-sox-and-internal-controls-market-survey.

420 *See* Section III.C.3.c. of the Proposing Release, note 4 above.

to the risk assessment auditing standards issued subsequent to this survey), we estimated that the average non-audit costs attributable to the ICFR auditor attestation requirement are currently approximately $100,000 per year.[421] As noted in the Proposing Release, this estimate is subject to uncertainty because it is unclear exactly how the current costs may differ from the survey responses a decade ago, and the costs may be different for low-revenue issuers.

Commenters did not provide alternative methodologies for obtaining an estimate of the average non audit-fee savings. One recent study focusing on low public float issuers considered the potential effect of the ICFR auditor attestation requirement on selling, general and administrative ("SG&A") expenses other than audit fees, and concluded that there was an association with an increase in these internal costs, but was unable to reliably estimate the magnitude of this effect.[422] We therefore maintain, without change, our estimate of $100,000 in average non-audit compliance cost savings per year per affected issuer that would be newly exempt from the ICFR auditor attestation requirement.

As in the case of audit fees, some of the affected issuers are expected to experience lower cost savings while others would experience greater savings, depending on their individual circumstances. For example, we noted in the Proposing Release that some issuers had reported potential cost savings other than audit fees ranging from about $110,000 to about $350,000.[423] While commenters to the Proposing Release generally did not separately break out these non-audit costs, they reported total costs including audit fees but also internal labor and consultant costs ranging from $40,000 to over $2 million, though, as noted above, some include one-time

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421 *Id.*

422 *See* McCallen *et al. 20*19 study, note 308 above.

423 See note 211 of the Proposing Release, note 4 above.

start-up costs as well as ongoing annual costs, and the largest estimate includes costs attributable to SOX Section 404(a) and other SOX requirements.[424]

e. Implications of the cost savings

While we estimate the average compliance cost associated with the ICFR auditor attestation requirement for the affected issuers, it is more difficult to discern whether incurring the costs of this requirement represents the most effective use of funds for these issuers. As discussed in Section IV.C.3.c. below, issuers for whom the requirement is eliminated may determine that it is worthwhile to use these funds to voluntarily undergo an audit of ICFR.[425] Alternatively, some of these issuers could directly invest the compliance cost savings in improving their operations and prospects for growth, or in their control systems.

In total, we estimate an average cost savings of $210,000 per issuer per year, with some of the affected issuers experiencing lesser or greater savings.[426] While a few commenters noted that ICFR auditor attestations have become less expensive over time[427] or that they should already be less expensive for the affected issuers due to the ability to scale the audit of ICFR,[428] we note that our analysis, using only recent years of data and low-revenue issuers, is intended to capture any such effects.

Several commenters argued that these cost savings are economically small.[429] In

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424 *See* letters from Cerecor, Guaranty, Pieris, Syros, and Terra Tech, as discussed in more detail in above note 414. *See also* Ardelyx Presentation, citing the BIO Study, note 69 above.

425 *See* letter from BIO (supporting allowing "issuers and their investors the flexibility to determine for themselves whether Section 404(b) is relevant to their business").

426 As noted above, this estimate is not intended to apply to affected issuers that would not otherwise be subject to the ICFR auditor attestation requirement (i.e., EGCs) or that would remain subject to the FDIC auditor attestation requirement (i.e., banks with assets of over $1 billion).

427 *See, e.g.*, letters from CFA Inst. and Deloitte.

428 *See* letter from CFA.

429 *See, e.g.,* letters from CFA, CFA Inst., CII, and Prof. Barth *et al*.

particular, they estimated that the savings represent 0.5 percent of the average affected issuer's revenue and 0.1 percent of its market value.[430] Similarly, many commenters asserted that the proposed amendments would not enhance capital formation—and some indicated they could even reduce capital formation.[431] Others noted that, in general, the costs of the ICFR auditor attestation requirement are substantial,[432] and that by eliminating the requirement for certain issuers, the proposed amendments would enhance capital formation or allow those issuers to preserve capital.[433] We continue to believe that the average expected savings is likely, in many cases, to represent a meaningful cost savings for issuers with less than $100 million in revenue and may thus have beneficial economic effects on competition and capital formation.

In particular, while the average annual cost savings may represent a small percentage of the average affected issuers' revenues and market capitalizations, it is significant relative to the income and cash flows of these issuers. As noted in the Proposing Release, low-revenue issuers are likely to face financing constraints because they do not have access to internally-generated capital.[434] A majority of the affected issuers that will be newly exempt from the ICFR auditor attestation requirement, and that will not be subject to the FDIC auditor attestation requirement,

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[430] We obtain similar estimates. Specifically, we estimate that the annual savings represents of 0.7 percent of the median revenue and 0.1 percent of the median market capitalization of the affected issuers that would be newly exempt from all ICFR auditor attestation requirements. We note, however, that 12 percent of these issuers have zero revenues, and that the savings are estimated for a single year while market capitalization incorporates expectations regarding all future years of performance.

[431] *See, e.g.*, letters from Better Markets, CII, CFA, and Prof. Ge *et al.* *See also* CFA Inst. (stating that the Proposing Release, note 4 above, does not demonstrate that eliminating the ICFR auditor attestation requirement would enhance capital formation).

[432] *See, e.g.,* letters from BIO, Broadmark, Carver, Guaranty, ICBA, MSB, SSB, and Syros.

[433] *See, e.g.*, letters from Andersen, CLSA, Concert, ICBA, and NASBA.

[434] For example, the Proposing Release, note 4 above, cited one commenter that indicated that "pre-revenue small businesses utilize only investment dollars to fund their work" and that any cost savings thus "could lead to funding for a new life-saving medicine." *See* note 213 of the Proposing Release, note 4 above.

have negative net income and negative net cash flows from operations.[435] In the absence of significant income generation, the average savings of $210,000 per year may be likely to be put to productive use,[436] such as towards capital investments, which would enhance capital formation. A number of issuers commented that they anticipated that the savings would allow for increased investment in their core business.[437] Also, while some issuers may experience lesser savings, some commented that they expect to experience substantially greater savings,[438] so the cost savings are likely to be significant for some, even if not all, of the affected issuers.

Further, several commenters cited fixed costs of compliance that do not scale with size.[439] Because of the fixed costs component of compliance costs, smaller issuers generally bear proportionately higher compliance costs than larger issuers.[440] To illustrate this disparity, we estimated in the Proposing Release that total audit fees represent about 22 percent of revenues on average for accelerated filers with less than $100 million in revenues, versus 0.5 percent of revenue for those above $100 million in revenues.[441] Reducing the affected issuers' costs would

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435 *See* note 362 above.

436 For example, in a survey of issuers in the biotech industry, among 11 biotech EGCs that responded to a question regarding how an extension of the exemption from the ICFR auditor attestation requirement would affect them given the costs associated with the requirement, eight out of the 11 issuers indicated that they expected a positive impact on investments in research and development and six out of the 11 issuers indicated that they expected a positive impact on hiring employees. *See* BIO Study, note 69 above.

437 *See,* e.g., letters from Cerecor, Concert, Guaranty, Pieris and Syros.

438 *See,* e.g., letters from Cerecor, Corvus, and Terratech, estimating savings of $1 to $2 million.

439 *See* letters from ASA, Broadmark, Chamber, and Guaranty.

440 While it is difficult to identify the specific source of the fixed component of compliance costs, there is empirical evidence of such fixed costs based on differences in the ratio of such costs to measures of issuer size across issuer size categories. For example, the ratio of the costs for accelerated filers of complying with Section 404 to the book value of the issuer's assets decreases with issuer size. *See, e.g.,* Figure 1 of Alexander *et al.* 2013 Study, note 401 above. There is evidence of some such fixed costs persisting even after the 2007 change in the ICFR auditing standard facilitating the scaling of an audit of ICFR, as demonstrated by the results in the cited figure for issuers that had been complying with Section 404(b) for five years (as observations in the figure pertaining to lesser years of experience may include costs experienced by some issuers in years prior to the 2007 changes).

441 *See* Section III.C.2.d. of the Proposing Release, note 4 above.

reduce their overhead expenses and may enhance their ability to compete with larger issuers.

The alleviation of these costs could be a positive factor in the decision of additional companies to enter public markets.[442] That is, if future compliance costs associated with ICFR auditor attestations weigh against these companies becoming publicly traded, reducing these expected future costs may enhance capital formation in the public markets and the efficient allocation of capital at the market level. As noted above, the expected compliance cost savings are likely to vary across issuers. The amendments may be most likely to influence the decision to enter the public markets for companies that anticipate particularly high costs to obtain an ICFR auditor attestation and that expect low levels of revenue to persist for many years into the future.

Some commenters suggested that the amendments would encourage companies to enter the public markets.[443] On the other hand, other commenters maintained that the ICFR auditor attestation requirement does not prevent companies from entering the public markets.[444]

Research investigating the link between SOX and companies exiting or choosing not to enter public markets has been inconclusive.[445] We agree with commenters who stated that a number of other factors have been associated with the decline in listings.[446] Further, newly

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442 *See, e.g.*, letter from ICBA.

443 *See, e.g.*, letters from AdvaMed, AdvaMed *et al.*, Broadmark, Cerecor, and ICBA.

444 *See, e.g.*, letters from CFA, CFA Inst., CII, and Crowe.

445 There is some evidence of a decreased rate of IPOs and an increased rate of going private transactions and deregistrations in the United States after SOX. However, it is unclear to what extent these changes can be attributed to SOX (or to the auditor attestation requirement in particular) versus other factors, and to what extent these changes are a cause for concern. *See e.g.*, Coates and Srinivasan 2014 Study, note 369 above, at 636-640 (summarizing a number of studies in this area).

446 *See, e.g.*, letters from CFA, CFA Inst., CII, and Crowe. Other factors commenters cited include the expansion of exemptions to registration that increase companies' ability to raise funds privately, *see, e.g.*, letters from CFA, CII, and Crowe; corporate consolidations, *see, e.g.*, letters from CFA and CII; market conditions, *see* letter from CFA; and the general regulatory environment, *see* letter from Crowe.

public issuers can already avail themselves of an exemption from the ICFR auditor attestation requirement for at least one and generally up to five years after their IPO.[447] While the amendments could be a positive factor in the decision of additional companies to enter public markets, it may not be the decisive factor, and the direct impact of the amendments on the number of publicly traded companies may be limited to the extent that companies may be more focused on other factors associated with the decision to go public.

3. Potential Costs of Expanding the Exemption from the ICFR Auditor Attestation Requirement for Affected Issuers

Exempting the affected issuers from the ICFR auditor attestation requirement may result, over time, in management at this category of issuers being less likely to maintain effective ICFR, which in turn may result in less reliable financial statements, on average, for these issuers. The discussion below explores this potential effect and its implications in detail. We also consider two mitigating factors that could be associated with the affected issuers on average, though we acknowledge that they may not apply equally to all of the affected issuers. First, low-revenue issuers may, on average, be less susceptible to the risk of certain kinds of misstatements, such as errors associated with revenue recognition.[448] Second, in many cases, the market value of such issuers may be driven to a greater degree by their future prospects than by the current period's financial statements, which may affect how, on average, investors use these issuers' financial statements. This discussion is focused on affected issuers that will be newly exempt from the ICFR auditor attestation requirement and will not be subject to the FDIC auditor attestation requirement.

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[447] *See* note 11 above regarding the exemption of EGCs from the auditor attestation requirement.

[448] *See* BIO Study, note 69 above (finding that biotechnology EGCs have lower restatement frequencies than other issuers, after controlling for other factors, and attributing this to their "absence of product revenue" based on findings that revenue recognition is one of the most frequent drivers of financial restatements).

Exempting the affected issuers from the ICFR auditor attestation requirement could also increase the risk that material weaknesses in ICFR may not be detected and disclosed, and thereby reduce the information available to investors for gauging the reliability of these issuers' financial statements. In this regard, we also discuss below the potential effects related to the identification and disclosure of material weaknesses in ICFR at the affected issuers. However, given the size of the estimated effect as well as recent findings discussed in Section IV.C.3.a. below on how ICFR auditor attestations may provide limited information about the risk of future restatements,[449] we believe that any such effect would not significantly affect investors' overall ability to make informed investment decisions.

a. Broad considerations and evidence regarding the effects of ICFR auditor attestations on financial reporting

This section summarizes a number of broad economic considerations related to the possible effects of an ICFR auditor attestation requirement on financial reporting in order to provide context for the more detailed analysis of the costs of exempting the affected parties from this requirement that follows. As discussed below, the anticipated effects of changes to the population of issuers subject to the ICFR auditor attestation requirement will depend on the characteristics of the specific group of issuers that will be affected. In this regard we note that prior research has not focused on the effects of the ICFR auditor attestation requirement on low-revenue issuers in particular. As discussed in Section IV.B.1., there also have been significant changes over time in the implementation of the ICFR auditor attestation requirement, the standards applying to a financial statement audit even in the absence of an audit of ICFR, and the execution of audits of financial statements and of ICFR, which may have had the effect of

[449] *See* notes 453 through 459 below and accompanying text.

reducing both the incremental costs and incremental benefits of an ICFR auditor attestation since the periods studied in much of the existing research. We therefore acknowledge that, while we believe that consideration of the past research is an important part of our analysis, these factors limit our ability to rely on the findings of past research to predict how the amendments would affect the particular class of issuers implicated by this rulemaking.

ICFR auditor attestations can have two primary types of benefits. First, the ICFR auditor attestation reports can provide incremental information to investors about the reliability of the financial statements. Second, the reliability of the financial statements can be enhanced. That is, the expectation of, or process involved in, the ICFR auditor attestation could lead issuers to maintain better controls, which could lead to more reliable financial reporting. Importantly for our evaluation of these possible benefits, however, we do not directly observe the effectiveness of ICFR and the reliability of financial statements, but only the associated disclosures by issuers. For example, while restatements may indicate that controls have failed, such restatements are often predicated on the underlying misstatements being detected. Given such limitations with the available data, the analysis in existing studies and in this release is necessarily less than definitive.

Regarding the first possible benefit of ICFR auditor attestations, academic research provides some evidence that ICFR auditor attestation reports contain information about the reliability of financial statements, but also demonstrates that the incremental information provided by these reports may be limited. The 2011 SEC Staff Study summarizes evidence that ICFR auditor attestations generally resulted in the identification and disclosure of material weaknesses that were not previously identified or whose severity was misclassified when identified by management in its assessment of ICFR, and that investor risk assessments and

investment decisions were associated with the findings in auditor attestation reports.[450] As noted by a commenter,[451] various survey results are also supportive of these reports being informative to investors.[452]

However, more recent studies have found that auditor identification of material weaknesses in ICFR tends to be concurrent with the disclosure of restatements, rather than providing advance warning of the potential for restatements.[453] While these findings do not imply that ICFR auditor attestation reports fail to provide any useful information about the risk of future restatements,[454] they demonstrate that this information may be limited. Further, researchers have been able to predict the identification by auditors of material weaknesses in ICFR beyond those identified by management, to some extent, by using otherwise available information about issuers beyond current restatements, such as their institutional ownership,

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450 *See* 2011 SEC Staff Study, note 198 above, at 97-99 and 102-104. *See also* Coates and Srinivasan 2014 Study, note 369 above.

451 *See* letter from CII.

452 *See* Lawrence Brown, Andrew Call, Michael Clement, and Nathan Sharp, *The Activities of Buy-Side Analysts and the Determinants of their Stock Recommendations*, 62 J. OF ACCT. AND ECON. 139 (2016) (finding, in a survey of buy-side analysts, that 60 percent responded that material weaknesses in ICFR are definitely a red flag of management potentially misrepresenting financial results, and that the existence of a material weakness in ICFR was the most cited red flag for misrepresentation followed by weak corporate governance; however, this survey did not differentiate between firms subject or not subject to the ICFR auditor attestation requirement).

453 *See, e.g.*, Sarah Rice & David Weber, *How Effective is Internal Control Reporting under SOX 404? Determinants of the (Non-)Disclosure of Existing Material Weaknesses*, 50(3) J. OF ACCT. RES. 811 (2012); William Kinney, Roger Martin, & Marcy Shepardson, *Reflections on a Decade of SOX 404(b) Audit Production and Alternatives*, 27(4) ACCT. HORIZONS 799 (2013); and Daniel Aobdia, Preeti Choudhary, & Gil Sadka, *Do Auditors Correctly Identify and Assess Internal Control Deficiencies? Evidence from the PCAOB Data*, Working Paper (2018), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2838896. *See also* Kinney and Shepardson 2011 Study, note 404 above.

454 *See, e.g.,* 2011 SEC Staff Study, note 198 above, at 86 (citing evidence that while both issuers subject to SOX Section 404(b) as well as those only subject to SOX Section 404(a) often report restatements despite previously reporting that their ICFR was effective, such restatements were 46 percent higher among those filing only SOX Section 404(a) reports). *See also* PCAOB Investor Advisory Group, *Report from the Working Group on the Investor Survey* (2015), available at https://pcaobus.org/News/Events/Documents/09092015_IAGMeeting/Investor_Survey_Slides.pdf (reporting survey findings that 72 percent of institutional investors indicated that they relied on ICFR auditor attestations either "extensively" or "a good bit").

aggregate losses, past restatements, and late filings.[455] One commenter notes that this predictability does not imply that there is limited incremental information provided by ICFR auditor attestation reports, as their analysis suggests that investors are not able to fully discern misreporting by issuers about their ICFR.[456] Still, we believe that the evidence suggests that markets at least partially, though perhaps not fully, incorporate this information even in the absence of an ICFR auditor attestation.[457] Limitations to the incremental information provided by ICFR auditor attestation reports about the risk of future restatements may result from disincentives, such as the increased risk of litigation and greater likelihood of management and auditor turnover that have been associated with earlier material weakness disclosures, for issuers and their auditors to disclose material weaknesses in the absence of restatements.[458] It may also result from issues with the quality of the audit of ICFR. In this regard, researchers have found that PCAOB scrutiny of these audits has been associated with a slightly higher rate of identification of material weaknesses in ICFR prior to a later restatement.[459]

A further reason why ICFR auditor attestation reports may provide only a weak warning

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455 *See, e.g.*, Ge *et al.* 2017 Study, note 393 above.

456 *See* letter from Prof. Ge *et al.*

457 *See, e.g.,* H. Ashbaugh-Skaife, D. Collins, W. Kinney, & R. LaFond, *The Effect of SOX Internal Control Deficiencies on Firm Risk and Cost of Equity*, 47(1) J. OF ACCT. RES. 1 (2009) ("Ashbaugh-Skaife *et al.* 2009 Study") (finding that companies that newly disclose material weaknesses in their ICFR have an increase in their cost of capital, but that this increase is lower for companies with the characteristics most associated with having such material weaknesses, *i.e.*, those for which the market may be least surprised by the disclosures, at about 50 basis points, and higher for companies without such characteristics, at about 125 basis points).

458 *See* Sarah Rice, David Weber, & Biyu Wu, *Does SOX 404 Have Teeth? Consequences of the Failure to Report Existing Internal Control Weaknesses*, 90(3) ACCT. REV. 1169 (2015). We note that auditors have a duty to follow auditing standards and, if they do not, face associated enforcement, inspection, reputation, and litigation risks that provide a countervailing incentive.

459 *See, e.g.*, Defond and Lennox 2017 Study, note 307 above (finding that PCAOB inspections may increase auditors' issuance of adverse internal control opinions to clients with later restatements; in particular, the study documents that in 2010, 96 percent of financial statements that were later restated were accompanied by ICFR auditor attestations disclosing no material weaknesses in ICFR, while this rate dropped to 91 percent by 2013).

about future restatements is that the audit of ICFR may contribute to the avoidance of misstatements, leading us to observe only the residual restatements where the misstatement risk was not foreseen or a misstatement was not detected for reasons unrelated to internal controls. Thus, the second possible benefit we consider is that the audit of ICFR may encourage management to maintain more effective controls and thereby deter accounting errors and fraud. The academic research discussed below documents substantial evidence that would be consistent with such effects, though, as is common in financial economics, it is difficult to determine whether the documented differences can be causally linked to the audit of ICFR.[460]

In particular, while issuers are subject to a number of requirements discussed above that are intended to help to provide adequate internal controls and reliable financial statements,[461] studies have documented a significant association between audits of ICFR and the maintenance of better internal controls. The 2011 SEC Staff Study provides analysis and summarizes research indicating that issuers that were not required to obtain an ICFR auditor attestation disclosed ineffective ICFR at a greater rate than those that were subject to such requirements,[462] and newer studies demonstrate that this difference has remained consistent in recent years.[463]

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460 *See* Coates and Srinivasan 2014 Study, note 369 above, and Leuz and Wysocki 2016 Study, note 396 above (both articles discussing the limited ability to make causal attribution based on research on the effects of the provisions of SOX, but also highlighting the specific studies that can more plausibly make causal claims). *See also Report to Congress: Access to Capital and Market Liquidity*, August 2017 SEC Staff study 24-27 (discussing similar limitations, in a different context, in the ability to make causal inferences about the effects of regulation because of data and experimental design issues), available at https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf.

461 *See* Section IV.B.1. above.

462 *See* 2011 SEC Staff Study, note 198 above, at 41 and 86-87. The rate of ineffective ICFR is based on the findings of management reports on ICFR pursuant to SOX Section 404(a). Because auditor attestations of ICFR are associated with an increased detection and disclosure of material weaknesses, as discussed above, the rate of ineffective ICFR reported by issuers not subject to the auditor attestation requirement may be understated, which would result in this difference also being understated.

463 *See, e.g.*, Audit Analytics, *SOX 404 Disclosures: A Fourteen Year Review* (Sept. 2018) ("2018 Audit Analytics Study"), available at www.auditanalytics.com/blog/sox-404-disclosures-a-fourteen-year-review/.

Further, a recent paper finds that the ICFR auditor attestation requirement, but not management ICFR reporting requirements alone, are associated with enhanced quarterly earnings accrual quality, and argues that this is an indication of the improved quality of internal controls.[464] We note, however, that this study finds that the improvements for issuers subject to the ICFR auditor attestation requirement are attenuated after the 2007 change in the ICFR auditing standard discussed in Section IV.B.1. above.[465] The ICFR auditor attestation requirement has also been associated with a higher rate of remediation of material weaknesses after they are disclosed.[466] As noted by a commenter,[467] survey evidence is also consistent with this requirement being associated with more effective ICFR. For example, this commenter cites a recent survey of public companies that found that 57 percent responded that one of the primary benefits of the ICFR auditor attestation requirement was "improved internal control over financial reporting (ICFR) structure."[468]

To the extent that the ICFR auditor attestation requirement leads to more effective ICFR,

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464 *See* Schroeder and Shepardson 2016 Study, note 305 above (using quarterly accruals quality, measured by the level of quarterly discretionary working capital accruals and the quarterly accrual estimation error, as a proxy for internal control quality based on the argument that internal control improvements should be exhibited in unaudited financial reports).

465 *Id.*

466 *See* Vishal Munsif & Meghna Singhvi, *Internal Control Reporting and Audit Fees of Non-Accelerated Filers*, 15(4) J. OF ACCT., ETHICS & PUB. POL'Y 902 at 915 (2014) (finding that 49 out of 160, or 30 percent, of non-accelerated filers that disclosed a material weakness in 2008 reported no material weaknesses in 2009, in contrast to 64 out of 83, or 77 percent, of accelerated filers in a similar situation). *See also* Jacqueline Hammersley, Linda Myers, & Jian Zhou, *The Failure to Remediate Previously Disclosed Material Weaknesses in Internal Controls*, 31(2) AUDITING: J. PRAC. & THEORY 73 (2012); and Karla Johnstone, Chan Li, & Kathleen Rupley, *Changes in Corporate Governance Associated with the Revelation of Internal Control Material Weaknesses and their Subsequent Remediation*, 28(1) CONTEMP. ACCT. RES. 331 (2011) (both finding a similar rate of remediation for accelerated filers for an earlier sample period).

467 *See* letter from CII.

468 *Id*. *See* also *Benchmarking SOX Costs, Hours and Controls*, Protiviti (June 24, 2019), available at https://www.protiviti.com/sites/default/files/united_states/insights/2019_sarbanes_oxley_compliance_surveyprotiviti.pdf.

this requirement may thereby lead to more reliable financial statements. Some studies have found that a failure to maintain effective ICFR has been associated with a higher rate of future restatements and lower earnings quality,[469] a higher rate of future fraud revelations,[470] more profitable insider trading,[471] and less accurate analyst forecasts.[472]

Generally, ICFR auditor attestations also have been found to be directly associated with financial statements that are more reliable than in the absence of these attestations.[473] We note, however, that two recent studies, using different methodologies, find evidence that conflicts with these other studies. In particular, the evidence in these studies, which use data from 2007 through 2013[474] and 2014,[475] respectively, does not support the conclusion that the ICFR auditor attestation requirement is associated with more reliable financial statements, and one of the

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469 *See* Coates and Srinivasan 2014 Study, note 369 above, at 649-650.

470 *See* Dain Donelson, Matthew Ege, & John McInnis, *Internal Control Weaknesses and Financial Reporting Fraud*, 36(3) AUDITING: A J. OF PRAC. AND THEORY 45 (2017) ("Donelson *et al. 20*17 Study") (finding that issuers with a material weakness in ICFR are 1.24 percentage points more likely to have a fraud revelation within the next three years compared to issuers without a material weakness, relative to a 1.60 percent unconditional probability of fraud).

471 *See* Hollis Asbhaugh-Skaife, David Veenman, & Daniel Wangerin, *Internal Control over Financial Reporting and Managerial Rent Extraction: Evidence from the Profitability of Insider Trading*, 55(1) J. OF ACCT. AND ECON. 91 (2013).

472 *See, e.g.*, Sarah Clinton, Arianna Pinello, & Hollis Skaife, *The Implications of Ineffective Internal Control and SOX 404 Reporting for Financial Analysts*, 33(4) J. OF ACCT. AND PUB. POL'Y 303 (2014).

473 *See* 2011 SEC Staff Study, note 198 above, at 98-100. For more recent evidence, *see, e.g.*, Yuping Zhao, Jean Bedard, & Rani Hoitash, S*OX 404, Auditor Effort, and the Prevention of Financial Report Misstatements*, 36(4) AUDITING: A J. OF PRAC. & THEORY 151 (2017); and Lucy Chen, Jayanthi Krishnan, Heibatollah Sami, & Haiyan Zhou, *Auditor Attestation under SOX Section 404 and Earnings Informativeness*, 32(1) AUDITING: A J. OF PRAC. & THEORY 61 (2013).

474 *See* Bhaskar *et al.* 2018 Study, note 305 above (finding that, among companies with less than $150 million in market capitalization, those providing auditor attestations of ICFR, whether voluntarily or because they are accelerated filers, had a higher rate of material misstatements and lower earnings quality than others in this category in the period from 2007 through 2013).

475 *See* McCallen *et al.* 2019 Study, note 308 above (finding that, among companies with close to $75 million in public float, those above this threshold, which are likely subject to the ICFR auditor attestation requirement, do not experience lower restatements than those below this threshold in the period from 2007 through 2015).

studies[476] even finds an association with lower reliability, consistent with concerns discussed in Section IV.B.1. above that the quality of audits of ICFR dropped at least temporarily after 2007.

To evaluate the economic implications of any effects the ICFR auditor attestation requirement has on ICFR and financial statements, we can consider factors such as production or investment at the issuer or market level. For example, at the issuer level, more reliable disclosures are generally expected, based on economic theory, to lead investors to demand a lower expected return to hold an issuer's securities (*i.e.*, a lower cost of capital).[477] A lower cost of capital may enhance capital formation by encouraging issuers to issue additional securities in order to raise funds for new investments. Empirically, material weaknesses in ICFR,[478] restatements,[479] and low earnings quality[480] have all been associated with a higher cost of debt or equity[481] capital.

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476 *See* Bhaskar *et al.* 2018 Study, note 305 above.

477 *See, e.g.*, Douglas Diamond & Robert Verrecchia, *Disclosure, Liquidity, and the Cost of Capital*, 46(4) J. OF FIN. 1325 (1991) ("Diamond and Verrecchia 1991 Study"); David Easley & Maureen O'Hara, '*Information and the Cost of Capital*,' 59(4) J. OF FIN. 1553 (2004); Richard Lambert, Christian Leuz, & Robert Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*," 45(2) J. OF ACCT. RES. 385 (2007); and Christopher Armstrong, John Core, Daniel Taylor, & Robert Verrecchia, *When Does Information Asymmetry Affect the Cost of Capital?* 49(1) J. OF ACCT. RES. 1 (2011). We note that these articles also detail limited theoretical circumstances under which more reliable disclosures could lead to a higher cost of capital, such as in the case where improved disclosure is sufficient to reduce incentives for market making.

478 *See, e.g.*, Dragon Tang, Feng Tian, & Hong Yan, *Internal Control Quality and Credit Default Swap Spread*s, 29(3) ACCT. HORIZONS 603 (2015); Lawrence Gordon & Amanda Wilford, *An Analysis of Multiple Consecutive Years of Material Weaknesses in Internal Control*, 87(6) ACCT. REV. 2027 (2012) ("Gordon and Wilford 2012 Study"); and Ashbaugh-Skaife *et al.* 2009 Study, note 457 above. We note that earlier work did not detect an association between SOX Section 404 material weaknesses and the equity cost of capital. *See, e.g.,* M. Ogneva, K. R. Subramanyam, & K. Rachunandan, *Internal Control Weakness and Cost of Equity: Evidence from SOX Section 404 Disclosures*, 82(5) ACCT. REV. 1255 (2007) ("Ogneva *et al.* 2007 Study"). *See also* 2011 SEC Staff Study, note 198 above, at 101-102.

479 *See, e.g.*, Paul Hribar & Nicole Jenkins, *The Effect of Accounting Restatements on Earnings Revisions and the Estimated Cost of Capital*, 9 REV. OF ACCT. STUD. 337 (2004) ("Hribar and Jenkins 2004 Study").

480 *See, e.g.*, Jennifer Francis, Ryan LaFond, Per M. Olsson, & Katherine Schipper, *Cost of Equity and Earnings Attributes*, 79(4) ACCT. REV. 967 (2004) ("Francis *et al.* 2004 Study").

481 We note that empirical studies of the cost of equity capital face particular challenges in accurately measuring the cost of equity capital, which can reduce their reliability, but that this is mitigated in studies that look at changes over time, *see, e.g.,* Gordon and Wilford 2012 Study, note 478 above; Ashbaugh-Skaife *et al.* 2009

More effective ICFR and more reliable financial reporting may also lead to improved efficiency of production if managers themselves thereby have access to more reliable data that facilitates better operating and investing decisions.[482] For example, one study finds that the investment efficiency of issuers improves, in that both under-investment and over-investment are curtailed, after the disclosure and remediation of material weaknesses.[483] Another study finds that issuers that remediate material weaknesses in ICFR that are related to inventory tracking thereafter experience higher inventory turnover, together with improvements in sales and profitability.[484] That said, it is difficult to generalize the results beyond these samples to determine whether non-remediating issuers or issuers with different types of material weaknesses in ICFR could expect similar operational benefits from remediation. The ICFR auditor attestation requirement may also result in benefits at the market level, though these are more difficult to measure than those at the issuer level.[485] The potential for market-level impact is

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Study, note 457 above; and Hribar and Jenkins 2004 Study, note 479 above, rather than in the cross-section. *See, e.g.,* Ogneva *et al.* 2007 Study, note 478 above, and Francis *et al.* 2004 Study, note 480 above. *See also, e.g.*, Stephannie Larocque & Matthew R. Lyle, *Implied Cost of Equity Capital Estimates as Predictors of Accounting Returns and Stock Returns*, 2(1) J. OF FIN. REP. 69 (2017) (discussing concerns about measures of the cost of equity capital); and Charles M. C. Lee, Eric C. So, & Charles C. Y. Wang, *Evaluating Firm-Level Expected-Return Proxies*, Harvard Business School Working Paper 15-022 (2017) (finding that "in the vast majority of research settings, biases in [equity cost of capital measures] are irrelevant" and that the cost of equity capital measures used in the accounting literature "are particularly useful in tracking time-series variations in expected returns").

[482] *See, e.g.*, Ge *et al.* 2017 Study at 359, note 393 above (arguing that internal control misreporting leads to lower operating performance due to the non-remediation of ineffective controls, and estimating the degree of such underperformance based on the improvement shown by issuers that are non-accelerated filers after disclosing and remediating material weaknesses, relative to other such issuers that are suspected of having unreported material weaknesses).

[483] *See* Mei Cheng, Dan Dhaliwal, & Yuan Zheng, *Does Investment Efficiency Improve After the Disclosure of Material Weaknesses in Internal Control over Financial Reporting?*, 56(1) J. OF ACCT. AND ECON. 1 (2013).

[484] *See* Mei Feng, Chan Li, Sarah McVay, & Hollis Skaife, *Does Ineffective Internal Control Over Financial Reporting Affect a Firm's Operations? Evidence From Firms' Inventory Management*," 90(2) ACCT. REV., 529 (2015) ("Feng *et al.* 2015 Study").

[485] *See, e.g.*, Leuz and Wysocki 2016 Study, note 396 above (stating that researchers "generally lack evidence on market-wide effects and externalities from regulation, yet such evidence is central to the economic justification

largely driven by network effects (which are associated with the broad adoption of practices) and by other externalities (*i.e.*, spillover effects on issuers or parties beyond the issuer in question). For example, to the extent that the ICFR auditor attestation requirement leads to more reliable financial statements at a large number of issuers, it may lead to a more efficient allocation of capital across different investment opportunities at the market level.[486] The ICFR auditor attestation requirement also can enhance capital formation to the extent that it improves overall investor confidence, for which there is some suggestive evidence,[487] and thus encourages investment in public markets.[488]

Many commenters cited the benefits that have been ascribed to the ICFR auditor attestation requirement in general and attested to their importance. For example, some stated that the ICFR auditor attestation requirement promotes more effective ICFR and more accurate ICFR disclosures,[489] including a greater likelihood and timeliness of disclosing ineffective or weak ICFR,[490] and that effective ICFR leads to better and more reliable financial statements,[491] audit

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of regulation" and acknowledging that "the identification of such market-wide effects and externalities is even more difficult than the identification of direct economic consequences on individual firms").

[486] There is also some evidence that more reliable financial disclosures also facilitate a more effective market for corporate control, which can increase overall market discipline and thus enhance the efficiency of production by incentivizing more effective management. *See* Amir Amel-Zadeh & Yuan Zhang, *The Economic Consequences of Financial Restatements: Evidence from the Market for Corporate Control*, 90(1) ACCT. REV. 1 (2015). *See also* Vidhi Chhaochharia, Clemens Otto, & Vikrant Vig, *The Unintended Effects of the Sarbanes–Oxley Act*, 167(1) J. OF INSTITUTIONAL AND THEORETICAL ECON. 149 (2011).

[487] *See, e.g.*, 2013 GAO Study, note 297246 above (finding that 52 percent of the companies surveyed reported greater confidence in the financial reports of other companies due to the ICFR auditor attestation requirement; in contrast, 30 percent of the respondents reported that they believed this requirement raised investor confidence in their own company).

[488] For a further discussion of potential externalities, *see* Coates and Srinivasan 2014 Study, note 369 above, at 657-659.

[489] *See, e.g.,* letters from Better Markets, CFA, CII, Crowe, Grant Thornton, Prof. Barth *et al.*, and PWC.

[490] *See, e.g.,* letters from Better Markets, CFA, Crowe, and Prof. Barth *et al.*

[491] *See, e.g.,* letters from CAQ, CFA, CII, and Grant Thornton.

quality,[492] and analyst forecasts[493] as well as fewer restatements, misstatements,[494] and instances of fraud and insider trading.[495] Others more directly linked the ICFR auditor attestation requirement with enhanced transparency,[496] a higher quality and reliability of issuers' financial statements,[497] and corporate governance[498] and a reduced number of restatements, misstatements,[499] and instances of fraud.[500] Some commenters noted that the ICFR auditor attestation requirement increases investor confidence generally[501] and that investors view the requirement as beneficial.[502]

Importantly, all of these benefits, at both the issuer and market level, likely vary across issuers of different types. For example, younger, loss-incurring issuers with lower market capitalization and lower institutional ownership, as well as those with more segments, tend to be more likely to newly disclose material weaknesses as they transition into the ICFR auditor attestation requirement.[503] However, the market appears to account for the association of material weaknesses with these and other observable issuer characteristics. Thus, issuers that

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492 *See, e.g.,* letter from CAQ.

493 *See, e.g.,* letter from CFA.

494 *See, e.g.,* letters from CAQ and CFA.

495 *See, e.g.,* letter from CFA.

496 *See, e.g.,* letter from EY.

497 *See, e.g.,* letters from Better Markets, CFA, CII, Deloitte, EY, Grant Thornton, PWC, and RSM.

498 *See, e.g.,* letter from Deloitte.

499 *See, e.g.,* letters from CAQ, CFA Inst., Crowe, Deloitte, EY, Grant Thornton, and Prof. Barth *et al.*

500 *See, e.g.,* letters from Better Markets and Deloitte.

501 *See, e.g.,* letters from Better Markets, CAQ, CFA, and EY.

502 *See, e.g.,* letters from CII, CFA Inst., and EY.

503 *See* Ge *et al.* 2017 Study, note 393 above (regarding the term "younger," this study defines company age as the number of years a company has been covered in the Compustat database). *See also* 2011 SEC Staff Study, note 198 above, at 96 (summarizing previous research finding that internal control deficiencies are associated with smaller, complex, riskier, and more financially-distressed issuers).

have the characteristics associated with a higher rate of material weaknesses (and which investors may therefore value under the assumption that they are likely to have ineffective ICFR) but that receive an auditor attestation report that does not report any material weaknesses are found to have the greatest cost of capital benefit from such a report.[504] Small, loss-incurring issuers are also disproportionately represented amongst issuers that have allegedly engaged in financial disclosure frauds, indicating that any benefits in terms of investor protection and investor confidence may be particularly important for this population of issuers.[505] On the other hand, marginal changes in the reliability of the financial statements of issuers whose valuation is driven primarily by their future prospects—which could also include small, loss-incurring issuers—could have limited issuer- and market-level effects to the extent that the current financial statements of these issuers are less critical to assessing their valuation.[506]

b. Estimated effects on ICFR, the reliability of financial statements, and potential fraud

The academic literature discussed in Section IV.C.3.a. above suggests that the scrutiny associated with the ICFR auditor attestation may lead issuers that are required to obtain this attestation to maintain more effective ICFR and to remediate material weaknesses in ICFR more quickly, leading to more reliable financial statements. Further, as discussed above, studies have highlighted that smaller issuers are disproportionately represented in populations of issuers with ineffective ICFR and financial statements that require material restatement. In addition, smaller

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504 *See* Ashbaugh-Skaife *et al.* 2009 Study, note 457 above.

505 *See, e.g.*, COSO 2010 Fraud Study (finding that companies allegedly engaging in financial disclosure fraud in the period from 1998 through 2007 had median assets and revenue under $100 million and were often loss-incurring or close to breakeven) and *Characteristics of Financial Restatements and Frauds*, CPA J. (Nov. 2017), available at www.cpajournal.com/2017/11/20/characteristics-financial-restatements-frauds/ (for more recent evidence).

506 *See, e.g.*, Patricia Dechow & Catherine Schrand, *Earnings Quality*, RES. FOUND. OF CFA INST. 12 (2004) ("Dechow and Schrand 2004 Monograph").

issuers are less likely to have significant external scrutiny in the form of analyst and media coverage and monitoring by institutional owners,[507] which could otherwise provide another source of discipline to maintain the reliability of financial statements. However, two of the studies cited above find that the ICFR auditor attestation requirement was not associated with more reliable financial statements for lower market capitalization issuers from 2007 through 2013 or 2014,[508] and the existing studies in general may not be directly applicable to current circumstances given the 2010 change in risk assessment auditing standards, the 2007 change in the ICFR auditing standard and other recent changes discussed in Section IV.B.1. above. Importantly, the existing literature and most of the results cited by commenters regarding the benefits of the ICFR auditor attestation also do not directly examine low-revenue issuers.

This section therefore provides an analysis of low-revenue issuers using recent data to complement the existing studies and better inform our consideration of the possible costs of the amendments. However, some uncertainty will remain due to the challenges discussed above in measurement and in ascribing causality in any such analysis, the limited sample sizes that result when restricting the analysis to recent years, and the general difficulty of predicting how the parties involved will react to the amendments. As discussed in more detail in the Proposing Release,[509] our analysis includes an examination of two comparison populations of issuers that

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[507] *See, e.g.,* Joel Peress & Lily Fang, *Media Coverage and the Cross-Section of Stock Returns*, 64(5) J. OF FIN. 2023 at 2030 (2009) (finding that "firm size has an overwhelming effect on media coverage: large firms are much more likely to be covered"); Armando Gomes, Gary Gorton, & Leonardo Madureira, *SEC Regulation Fair Disclosure, Information, and the Cost of Capital*, 13 J. OF CORP. FIN. 300 at 307 (2007) (stating that "there is overwhelming evidence that size can explain analyst following"); and Eliezer Fich, Jarrad Harford, & Anh Tran, *Motivated Monitors: The Importance of Institutional Investors' Portfolio Weights*, 118(1) J. OF FIN. ECON. 21 (2015) (finding that institutional monitoring is greatest when a company represents a significant allocation of funds in the institution's portfolio, which is strongly associated with company size).

[508] *See* Bhaskar *et al.* 2018 Study, note 305 above, as discussed in note 474 above, and McCallen *et al.* 2019 Study, note 308 above, as discussed in note 475 above.

[509] *See* Sections III.C.2. and III.C.4. of the Proposing Release, note 4 above.

are not subject to the ICFR auditor attestation requirement but that otherwise have similar responsibilities with respect to ICFR (*i.e.,* non-accelerated filers, other than EGCs, and EGCs), with consideration given to the ways in which these issuers differ from the affected issuers.

One commenter suggested that we should more carefully consider the audit risks linked to specific industries that are expected to be affected by the amendments, highlighting the banking industry as one that may have special considerations.[510] We note that, as discussed above, the majority of the affected banking issuers are expected to remain subject to the FDIC auditor attestation requirement and therefore are not expected to be significantly affected by the amendments. Further, because of the small sample of affected issuers, we have a limited ability to split our sample and maintain statistical reliability. However, our aggregate estimates should reflect the overall diversity in the population of affected issuers.

Another commenter indicated that the primary quantifiable cost of an exemption from the ICFR auditor attestation requirement stems from misreporting regarding the effectiveness of ICFR.[511] While we consider this effect and its quantifiable implications in more detail below, we continue to believe that the incentive provided by the ICFR auditor attestation requirement to actually maintain better controls (versus just to more accurately report their status) remains a key benefit with certain quantifiable implications that could be lost due to an exemption from this requirement.

i. Effects on the prevalence of ineffective ICFR

We first consider possible effects related to the effectiveness of the affected issuers' ICFR. In the Proposing Release, we presented an analysis of the rate of ineffective ICFR from

[510] *See* letter from CFA Inst.

[511] *See* letter from Prof. Ge *et al*.

2014-2018 among low-revenue issuers that are subject to the ICFR auditor attestation requirement compared to low-revenue issuers not subject to this requirement.[512] In particular, we compared the reported rate of ineffective ICFR in these recent years for accelerated filers that are subject to the ICFR auditor attestation requirement and have revenues of less than $100 million, relative to the reported rate of ineffective ICFR for issuers in our comparison populations (non-accelerated filers, other than EGCs, and EGCs, neither of which is required to comply with the ICFR auditor attestation requirement) that also have revenues of less than $100 million. We focused on SOX Section 404(a) management reports on ICFR, with the caveat that management may not report as many material weaknesses in the absence of an audit of ICFR.[513] Based on this analysis, and with consideration for the difference in size, maturity, and overall resources of the affected issuers versus the comparison sample, we estimated that an additional 15 percent of the affected issuers may fail to maintain effective ICFR.[514] We did not receive comment on this specific estimate or comments providing data or methodologies that would improve our estimate. Our estimate is consistent with the estimated effect on ICFR based on a study of issuers transitioning into the ICFR auditor attestation requirement.[515] We do not expect

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512 *See* Section III.C.4.b. of the Proposing Release, note 4 above.

513 We separately consider this potential under-reporting of material weaknesses in the analysis below.

514 *See* Section III.C.4.b. of the Proposing Release, note 4 above. We also noted in this section of the Proposing Release, note 4 above, that our findings may not be surprising, as certain material weaknesses in ICFR may be corrected by, for example, hiring additional staff, which managers of an issuer that is not currently producing much revenue may prefer to defer to a later time. Indeed, about 80 to 85 percent of the low-revenue issuers reporting ineffective ICFR in the comparison populations in 2017 reported at least one staffing-related material weakness, though these were generally accompanied by other types of material weaknesses. *See* note 259 of the Proposing Release, note 4 above, and the accompanying text.

515 *See* Ge *et al.* 2017 Study, note 393 above, at 372 (finding that 62.5 percent of companies that reported material weaknesses as non-accelerated filers remediate such weaknesses upon entering accelerated filer status). To compare the result from this study to our estimate, note that we find in Table 7 above that about nine percent of accelerated filers report ineffective ICFR (further, the Proposing Release, note 4 above, found that the rate was similar for low and high revenue issuers). Our estimate of an additional 15 percentage points of the affected issuers reporting ineffective ICFR in the absence of an ICFR auditor attestation requirement would lead to a total of 24 percent (nine percent plus 15 percent) of the issuers reporting material weaknesses in ICFR in the

the full estimated effect to be experienced immediately upon effectiveness of the amendments. Instead, as discussed in detail at the end of this section, we expect a movement towards this higher rate of ineffective ICFR over time as some of the affected issuers make incremental changes in their investment in ICFR and as additional issuers enter the category of affected issuers.

ii. Effects on the detection and disclosure of material weaknesses in ICFR

Because the previous analysis focuses on disclosed rates of ineffective ICFR, it does not address the extent to which the amendments may affect the detection and disclosure of material weaknesses in ICFR. As discussed in Section IV.C.3.a. above, studies have found that audits of ICFR often result in the identification and disclosure of material weaknesses that were not previously identified or whose severity was misclassified in management's initial assessment. Thus, extending the exemption from the ICFR auditor attestation requirement to the affected issuers may decrease the likelihood that, when these issuers have underlying material weaknesses in ICFR, these material weaknesses are detected and disclosed.

In the Proposing Release, we noted that low-revenue issuers may be less likely than other issuers to fail to detect and disclose material weaknesses in the absence of an ICFR auditor attestation, perhaps because they have less complex financial systems and controls.[516] Consistent

absence of the requirement as compared to nine percent reporting material weaknesses in ICFR when subjected to the requirement. This is the same result one would get by applying the 62.5 percent remediation estimate from the cited study. In other words, if 62.5 percent of the issuers reporting material weaknesses in the absence of the ICFR auditor attestation requirement remediated their material weaknesses upon entering accelerated filer status and becoming subject to the requirement, that would mean that the rest of the issuers (37.5 percent) failed to remediate when becoming subject to the requirement. This would imply that a 24 percent rate of ineffective ICFR reported by the issuers in the absence of the requirement would correspond to a nine percent rate (24 percent times 37.5 percent) of ineffective ICFR reported by the issuers when subjected to the requirement.

[516] *See* 2017 SICPG Survey Report, note 419 above, at 6 (finding that 33 percent of survey respondents with revenues of $75 million or less reported that they manage no more than 100 total controls, as compared to 13 percent of those with revenues of $76 to $700 million and zero percent of those with revenues greater than $700 million).

with this hypothesis, we found that the low-revenue issuers that are not subject to the ICFR auditor attestation requirement report relatively high rates of ineffective ICFR despite these reports not being subject to the additional scrutiny of an ICFR auditor attestation.

In the Proposing Release, we did not quantitatively estimate a potential effect on the detection and disclosure of material weaknesses in ICFR, though we did qualitatively consider how the amendments could affect issuers depending on their proclivity to detect and disclose underlying material weaknesses in the absence of an ICFR auditor attestation.[517] Several commenters indicated that they expected the amendments to affect the detection and disclosure of material weaknesses in ICFR,[518] with one stating that "the primary quantifiable cost of 404(b) attestation exemption arises from internal control misreporting."[519] Further, other commenters noted that factors other than the complexity of issuers' systems and controls, such as their accounting personnel resources[520] or the intricacies of the issuers' business and industry, the strength of their governance, the competency of their management, and their international reach,[521] should be considered in assessing the risk of misreporting with respect to ICFR effectiveness. In response to these comments, we conducted a quantitative estimation of this effect and its potential implications.

Because undetected and undisclosed material weaknesses cannot be directly observed, we are not able to directly estimate the extent of such issues in our comparison samples of low-revenue issuers that are not subject to the ICFR auditor attestation requirement. Instead, we rely

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517 *See* Section III.C.4.c of the Proposing Release, note 4 above.

518 *See, e.g.,* letters from CFA Inst., EY, and Prof. Ge *et al*.

519 *See* letter from Prof. Ge *et al*.

520 *See* letters from CAQ and EY.

521 *See* letter from RSM.

on a recent study that estimates that an incremental 3.5 percent of issuers misreport their ICFR as being effective when not subject to the ICFR auditor attestation requirement as compared to when they are subjected to this requirement.[522] To obtain this estimate, the study uses the characteristics associated with ineffective ICFR to predict the actual rate of ineffective ICFR as opposed to the disclosed rate of ineffective ICFR, and uses changes in reporting around transitions into accelerated filer status to predict the proportion of suspected misreporters that would correctly report under an ICFR auditor attestation requirement.[523]

We directly apply the results from the study and estimate that 3.5 percent of the affected issuers that will be newly exempt from all ICFR auditor attestation requirements may misreport that their ICFR is effective, but would not misreport if subjected to those requirements. To be conservative, we do not adjust this estimate based on our conjecture that low-revenue issuers may be less likely than other issuers to fail to detect and disclose material weaknesses in the absence of an ICFR auditor attestation, perhaps because they have less complex financial systems and controls. However, we note that the estimate may be somewhat inflated to the extent that this conjecture is correct.

iii. Effects on restatements

We next consider the extent to which the possible effects on reported and unreported material weaknesses in ICFR might translate into less reliable financial statements. By definition, material weaknesses represent a reasonable possibility that a material misstatement of

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[522] *See* Ge *et al.* 2017 Study, note 393 above (estimating, based on data from 2007 through 2014, that 9.3 percent of non-accelerated filers incorrectly report their ICFR to be effective and that 38.1 percent of these, or 3.5 percent, would correctly report their ICFR to be ineffective if subjected to the ICFR auditor attestation requirement).

[523] *Id.*

the issuer's financial statements will not be prevented or detected on a timely basis,[524] and as discussed above, existing studies have demonstrated that ineffective ICFR are associated with less reliable financial statements. Thus, our estimated increase in the rate of ineffective ICFR likely would translate into a decrease in the reliability of the financial statements of the affected issuers. However, low-revenue issuers could be less susceptible, on average, to at least certain kinds of misstatements. In particular, 10 to 20 percent of restatements and about 60 percent of the cases of financial disclosure fraud in recent times have been associated with improper revenue recognition,[525] which is less of a risk, for example, for issuers that currently have no revenues.

We explored this possibility empirically in the Proposing Release, by comparing the percentage of issuers in different categories that eventually restated some of the financial statements that they reported for a given year, for the years 2014 through 2016. Because we directly considered differences in actual restatements across these groups of issuers, these results should incorporate the effects of differences across the groups in both reported and unreported material weaknesses in ICFR. Our analysis demonstrated that issuers with revenues of less than $100 million have, on average, restatement rates that are three to nine percentage points lower than those for higher-revenue issuers of the same filer status.[526] This result is consistent with

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524 *See* Regulation S-X Rule 1-02(a)(4).

525 *See* Audit Analytics, *2017 Financial Restatements: A Seventeen Year Comparison*, (May 2018), available at https://blog.auditanalytics.com/2017-financial-restatements-review/, and COSO 2010 Fraud Study, note 505 above.

526 *See* Section III.C.4.b. of the Proposing Release, note 4 above. As discussed in the Proposing Release, note 4 above, while observed restatements reflect misstatements that were detected and may only be a subset of actual misstatements, we believe that the lower restatement rates for low-revenue issuers are not driven by a difference in the ability to detect misstatements among these categories because we see this pattern for issuers with low rates of ineffective ICFR as well as for other issuers. This result is also consistent with the BIO Study, which finds that biotechnology EGCs have a two to three percentage point lower restatement rate than other non-accelerated or accelerated filers and attribute this to their "absence of product revenue." *See* BIO Study, note 69

low-revenue issuers being less likely to make restatements, even when they experience high rates of ineffective ICFR, perhaps because they are less susceptible to certain kinds of misstatements (such as those related to revenue recognition).

A number of commenters maintained that the risks of financial statement restatements or misstatements are greater for the issuers that would not be subject to the ICFR auditor attestation requirement under the proposed amendments than for other issuers.[527] A few of these commenters cited research that concludes that, since 2003, non-accelerated U.S. filers accounted for 62 percent of the total U.S. financial statement restatements.[528] However, we note that this research is not specific to low-revenue issuers, unlike our analysis. As our analysis in the Proposing Release demonstrated, restatements are less frequent for low-revenue issuers even among non-accelerated filers. Further, the cited research does not adjust for the high proportion of non-accelerated filers among all issuers.

Other commenters noted that low-revenue issuers may be more susceptible to misstatements in revenue recognition[529] or in areas other than revenue recognition,[530] and that a higher risk of misstatements may be driven by characteristics of these issuers other than their low revenue, such as their lower resources or fewer personnel,[531] complex transactions or arrangements,[532] or activities that require significant accounting judgments.[533] We note that our

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above (finding a 6.20 percent restatement rate for biotechnology EGCs compared to rates of 7.98 percent and 9.25 percent for other non-accelerated and accelerated filers respectively).

527 *See, e.g.,* letters from Better Markets, CAQ, EY, Grant Thornton, IMA, Prof. Barth *et al.*, and RSM.

528 *See, e.g.,* letters from CAQ and CFA Inst.

529 *See, e.g.,* letters from Better Markets and Prof. Barth *et al*.

530 *See, e.g.,* letter from BDO.

531 *See, e.g.,* letters from CAQ, Crowe, EY, and Grant Thornton.

532 *See, e.g.,* letter from BDO.

533 *See, e.g.,* letters from CFA Inst. and BDO.

analysis is intended to capture all of these risks of restatements, by directly comparing rates of empirical restatements, and that we still find that the lower revenue issuers, taken in aggregate, are less likely to restate their financial statements than other issuers of the same filer status. Thus, while certain subsets of the affected issuers may be more prone to restatements than others based on their specific characteristics, on average the affected issuers as a group appear to have a lower overall risk of restatement than higher-revenue issuers.

However, in response to the comments, we further examine the argument that the affected issuers may be less susceptible to certain kinds of misstatements, such as those related to revenue recognition, by examining the types of restatements among low- and higher-revenue accelerated filers other than EGCs in Table 11.[534] We note that the categorization of types and the names of these categories are based on the categories and category titles provided in the Ives Group Audit Analytics restatement database.

[534] These estimates are based on staff analysis of data from Ives Group Audit Analytics. *See* note 298 above for details on the identification of filer type. The sample includes 2,017 issuer-year level observations that have low revenues and 3,862 issuer-year observations that have higher revenues.

Table 11. Percentage of all accelerated filers other than EGCs with restatements of different types, by revenue category, for financial statements from 2014-2018

	Accelerated Filers (ex. EGCs)		
Restatement type	Revenue <$100M	Revenue ≥$100M	Relative Percentage
Revenue recognition issues	1.3%	3.3%	40%
Cash flows statement (SFAS 95) classification errors	1.0%	1.7%	60%
Tax expense/benefit/deferral/other (FAS 109) issues	1.0%	2.4%	42%
Inventory, vendor and/or cost of sales issues	0.8%	1.8%	45%
Debt, quasi-debt, warrants & equity (BCF) security issues	0.7%	0.6%	115%
Liabilities, payables, reserves and accrual estimate failures	0.7%	1.9%	37%
Accounts/loans receivable, investments & cash issues	0.7%	1.3%	53%
Expense (payroll, SGA, other) recording issues	0.6%	1.5%	43%
Acquisitions, mergers, disposals, re-org acct issues	0.5%	0.9%	55%
Acquisitions, mergers, only (subcategory) acct issues	0.4%	0.6%	65%
Deferred, stock-based and/or executive comp issues	0.4%	0.5%	85%
EPS, ratio and classification of income statement issues	0.3%	0.6%	53%
Balance sheet classification of assets issues	0.3%	0.4%	77%
Lease, SFAS 5, legal, contingency and commitment issues	0.3%	0.6%	53%
Foreign, related party, affiliated, or subsidiary issues	0.3%	0.7%	34%

Table 11 presents the percentage of low-revenue and higher-revenue accelerated filers other than EGCs restating their financial statements under a particular category of restatement for a given year from 2014 through 2018. The table presents the results for the 15 most common restatement categories for low-revenue accelerated filers other than EGCs. Restatements can fall into more than one category, so the total of these percentages across all restatement categories would exceed the average rate of restatements. We also report the relative percentage of the restatement rate in a given category among the low-revenue issuers relative to the higher-revenue issuers.

Table 11 demonstrates that 1.3 percent of low-revenue accelerated filers other than EGCs restated their financial statements for a given year from 2014 to 2018 due to revenue recognition issuers, representing about 40 percent of the rate of this type of restatement among higher-revenue accelerated filers other than EGCs. Similarly, for the next three most common

categories of restatements for low-revenue accelerated filers other than EGCs, the restatement rates of these issuers represented 42 – to 60 percent of the corresponding rates among higher-revenue accelerated filers other than EGCs. Thus, this evidence supports our belief that the affected issuers may be less susceptible to certain kinds of misstatements, such as those related to revenue recognition. However, consistent with commenters concerns about other sources of misstatements, particularly with respect to complex contracts and arrangements, we find that the rate of restatements in some other categories is more similar across the two groups. For example, the rate of restatements related to "Debt, quasi-debt, warrants & equity (BCF) security issues" and "Deferred, stock-based and/or executive comp issues" for the low-revenue issuers represent 115 percent and 85 percent respectively of the corresponding rates among the higher-revenue issuers. However, the rate of restatements is greater for the low-revenue issuers as compared to higher-revenue issuers only in the "Debt, quasi-debt, warrants & equity (BCF) security issues" category, and only by a small margin: the restatement rates in this category are within 0.1 percentage points of each other, such that they are not statistically differentiable in our sample.[535]

We therefore continue to believe that the evidence supports our hypothesis that the affected issuers are less likely to make restatements, perhaps because they are, on average, less susceptible to certain kinds of misstatements (such as those related to revenue recognition), than other accelerated filers. While this finding may mitigate the adverse effects on the reliability of financial statements for the affected issuers that will newly be exempt from all ICFR auditor attestation requirements, we nonetheless expect some such effects. Based on the analysis in the

[535] There is also a slightly higher rate of restatements without a specified category among the low-revenue issuers, with 0.1 percent of their issuer-year level observations being associated with "Unspecified (amounts or accounts) restatement adjustments" compared to 0.0 percent among the higher-revenue issuers.

Proposing Release, and with consideration for the difference in size and maturity of the affected issuers versus the comparison sample, we estimated that the rate of restatements among the affected issuers may increase by two percentage points.[536] Given their lower current rates of restatement, even after such an increase the affected issuers may, on average, restate their financial statements at a rate that is lower than that of issuers that will remain accelerated filers, and that does not exceed that of non-accelerated filers and EGCs with comparable revenues.

Several commenters indicated that we should have given consideration to the magnitude of restatements.[537] In response to these comments, we have undertaken two types of analysis. First, we consider the potential effects on restatements that are deemed by issuers to be material. To do this, we begin by repeating our analysis for all types of restatements from the Proposing Release for the subset of Item 4.02 restatements, which, as discussed above, are the restatements that issuers deem to be material and report in Form 8-K Item 4.02 disclosures, in Table 12.[538]

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536 *See* Section III.C.4.b. of the Proposing Release, note 4 above.

537 *See, e.g.,* letters from Better Markets, CFA Inst., and Prof. Barth *et al*.

538 The estimates in this table are based on staff analysis of Ives Group Audit Analytics data. Percentages are computed out of all issuers of a given filer type and revenue category with revenue data and a SOX Section 404(a) management report available in the Ives Group Audit Analytics database. The accelerated and non-accelerated categories exclude EGCs. See note 298 above for details on the identification of filer type.

Table 12. Percentage of issuers issuing Item 4.02 restatements by year of restated financials, by revenue category

Restated year:	Accelerated (ex. EGCs)	Non-Accelerated (ex. EGCs)	EGC
Revenue <$100M			
2014	2.4%	3.9%	5.8%
2015	3.5%	3.1%	4.2%
2016	3.3%	2.6%	3.4%
Average / year	*3.0%*	*3.2%*	*4.5%*
Revenue ≥$100M			
2014	4.1%	4.7%	2.7%
2015	3.7%	4.3%	8.7%
2016	2.4%	2.3%	2.6%
Average / year	*3.4%*	*3.8%*	*4.7%*
Difference in average/year	*-0.4%*	*-0.6%*	*-0.2%*

Table 12 demonstrates that, among low-revenue issuers, the accelerated filers other than EGCs have a 0.2 percentage point (relative to non-accelerated filers other than EGCs) or 1.5 percentage point (relative to EGCs) lower rate of Item 4.02 restatements than the issuers in the comparison populations, which are not subject to the ICFR auditor attestation requirement. Following our analysis in the Proposing Release, given the difference in size and maturity of the affected issuers versus the comparison samples, we look to the lower end of this range and, with rounding, estimate that the rate of Item 4.02 restatements among the affected issuers may increase by 0.5 percentage points. Given how low the rates of Item 4.02 restatements are, the sample sizes in Table 12 are not sufficient to reliably differentiate between these rates. We are nevertheless comfortable with this estimate because it is consistent with the estimate that would be obtained by applying the average rate of Item 4.02 restatements out of all restatements, per

Table 9 above,[539] to our estimate of the effect on total restatements.

This estimate of the effects on restatements that issuers deem to be material may help to provide some perspective on the magnitude of the anticipated effect. We provide further analysis of these magnitudes by exploring the market and financial statement impacts of the estimated effect on restatements. Table 15 in Section IV.C.3.c below provides related estimates per Item 4.02 restatement for low-revenue, seasoned issuers. In particular, the average net income impact for Item 4.02 restatements is estimated to be -$1.9 million per year of restated financials for the 80 percent of cases where there is a net income impact, which is -$1.9 million times 80 percent or -$1.5 million on average across all cases. The average stock market impact is estimated to be -$1.4 million divided by 1.4 years or -$1 million per year of restated financials. We multiply these estimates by our estimate that an additional 0.5 percentage points of the affected issuers may have an Item 4.02 restatement of their financial statements for a given year to obtain estimates of -$7,500 in net income impact or -$5,000 in stock market impact per year per affected issuer that will newly be exempt from all ICFR auditor attestation requirements.

One commenter provided alternative estimates of the magnitude of the effect on restatements, estimating that the affected issuers restated a total of $295 million in net income over the five years from 2014 through 2018 and that the 2018 restatements reduced market capitalizations by $294 million in aggregate.[540] We do not rely on these estimates for two primary reasons. First, these estimates reflect restatements that have occurred while these issuers

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[539] The ratio of Item 4.02 restatements to all restatements in Table 7 ranges from 15 percent for large accelerated filers other than EGCs (1.6 percent divided by 10.6 percent) up to 35 percent for non-accelerated filers other than EGCs (2.9 percent divided by 8.5 percent). Applying these rates to our estimated 2 percentage point effect on total restatements would result in an estimate of a 0.3 to 0.7 percentage point effect on Item 4.02 restatements.

[540] *See* letter from Prof. Barth *et al*. *See also* letter from Better Markets, citing these estimates.

are subject to the ICFR auditor attestation requirement.[541] They do not provide us with information about the magnitude of new restatements that would be experienced if this requirement were to be removed. The use of this estimate would reflect an assumption that restatements would increase by 100 percent upon removal of the ICFR auditor attestation requirement, and we do not believe that there is evidence to support such an assumption. If anything, these estimates demonstrate the limitations of the ICFR auditor attestation requirement, in that significant restatements still occur despite the requirement, rather than informing us of the risks of removing the requirement.

Secondly, these estimates reflect the years in which restatements were announced rather than when the actual misstatement occurred. Effective ICFR is intended to reduce the risk of material misstatements, so we believe it is important to focus on when misstatements occurred, not when earlier misstatements were detected and announced, which could actually be a sign of a careful audit and effective ICFR. Focusing on the year of the restatement announcement rather than the year of the misstatement could capture firms that may not have qualified as affected issuers during the time the misstatements were made, but only dropped into the category of affected issuers because of the reduction in public float or revenue that resulted from the major restatement and related issues.[542] In contrast to the commenter's analysis, our analysis is

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[541] Similarly, one commenter cites charges of misconduct at a low-revenue issuer and argues that "a well-designed ICFR audit might have uncovered the control deficiencies, and related revenue recognition violations, more quickly." *See* letter from CFA. However, based on its EDGAR filings, the issuer was in fact subject to the ICFR auditor attestation requirement in fiscal year 2014, the beginning of the period of alleged misconduct (and may have been subject to the requirement in the remainder of the period of alleged misconduct as well, but did not file Form 10-K in the following year), and the auditor's report in the associated Form 10-K attested that the issuer's ICFR was effective.

[542] For example, a media report identified a particular issuer included in one commenter's analysis of significant restatements among issuers that were proposed to be exempted. *See* Dave Michaels, *SEC Plan Gives Audit Relief to Firms that Wiped Out over $290 Million*, WALL ST. J., July 26, 2019. *See also* letter from Prof. Barth *et al.* (providing statistics but not identifying specific issuers). Based on its EDGAR filings, the identified issuer had revenues substantially in excess of $100 million, even after the revisions described in the article, for

designed to measure the rate and magnitude of the incremental restatements that can be attributed to misstatements in years in which the issuers would qualify under the amendments to be exempt from the ICFR auditor attestation requirement and that would not have occurred if the issuers were subjected to this requirement.

iv. Effects on fraudulent financial reporting

Several commenters indicated that we should give additional consideration to the potential impacts of the amendments on the risk of fraud.[543] Further, a number of commenters cautioned that the risks of fraudulent financial reporting may be particularly high for low-revenue issuers,[544] perhaps because of their incentives to demonstrate strong growth[545] or because of their high implied price-to-revenue multiples.[546] As part of our consideration of these comments, we conducted certain supplemental analysis regarding the risk of fraudulent financial reporting. That analysis, discussed below, provides additional context for considering the possible effects of the amendments. We note that commenters did not provide their own analyses or suggest specific methodologies for estimating any potential impact of the amendments on the risk of fraud.

We acknowledge that fraudulent misconduct does occur, including at low-revenue issuers, and that the incentives to engage in such misconduct could be heightened for certain low-revenue issuers, depending on their specific situation. It is less clear what the average risk

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fiscal years 2015 and 2016 (the periods with misstatements that were later restated). Further, this issuer was subject to the ICFR auditor attestation requirement as a large accelerated filer in 2015 and an accelerated filer in 2016. Therefore, we do not believe the amendments, if effective during those fiscal years, would have exempted this issuer from the ICFR auditor attestation requirement during the period in which the misstatements were made.

543 *See, e.g.,* letters from CFA Inst., CII, and Prof. Barth *et al*.

544 *See, e.g.,* letter from CFA, CFA Inst., CII and Prof. Barth *et al.*

545 *See, e.g.,* letter from CFA.

546 *See, e.g.,* letters from CII and Prof. Barth *et al.*

of fraud is across low-revenue issuers in general, and how this overall risk may be affected by the ICFR auditor attestation requirement. Measuring these effects is challenging because the sample sizes associated with typical measures of fraud are small, making reliable statistical determinations difficult. Further, we do not have an observable measure of all latent fraudulent conduct, but can only examine fraud that has been detected and that led to some observable action, which may not be a representative sample of all actual fraudulent activity. However, we acknowledge that it is important to carefully consider the potential impact of the amendments on the risk of fraud. We therefore use the available evidence and data to analyze this risk.

We start by considering Accounting and Auditing Enforcement Releases ("AAERs")[547] and cases of "financial misconduct" or "financial reporting fraud" based on subsets of these enforcement actions, as discussed below. A commenter noted that the Proposing Release did not consider the historical rate of fraud, the incidence of AAERs, the incidence of Wells notices and of formal SEC investigations.[548] While "fraud" may be defined in different ways, our analysis below considers the historical rate of fraud, based on analysis of a subset of AAERs, and the incidence of AAERs. We believe that these are more appropriate measures of potential fraud risk, as they reflect incidents in which the Commission proceeded with charges. In contrast, formal investigations and Wells notices do not always uncover, and/or result in charges of, wrongdoing.[549] The small sample size of AAERs limits our ability to apply the methodology we

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[547] AAERs refer to certain financial reporting related enforcement actions concerning civil lawsuits brought by the Commission in federal court and notices and orders concerning the institution and/or settlement of administrative proceedings. Links to these releases since 1999 are available at https://www.sec.gov/divisions/enforce/friactions.shtml.

[548] *See* letter from Prof. Barth *et al.*

[549] *See* David Solomon and Eugene Soltes, *Is "Not Guilty" the Same as "Innocent"? Evidence from SEC Financial Fraud Investigations*, Working Paper (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3402780 (finding that, for financial fraud investigations by the Commission between 2002 and 2005, only 25 percent resulted in enforcement actions); and Jean

used to estimate the potential impact on the prevalence of ineffective ICFR and the rate of restatements[550] to reliably estimate a potential effect on the incidence of AAERs. Instead, we begin by examining the representation of low-revenue as compared to higher-revenue issuers in the population of issuers with AAERs or subsets of AAERs that include certain types of charges, as compared to their representation in the broader population of issuers, in order to investigate commenters concerns that the affected issuers may face particularly high risks of fraudulent financial reporting. We then separately apply results from existing studies on fraudulent financial reporting to obtain an estimate of the potential impact of the amendments on such misconduct.

Because the overall sample size of AAERs is limited, we use the full sample of years for which data is available, such that the alleged misconduct we analyze ranges from fiscal year 1971 to 2016 (based on AAERs issued from 1982 through 2018). We focus on issuers that are not within five years of their IPO ("seasoned issuers") to better represent the affected issuers. Revenues are measured as of the date of the first misstated financial statements associated with an AAER, rather than at the date of the enforcement action, which is generally many years after this date.[551]

Eaglesham, *SEC Drops 20% of Probes After "Wells Notice*," WALL ST. J., Oct. 9, 2013 (reporting that, for the two-year period that ended in September 2012, 20 percent of the Wells notices issued were associated with investigations that were later closed without taking action being taken against the indicated parties). *See also* Terrence Blackburne, John Kepler, Phillip Quinn and Daniel Taylor, *Undisclosed SEC Investigations*, Working Paper (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3507083 (finding that, for Commission investigations that were closed between 2000 and 2017, only 44 percent were eventually publicly disclosed, though the study does not identify the subset of these cases involving charges or any action being taken).

[550] *See* Tables 13 and 14 of the Proposing Release, note 4 above, and the accompanying text.

[551] The estimates in Table 13 are based on staff analysis of the USC Marshall AAER Database, which contains information on AAERs issued between May 1982 and December 2018, supplemented with information from AAERs (for a smaller sample, as discussed below) and data from Compustat. Multiple AAERs associated with the same financial statement years are treated as a single case. Consecutive years of financial statements associated with AAERs are also treated as a single case.

Table 13. Representation of low-revenue and higher-revenue seasoned issuers in the population and among those with AAERs

	Among Issuers not Within 5 Years of IPO: *	
	Percent with Revenue <$100M	Percent with Revenue ≥$100M
Total issuer-year level observations with revenue data**	50%	50%
Issuers with AAERs:		
with alleged "financial misstatements"***	42%	58%
and with "financial misconduct" charges****	24%	76%
and with "financial reporting fraud" charges*****	30%	70%

* The years after an issuer's IPO are computed as of the first date of the financial statements associated with the AAERs.

** This row includes data for fiscal years from 1971 through 2016 to reflect the full horizon of years of alleged misconduct identified in the USC Marshall AAER Database. As noted below, data on "financial misconduct" charges and "financial reporting fraud" charges was only collected for AAERs issued from 2002 through 2018. While these charges represent alleged misconduct dating back to as early as 1985, they are more likely to reflect relatively more recent years than those reflected in the full sample of AAERs. We therefore note, for the purpose of consideration of the last two rows of Table 13, that the percentage of low-revenue issuers among the total issuer-year observations of seasoned issuers with revenue data is reduced somewhat in the more recent part of this sample, to about 47 percent when considering data from fiscal years 1985 through 2016 or about 42 percent when considering data from fiscal years 2000 through 2016.

*** This row represents AAERs that the USC Marshall AAER Database indicates as being associated with alleged financial misstatements.

**** This row represents AAERs among those included in the previous row that also include charges under Section 13(b)(2)(A) (requiring issuers to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer), Section 13(b)(2)(B) (requiring an issuer to devise and maintain a system of internal accounting controls sufficient to provide certain reasonable assurances), or Section 13(b)(5) (requiring that no person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account) of the Securities Exchange Act, or Rules 13b2-1 (requiring that no person directly or indirectly, falsify or cause to be falsified, any book, record or account) or 13b2-2 (requiring certain representations and conduct by directors and officers in connection with the preparation of required reports and documents) under the Securities Exchange Act. We only supplemented the USC Marshall AAER Database with information about these specific charges where applicable for AAERs issued from 2002 through 2018 (which include alleged misconduct associated with financial statements from fiscal year 1985 through 2016), so the set of AAERs considered in the computations in this row reflect a substantially smaller population of AAERs than those included in the second row of this table, which includes earlier AAERs (issued beginning in 1982). Our estimates do not significantly change if we remove charges associated only with third parties rather than the issuer in question and/or its staff from the sample before running the analysis.

***** This row represents AAERs among those included in the previous row that also include charges under the anti-fraud statutes in Section 17(a)(1) of the Securities Act or Section 10(b) of the Securities Exchange Act. *See also* note **** above regarding limitations on the population of AAERs for which we supplemented the USC Marshall AAER Database with information on these charges. Our estimates do not significantly change if we remove charges associated only with third parties rather than the issuer in question and/or its staff from the sample before running the analysis.

In Table 13, we consider all AAERs with alleged financial misstatements (row 2), as well as two subsets of these AAERs that we identify for those issued in, roughly, the past two decades.[552] The first subset (row 3) represents those that we can identify as including charges under Section 13(b)(2)(A), Section 13(b)(2)(B), or Section 13(b)(5) of the Securities Exchange Act, or Rules 13b2-1 or 13b2-2 under the Securities Exchange Act. These cases have been identified by researchers as representing "financial misconduct."[553] The second subset (row 4) is the subset of the "financial misconduct" cases that we can identify as also including charges under Section 17(a)(1) of the Securities Act or Section 10(b) of the Securities Exchange Act, which is one common way of identifying cases of "financial reporting fraud."[554] We note that others may define "financial misconduct" and "financial reporting fraud" differently.[555]

Per the second through fourth rows of Table 13, the representation of low-revenue seasoned issuers among all seasoned issuers with any of these types of AAERs ranges from 24 to 42 percent. For comparison, we also derive the representation of low-revenue seasoned issuers among all seasoned issuers in the population. Per the first row of Table 13, across all of the years of our sample, and specifically among the seasoned issuers, 50 percent of the issuer-year observations are associated with low revenues.[556] Thus, we do not find evidence based on the

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552 The population of AAERs considered in these subsets is limited to those issued from 2002 through 2018. *See* Table 13 above.

553 *See* Jonathan Karpoff, Allison Koester, D. Scott Lee, and Gerald Martin, *Proxies and Databases in Financial Misconduct Research*, 92(6) ACCT. REV. 129 (2017) ("Karpoff *et al.* 2017 Study"). This study also raised concerns about omissions in the USC Marshall AAER Database, which they refer to as the CFRM database, but they noted that they understood that this issue was being addressed and that users of the newer iterations of this dataset, after the date of the study, should face lower or zero rates of effective omissions.

554 *See, e.g.*, Karpoff *et al.* 2017 Study, note 553 above, and COSO 2010 Fraud Study, note 505 above.

555 *See, e.g.*, Karpoff *et al.* 2017 Study, note 553 above, (describing certain other measures researchers have used and their limitations), note 553 above.

556 While the latter two rows of Table 13, regarding "financial misconduct" and "financial reporting fraud," are based on relatively more recent data (AAERs issued from 2002 through 2018, reflecting alleged misconduct from 1985 to 2016), we note that considering the prevalence of low-revenue issuers in relatively more recent

available data that low-revenue issuers are more highly represented in the set of seasoned issuers associated with "financial misconduct" or "financial reporting fraud" than they are in the overall population of seasoned issuers.

A caveat to this finding is that it only reflects cases of discovered and charged alleged misconduct, and may not be representative of all cases of actual misconduct.[557] Also, this analysis is limited to the population of AAERs. There may be additional cases of alleged misconduct with respect to financial reporting that are charged but not associated with AAERs, and low-revenue issuers could be more highly represented among these cases.[558] Further, even if the affected issuers may not be more likely to engage in fraudulent financial reporting than other seasoned issuers on average, certain of these affected issuers may have heightened incentives to engage in such activities, as noted by the commenters cited above.

We next consider whether expanding the exemption from the ICFR auditor attestation requirement for such issuers would affect their likelihood of engaging in such activities. To address this question, we rely on a study that associates material weaknesses in ICFR with an increased rate of "financial reporting fraud."[559] In particular, the study associates reporting

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years does not change our conclusions. For example, the percentage of low-revenue issuers among the total issuer-year observations of seasoned issuers with revenue data is about 47 percent when considering data from 1985 through 2016 (reaching a minimum of 38 percent in 2016), which still exceeds the 25 to 30 percent of the seasoned issuers associated with "financial misconduct" or "financial reporting fraud" that have low revenues.

[557] We note that the required data, such as data on revenues, may be less likely to be available for low-revenue issuers to the extent that, like other small issuers, they are less likely to be covered by traditional databases. This could reduce our ability to detect a higher representation of these issuers among those with various types of AAERs. However, this should generally be accounted for in our analysis because we draw comparisons only within the population of issuers with available data, and the same limitation applies to our ability to estimate the representation of such issuers in the overall population as in the population with AAERs.

[558] For example, not all of the enforcement actions listed in the category of "Issuer Reporting / Auditing & Accounting" in the Annual Report of the Commission's Division of Enforcement are associated with AAERs. *See, e.g.*, *2019 Annual Report*, Division of Enforcement, available at https://www.sec.gov/enforcement-annual-report-2019.pdf.

[559] *See* Donelson *et al.* 2017 Study, note 470 above. This study identifies "financial reporting fraud" as either (1) the sample of "fraud" cases in the "financial misrepresentation dataset" from www.fesreg.com that underlies the

"entity-level" material weaknesses in ICFR,[560] but not other types of material weaknesses, with a 1.22 percentage point increase in the rate of "financial reporting fraud" over the following three years, or 0.41 percentage points (1.22 divided by three) per year.

Given that any impact of the ICFR auditor attestation requirement on the risk of fraud is likely to result from the effect of this requirement on the effectiveness of ICFR, we apply the results of this study to our estimated effect on ICFR to quantify the potential increase in this risk that could be associated with the amendments. Per the results earlier in this section, we estimate that the amendments may eventually result in an additional 15 percentage points of the affected issuers maintaining ineffective ICFR. Examining the types of material weaknesses experienced by low-revenue issuers of different filer statuses, we find that up to 85 percent of their material weaknesses would be classified as "entity-level" material weaknesses as defined by the study we are relying on.[561] Applying the above annualized estimate of a 0.41 percentage point increase in the rate of financial reporting fraud for issuers reporting "entity-level" material weaknesses to our estimate of a 12.75 percentage point (15 percentage points times 85 percent) increase in the prevalence of such material weaknesses, we estimate that the amendments could eventually lead to an additional 0.05 percentage points (0.41 percent times 12.75 percentage points) of the

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Karpoff *et al.* 2017 Study, note 553 above, which, based on the latter study, represents the subset of Commission or Department of Justice enforcement actions that include charges under Sections 13(b)(2)(A), Section 13(b)(2)(B), or Section 13(b)(5) of the Securities Exchange Act, or Rules 13b2-1 or 13b2-2 under the Securities Exchange Act, that also include charges under the anti-fraud statutes in Section 17(a)(1) of the Securities Act or Section 10(b) of the Securities Exchange Act; or (2) settled securities class-action lawsuits that allege violations of GAAP.

[560] This study defines entity-level material weaknesses as those that Ives Group Audit Analytics identifies as being in any of the following categories: (1) non-routine transaction control issues; (2) journal entry control issues; (3) foreign, related-party, affiliated, or subsidiary issues; (4) an ineffective, nonexistent, or understaffed audit committee; (5) senior management competency, tone, or reliability issues; (6) an insufficient or nonexistent internal audit function; (7) ethical or compliance issues with personnel; or (8) accounting personnel resources, competency, or training issues. *See* Donelson *et al. 20*17 Study, note 470 above.

[561] *See* note 560 above.

affected issuers being associated with alleged "financial reporting fraud" with respect to their financial statements for a given year.

To better understand the magnitude of this potential effect, we rely on another study that estimates that issuers lose a total of 38 percent of their equity market value upon announcements of "financial misrepresentation," or, given that the alleged violation periods in their sample span 27 months on average, 17 percent of equity market capitalization for each affected year.[562] The affected issuers that will be newly exempt from all ICFR auditor attestation requirements have an average equity market capitalization of about $205 million. We therefore estimate that the magnitude of the potential increase in fraud risk is 0.05 percentage points (our estimated annualized rate of the increase in issuer-years associated with "financial reporting fraud") times 17 percent times $205 million, or about $17,500 in market capitalization per year per affected issuer that will be newly exempt from the ICFR auditor attestation requirements. We view this estimate as conservative because the study we rely on includes issuers that are younger and significantly smaller than the affected issuers, and we believe that the percentage of market capitalization loss is likely to be greater for such firms.

Overall, this analysis does not cause us to change our primary conclusions regarding the potential effects of the amendments.

v. Timing of the effects

We anticipate that the potential adverse effects of the amendments will develop gradually

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[562] *See* Jonathan Karpoff, D. Scott Lee, and Gerald Martin, *The Cost to Firms of Cooking the Books*, 48(3) J. OF FIN. AND QUANTITATIVE ANALYSIS 581 (2008) ("Karpoff *et al.* 2008 Study"). The study defines "financial misrepresentation" consistently with the "financial misrepresentation dataset" from www.fesreg.com which, based on the Karpoff *et al.* 2017 Study, note 553 above, represents the subset of Commission or Department of Justice enforcement actions that include charges under Sections 13(b)(2)(A), Section 13(b)(2)(B), or Section 13(b)(5) of the Securities Exchange Act, or Rules 13b2-1 or 13b2-2 under the Securities Exchange Act. While the "financial misrepresentation" sample does not also require charges under the anti-fraud statutes, the Karpoff *et al.* 2008 Study indicates that over three-fourths of this sample was associated with fraud charges.

and are likely to be relatively limited in the short term. We discuss the reasons that we expect a gradual evolution in the remainder of this section. Nevertheless, we recognize that a delay in realizing some of the associated costs from the amendments would not necessarily mitigate their ultimate effects. The preceding discussion is based on the comparison of steady-state differences across issuers in different categories, and represents an analysis of the eventual effects of the amendments. Because the amendments will allow some current accelerated filers to transition to non-accelerated filer status, some issuers that have already been subject to an audit of ICFR for one or more years may no longer be required to obtain an ICFR auditor attestation. While other issuers will enter into the affected issuers category without having previously obtained an ICFR auditor attestation, and such issuers are likely to represent a larger fraction of the affected issuers over time, initially issuers with experience with ICFR auditor attestations are expected to represent a substantial fraction of the affected issuers.

Newly exempt issuers may have implemented control improvements that would persist regardless of a transition. For example, they may have made investments in systems, procedures, or training that are unlikely to be reversed. It is difficult to predict the degree of inertia in ICFR and financial reporting in order to gauge how quickly, if at all, issuers that cease audits of ICFR may evolve such that their ICFR and the reliability of their financial statements is more characteristic of exempt issuers.[563] The gradual nature of such an evolution, and the associated halo effect of the last disclosed ICFR auditor attestation, may limit the short-term costs of the amendments. In addition, issuers that believe control improvements are valuable for reporting

[563] We note that there is a relatively small sample of accelerated filers transitioning to non-accelerated filer status because of changes in their public float, as compared to transitions in the other direction, and that such transitions likely represent special circumstances such as underperformance. Therefore, such transitions are not particularly helpful for predicting the outcomes of accelerated filers transitioning to non-accelerated filer status because of the amendments.

and certifying results will be free to spend the resources saved on the attestations on such improvements.

Affected issuers with experience with audits of ICFR may also be more likely to continue to obtain an ICFR auditor attestation on a voluntary basis than other exempt issuers are to begin voluntary audits of ICFR. This may be due to such issuers having already incurred certain start-up costs or facing demand from their current investors to continue to provide ICFR auditor attestations. Some issuers in the groups that we use for comparison, which are not subject to an ICFR auditor attestation requirement, voluntarily obtain an ICFR auditor attestation. Thus, the comparisons made above at least partially account for the fact that some issuers may choose to obtain an ICFR auditor attestation even in the absence of a requirement. However, to the extent the rate of voluntary ICFR auditor attestations would be higher amongst the issuers that will be newly exempt from the ICFR auditor attestation requirement than other exempt issuers, the anticipated costs of the amendments in the near term may be further reduced.

c. Implications for investor decision-making

While we anticipate that the frequency of ineffective ICFR and, to a lesser extent, restatements may increase among the affected issuers as a result of the amendments, the economic effects of these changes may be reduced by another factor that may apply to many of these issuers. In particular, the usefulness of more reliable financial statements is linked to the degree to which they factor into the decisions of investors,[564] for example, with respect to these investors' valuations of issuers.[565] The financial statements of many low-revenue issuers may

[564] *See, e.g.*, Dechow and Schrand 2004 Monograph, note 506 above.

[565] *See, e.g.,* Jennifer Francis & Katherine Schipper, *Have Financial Statements Lost Their Relevance?*, 37(2) J. OF ACCT. RES. 319 (1999) ("Francis and Schipper 1999 Study"); and S. P. Kothari, *Capital Markets Research in Accounting,* 31 J. OF ACCT. AND ECON. 105 (2001).

have relatively lower relevance for market performance if, for example, relative to higher-revenue issuers, their valuation hinges more on their future prospects than on their current financial performance.

We explored this possibility empirically in the Proposing Release, which used the methodology applied in previous studies to calculate, for issuers above and below the $100 million revenue threshold, the extent to which the variation in market performance is related to the variation in financial measures. For issuers at or above $100 million in revenue, we found, consistent with the findings of previous studies of all issuers, that key financial variables (the book value of assets and liabilities, the book value of equity, earnings, and the change in earnings) explain about 60 to 70 percent of the variation in equity market capitalization and 7.5 percent of the variation in stock returns.[566] In contrast, for issuers with revenues of less than $100 million, we found that these financial variables explain about 30 percent of the variation in equity market capitalization and just over 4.5 percent of the variation in stock returns.

One commenter indicated that a low-revenue issuer could have a large market capitalization and thus "greater investor exposure."[567] While we agree that such affected issuers would generally expose more investors to risk, we note that the results discussed above suggest that, on average, relative to higher-revenue issuers, less of this risk seems to be associated with the issuers' current financial statements than with their future prospects.[568] Another commenter

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[566] *See* Table 15 of the Proposing Release, note 4 above. *See also* Francis and Schipper 1999 Study note 565 above. While that study ends in 1994, before our 20 year horizon, the results are similar. For example, for the most recent ten years in that study, the book values of assets and liabilities explain 54 to 70 percent of the variation in equity market valuation, the book value of equity and earnings explain 63 to 78 percent of the variation in equity market valuation, and earnings and the change in earnings explain six to 20 percent of the variation in stock returns.

[567] *See* letter from Grant Thornton.

[568] Also, the affected parties are limited to issuers with no more than $700 million in public float. Further, as discussed in Section IV.C.3.d. below, we estimate that in aggregate the affected issuers that will be newly

agreed that future prospects are important to the valuation of entities in a growth phase, but noted that the financial variables we consider in our analysis are more likely to be considered in the valuation of low-revenue issuers that are more seasoned, and that we should therefore more fully consider the implications for these issuers in particular.[569] This commenter also suggested that we might consider additional financial variables that may be more relevant to the valuation of low-revenue issuers, such as the rate of revenue growth and measures of liquidity. In response to this comment, we conducted supplemental analysis of the empirical relevance of financial statements for low-revenue issuers in Table 14.[570] Specifically, because the affected issuers that will newly be exempt from the ICFR auditor attestation requirement are generally not within five years of their IPO, we limit the analysis to more seasoned issuers. Further, we run the analysis with additional variables, as discussed below.

exempt from all ICFR auditor attestation requirements represent 0.2 percent of the total equity market capitalization of issuers.

569 *See* letter from Crane.

570 The reported statistics are adjusted R-squared statistics based on regression analysis by staff using data from the Standard & Poor's Compustat and Center for Research in Security Prices databases. Seasoned issuers are those for which the data date is not within five years of the reported IPO date, where IPO dates are available. Market value and financial variables are measured as of the end of the fiscal year. Earnings is income before extraordinary items. Stock return is the 15-month stock return ending three months after fiscal year-end, to account for reporting lags. For the stock return regression, the explanatory variables are scaled by the lagged market value of equity, and outliers in one percent tails of variable distributions are dropped to reduce noise. *See* Francis and Schipper 1999 Study, note 565 above, for additional details.

Table 14. Percentage of variation in market performance explained by variation in financial performance for 1999 through 2018, by revenue category

Market Variable	Explanatory Variables	Revenue <$100M	Revenue ≥$100M
Seasoned issuers (not within five years of IPO):			
Market value of equity	Book value of assets, book value of liabilities	40.9%	58.8%
Market value of equity	Book value of equity, earnings	46.2%	70.2%
Stock return	Earnings, change in earnings	5.5%	7.6%
Seasoned issuers, additional variables:			
Market value of equity	Book value of equity, earnings, revenue, R&D expense, quick ratio	55.8%	81.5%
Stock return	Earnings, change in earnings, revenue, change in revenue, R&D expense, change in R&D expense	8.4%	9.0%

The first three rows of Table 14 are similar to the analysis in the Proposing Release, but are limited to issuers that are not within five years of their IPO. Focusing on this subsample of low-revenue issuers, which is more representative of the affected issuers that would be newly exempt from the ICFR auditor attestation requirement, we find that the financial variables considered in the Proposing Release explain about 40 to 45 percent of the variation in equity market capitalization and about 5.5 percent of the variation in stock returns. These percentages are slightly higher than our results for all low-revenue issuers in the Proposing Release (for which the variables explain about 30 percent and 4.5 percent of the variation in equity market capitalization and stock returns respectively, as noted above). However, they remain substantially lower than the results for higher-revenue seasoned issuers, for which the variables explain about 60 to 70 percent of the variation in equity market capitalization and about 7.5

percent of the variation in stock returns.

The second panel of Table 14 considers additional variables based on the comment letter discussed above and on academic accounting literature on key value-relevant metrics. For example, the role of the book value of equity in valuation may reflect, among other things, the liquidation or adaptation value of an issuer.[571] However, a commenter noted that, for issuers with little to no revenue, liquidity metrics are often relevant to a user's evaluation of future prospects.[572] We agree that there is evidence that, for certain issuers, liquidity metrics that relate current assets to current liabilities may provide key additional information on the likelihood of, and value upon, liquidation.[573] We therefore include the quick ratio (current assets less inventories, which may be difficult to monetize in the short term, minus current liabilities) in the analysis as a supplement to the book value of equity.

In considering further variables that would be appropriate to include in this analysis, we note that low-revenue issuers are significantly more likely to be loss-making than higher-revenue issuers.[574] The academic literature provides evidence that for loss firms, revenues (and the change in revenues, or revenue growth) can be more value-relevant than earnings (and the change in earnings).[575] A commenter also identified the rate of revenue growth as an example of

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571 *See, e.g.,* Philip Berger, Eli Ofek, and Itzahk Swary, *Investor Valuation of the Abandonment Option*, 42(2) J. OF FIN. ECON. 259 (1996); David Burgstahler and Ilia Dichev, *Earnings, Adaptation and Equity Value*, 72(2) ACCT. REV. 187 (1997).

572 *See* letter from Crowe.

573 *See, e.g.,* Sergei Davydenko, *When Do Firms Default? A Study of the Default Boundary,* Working Paper (2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=672343 (finding that the quick ratio is highly correlated with the short-term probability of default, particularly for firms with less access to external capital).

574 In this analysis, about half of the low-revenue issuers are loss-making, compared to about ten percent of the higher-revenue issuers.

575 *See, e.g.,* Aswath Damodaran, *The Dark Side of Valuation: Firms with No Earnings, No History and No Comparables,* Working Paper (1999), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1297075.

a financial statement variable that investors may consider for low-revenue firms.[576] Separately, we note that research and development ("R&D") costs are expensed and thereby reduce earnings, while there is evidence that the future benefits of R&D activity may not be reflected in the earnings of loss-making firms.[577] For these reasons, we include revenues and R&D expenses (and the change in these measures) as a supplement to earnings (and the change in earnings) in the analysis in the second panel of Table 14.

As demonstrated in the last two rows of Table 14, including these additional variables does increase the amount of variation in equity market capitalization and stock returns explained by the financial statement variables. However, the percentage of explained variation remains lower for low-revenue seasoned issuers than for higher-revenue seasoned issuers.

These results demonstrate that financial statement information is not irrelevant for low-revenue issuers. That is, information from financial statements is associated with market prices and returns for these issuers as well as other issuers. Thus, the potential reduction in the reliability of financial statements for the affected issuers is expected to have some negative implications. However, the lower empirical relevance of financial statements on average for these issuers may partially mitigate the potential adverse effects of the amendments.

In contrast to these findings, a number of commenters cited analysis in Commissioner Jackson's Statement suggesting that, based on the stock market reaction to annual report filings disclosing material weaknesses in ICFR, investors care most about the information provided by

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576 *See* letter from Crowe.

577 *See, e.g.,* Laurel Franzen and Suresh Radhakrisnan, *The Value Relevance of R&D across Profit and Loss Firms,* 28 (1) J. OF ACCT. AND PUB. POL'Y 16 (2009).

the ICFR auditor attestation of low-revenue issuers.[578] Further, one of these commenters stated that the markets impose a "much heftier penalty" on small companies that restate than they do on larger companies.[579] On the other hand, other commenters expressed the view that the ICFR auditor attestation requirement is not important or material to the investors of affected issuers, based on their own experience and/or a study referencing an analysis of the market reaction to Section 302 internal control weakness disclosures.[580] As further evidence, two of these commenters asserted that investors rarely ask an issuer that is exempt from obtaining an ICFR auditor attestation to voluntarily comply with the requirement.[581] In response to these comments, we have conducted analyses of the investor response to ICFR disclosures and restatement announcements at low-revenue issuers versus other issuers.

First, we consider the market reaction to the filing of annual reports that contain ICFR auditor attestations reporting material weaknesses in ICFR. We only consider ICFR auditor attestation reports, as opposed to Section 404(a) management reports, in order to focus on a sample of issuers comparable to the affected issuers[582] and those reports that would no longer be

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578 *See, e.g.,* letters from CFA, CFA Inst., and CII, citing the event study analysis in Commissioner Jackson's Statement.

579 *See* letter from CFA.

580 *See, e.g.,* letters from Adamas, Ardelyx, ASA, BIO, Carver, Catalyst, Chiasma, Corvus, CymaBay, Equillium, Evoke, Gritstone, Kezar, Marinus, Millendo, Organovo, Pieris, Revance, SI-BONE, Syros, Teligent, and Zynerba. Many of these letters cited the BIO Study, note 69 above, which in turn cites Jacqueline Hammersley, Linda Myers, and Catherina Shakespeare, *Market Reactions to the Disclosure of Internal Control Weaknesses and to the Characteristics of those Weaknesses under Section 302 of the Sarbanes Oxley Act of 2002,* 13(1) REV. OF ACCT. STUD. 141 (2008) ("Hammersley *et al. 20*08 Study"). The BIO letter also directly cites the latter study. The BIO Study and BIO letter highlight the finding of the Hammersley *et al. 20*08 Study that the market response to issuers disclosing material weaknesses in disclosure controls in their Section 302 disclosures is, in the whole sample, not statistically different from zero. However, we note that this study does find evidence of a statistically significant negative market reaction to such disclosures in a subsample uncontaminated by other announcements in the event window.

581 *See* letters from Ardelyx and BIO.

582 In particular, Section 404(a) management reports are required of all issuers other than RICs and ABS issuers, including those that are already non-accelerated filers and would therefore not be affected by the amendments.

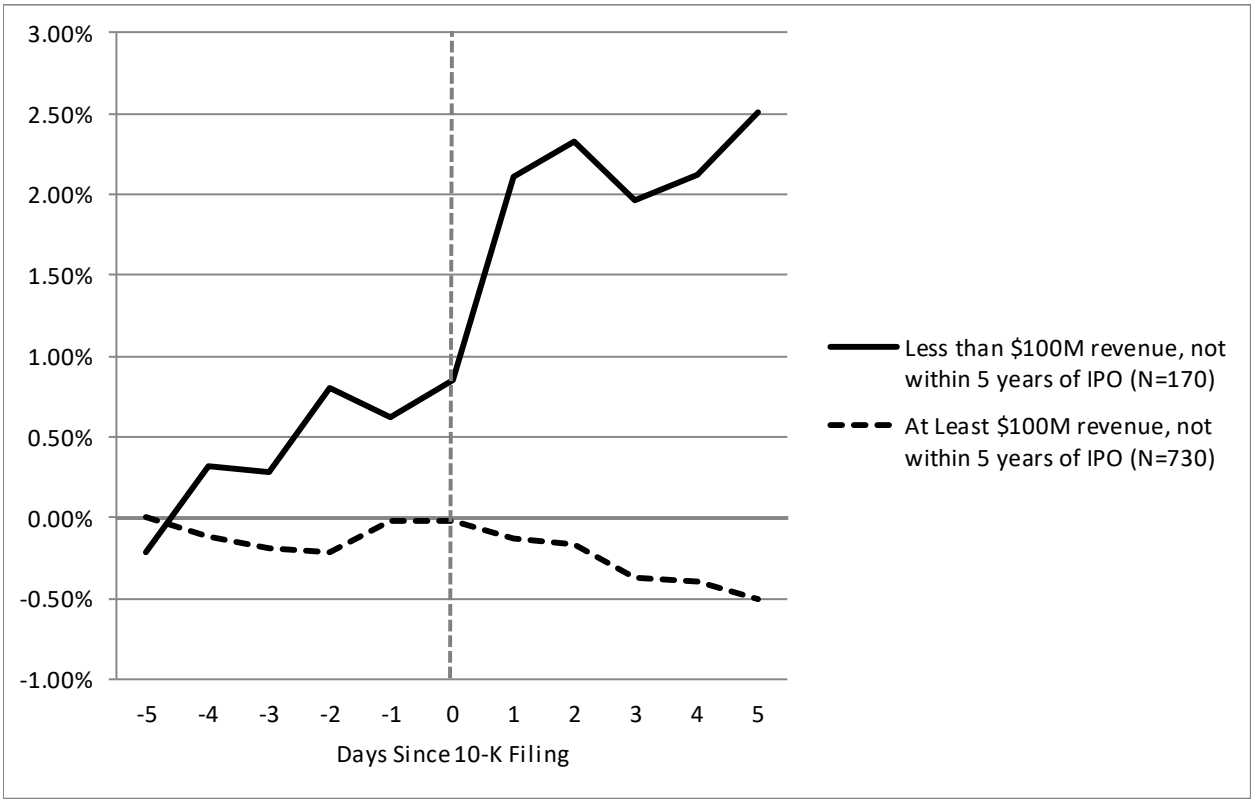
required under the amendments. Because material weaknesses may persist across years, consecutive disclosures that continue to report material weaknesses are not likely to represent news to the market. We therefore focus on material weakness disclosures that are preceded by an ICFR auditor attestation reporting effective ICFR. We consider issuers with revenues of less than $100 million and higher-revenue issuers, but exclude those within five years of their IPO to more closely represent the affected issuers.[583] Figure 7[584] presents the results of our event study analysis for disclosures in the last decade.[585]

[583] We obtain substantially similar results if we consider all issuers, rather than excluding those within five years of their IPO, or if we include consecutive annual reports with material weakness disclosures, rather than focusing on new material weakness disclosures.

[584] This figure is based on results from the Event Study by WRDS module available through Wharton Research Data Services and staff analysis of data from Ives Group Audit Analytics, Compustat, and CRSP. The figure includes all seasoned issuers that have an auditor attestation of ICFR that newly reports material weaknesses in ICFR following a previous attestation to effective ICFR in annual reports filed in calendar years 2009 through 2018. We exclude issuers for which the data date is within five years of the IPO date (i.e., non-seasoned issuers), if available. The cumulative average abnormal returns are calculated with respect to expected returns based on a multi-factor model including the three Fama French factors and a momentum factor, where the model parameters are calculated over an estimation period of up to 100 trading days ending 50 trading days before the event period.

[585] This time horizon was chosen to maximize the sample size while limiting the study to the period after the effectiveness of AS No. 5 (now referred to as AS 2201, note 292 above), which may have changed the nature of ICFR auditor attestations. *See* Section IV.B.1. above for a discussion of this auditing standard and the evidence that the nature of ICFR auditor attestations may have changed as a result of its adoption. Our results are substantially similar when considering alternative time horizons, such as the past five years.

Figure 7. Cumulative Average Abnormal Return around Annual Report Filings in which Auditor Newly Reports Ineffective ICFR, 2009-2018



Our analysis does not suggest that investors care more about the information produced by the ICFR auditor attestation requirement at low-revenue issuers. In particular, investors did not react more negatively to low-revenue issuers disclosing material weaknesses than to such disclosures by the higher-revenue issuers. None of the cumulative average abnormal returns plotted in the figure, whether for low- or higher-revenue issuers, are statistically differentiable from zero at conventional confidence levels.[586]

Our figure differs from the similar analysis that was cited by commenters for a number of

[586] The analysis applies the standardized cross-sectional test, which is robust to cross-sectional dependence in abnormal returns (which often results when events cluster in time, as in the case of annual report filing dates) as well as any event-induced increase in the variance of returns, to measure the statistical significance of the abnormal returns. *See* Ekkehart Boehmer, Jim Musumeci, and Annette Poulsen, *Event-Study Methodology under Conditions of Event-Induced Variance*, 30(2) J. OF FIN. ECON. 253 (1991) ("Boehmer *et al.* 1991").

reasons. First, that analysis includes a number of duplicate observations.[587] The duplication generally occurs when there is both an ICFR auditor attestation and a Section 404(a) management report reporting a material weakness in the same annual report. While the duplicate observations appear to have only a modest effect on the pattern of the measured cumulative abnormal returns, they likely have the effect of biasing downward the width of the confidence interval presented in the analysis. When we remove the duplicates, we find that, as in our own analysis, the cumulative average abnormal returns for low-revenue issuers are not statistically differentiable from zero at conventional confidence levels for any day within the 11-day event period surrounding the disclosure date.[588] Also, we note that even without this adjustment, the confidence intervals plotted in the other analysis indicate that, by the end of the presented event period, the cumulative average abnormal returns are no longer statistically differentiable from zero for issuers with below $100 million in revenues.[589]

Second, more than half of the non-duplicate low-revenue observations in the other analysis appear to reflect reports of material weaknesses in Section 404(a) management reports in the absence of an ICFR auditor attestation. As discussed above, our analysis excludes observations where there is only a Section 404(a) management report because we believe they

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587 About 30% of the low-revenue observations in the analysis are exact duplicates in terms of company identifiers, event date, revenue and returns. *See* "Abnormal Returns Data," available at https://www.sec.gov/news/public-statement/jackson-statement-proposed-amendments-accelerated-filer-definition.

588 The width of the confidence interval at the far right side of the figure (for day +5) in the analysis cited by commenters appears to be about 0.85 percentage points. We understand that the standard errors in that analysis are simple cross-sectional standard errors (which are robust to event-induced increases in the variance of returns but not to any cross-sectional dependence in abnormal returns). Removing the duplicates, we find that the width of the corresponding 95% confidence interval would be 2.02 percentage points using this approach, which is about 2.4 times wider than the reported confidence interval.

589 In particular, the presented confidence bands for the cumulative abnormal returns include zero by day 11 of the analysis, which considers the 11-day period beginning five days prior and ending five days subsequent to the date of disclosure.

have limited relevance when considering the affected issuers and the effects of the amendments. Third, the other analysis reflects a different time horizon (2004 through 2017) than our analysis (2009 through 2018). In our analysis, we restrict the time horizon to the period after the effectiveness of AS No. 5 because the nature of ICFR auditor attestations may have changed after this point. These additional differences in the underlying sample appear to drive the differences in the pattern of the cumulative average abnormal returns in the analysis cited by commenters relative to our own analysis.[590] However, even if we were to use the broader set of reports and/or the time horizon of the other analysis, we continue to find that the cumulative average abnormal returns are not statistically differentiable from zero at conventional confidence levels for any day within the 11-day event period surrounding the disclosure date.

There is substantial noise inherent to an analysis of the disclosure of material weaknesses in annual reports, both because these reports often contain or are accompanied by significant confounding information[591] and because material weaknesses are often disclosed in advance of the annual report.[592] We therefore also undertook analysis of the market and financial statement impact of material restatements disclosed in Item 4.02 Form 8-K filings, which are relatively less

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[590] While, as discussed above, we also refine the analysis presented in Figure 7 to exclude consecutive disclosures that continue to report material weaknesses and to limit the analysis to seasoned issuers, we find that these choices have more modest effects on the pattern of cumulative average abnormal returns.

[591] Staff analysis of material weakness disclosures that were accompanied by large positive or negative stock returns found evidence of announcements of confounding news that are associated with large positive returns (e.g., significantly beat earnings estimates, positive news about Phase III trial, liquidity infusion, merger announcement) and large negative returns (e.g., significantly miss earnings estimates, liquidity problems and security issuance at significant discount). *See* also, e.g., Paul Griffin, *Got Information? Investor Response to Form 10-K and Form 10-Q EDGAR Filings*, 8(4) REV. OF ACCT. STUD. 433 (2003) (for more detail on the overall information content of annual reports) and Edward Li and K. Ramesh, *Market Reaction Surrounding the Filing of Periodic SEC Reports*, 84(4) ACCT. REV 1171 (2009) (for further analysis of the information content released in, and at the time of, annual report filings).

[592] Staff analysis of material weakness disclosures that were preceded by an ICFR auditor attestation reporting effective ICFR found that in about one-third of cases these new material weaknesses had been disclosed prior to the annual report, such as in an Item 4.02 Form 8-K or a Form 10-Q filing.

likely to be accompanied by unrelated news or to be disclosed in advance of the filing. We consider restatements over the 10-year horizon from 2009 through 2018 to obtain more reliable estimates while still focusing on a recent period that should be reasonably representative of the current environment.[593]

Table 15. Estimated effects of Item 4.02 8-K restatements announced by seasoned issuers in 2009-2018, by revenue category at time of the misstatement

	Issuers not within five years of IPO:	
	Revenue <$100M	Revenue ≥$100M
Average 2-day announcement return (%)	-0.9%	-3.3%
Announcement return statistically distinguishable from zero (95% confidence level)	No	Yes
Average 2-day announcement return (95% confidence interval)	-2.2% to +0.3%	-4.2% to -2.3%
Average 2-day announcement effect ($)	-$1.4M	-$22.0M
Percent with adverse financial statement effect*	78%	80%
Percent with income effect	83%	81%
Among those with income effect, average net income effect ($) per year of restated financials	-$1.9M	-$13.2M
Average length of restated period	1.4 years	2.0 years

* This row, based on the "Effect" variable from Ives Group Audit Analytics, indicates whether the net effect to the financial statements (income statement, balance sheet or cash flows) was negative.

[593] The estimates in Table 15 are based on staff analysis of restatements associated with an Item 4.02 8-K dated within calendar years 2009 through 2018. The sample includes, for issuers that are not within five years of their IPO, 260 restatements by low-revenue issuers and 384 restatements for higher-revenue issuers with non-missing stock returns. The data on restatements, including their financial statement effects, are from Audit Analytics. Revenues are measured as of the beginning of the restated period. The data on revenues and IPO dates are from Compustat. The announcement returns are cumulative abnormal returns based on results from the Event Study by WRDS module available through Wharton Research Data Services. They represent the cumulative abnormal returns for the two-day event period including the date of the associated 8-K filing and the following trading day. These abnormal returns are estimated relative to a benchmark model of returns based on the three Fama-French factors and a momentum factor, where the model parameters are calculated over an estimation period of up to 100 trading days ending 50 trading days before the event date. The confidence intervals are based on the standardized cross-sectional test of Boehmer *et al.* 1991, note 586 above.

As with our previous analyses, this supplemental analysis also does not support the assertion that investors care more about the reliability of the information in the financial statements of low-revenue issuers than that of higher-revenue issuers. The market reaction to Item 4.02 Form 8-K filings is statistically indistinguishable from zero for low-revenue, seasoned issuers, but is negative and statistically significant for higher-revenue issuers. While the point estimates for the market impact of the restatements are uncertain, as demonstrated by the confidence intervals presented in the second row of Table 15, the corresponding point estimates for the dollar market impact per restatement announcement are also substantially lower (at $1.4 million versus $22.0 million) for low-revenue seasoned issuers as compared to higher-revenue seasoned issuers. The rate of Item 4.02 restatements with negative financial statement impact or with net income impact is similar for both categories of issuers, at about 80 percent. We also consider how the average dollar market impact of the restatements relates to the average dollar correction in annualized net income, in case investors react more strongly per dollar of the correction in annualized net income for low-revenue issuers. However, Table 15 does not provide evidence that the corresponding point estimate dollar market impact is proportionately greater relative to the average annualized effect on net income for low-revenue seasoned issuers than for high revenue seasoned issuers.[594]

Overall, we acknowledge that a lower reliability of their financial statements may have significant effects on the valuation of certain low-revenue issuers. It is possible, for example, as one commenter stated, that "[for] many low-revenue companies that are struggling to become high revenue companies…their ability to attract capital may depend primarily on their ability to

[594] In particular, the ratio of average dollar market impact of the restatements relative to the average dollar correction in annualized net income for low-revenue seasoned issuers is -$1.4M/-$1.9M or about 0.7, while the corresponding ratio for higher-revenue seasoned issuers is -$22.0/-$13.2 or about 1.7.

convince analysts and investors that their revenues are strong and steadily rising."[595] However, when we consider the evidence in aggregate across the population of low-revenue and higher-revenue seasoned issuers based on the three different types of analyses in this section, we find some evidence that financial statements and their reliability are less associated with market prices for low-revenue issuers and no evidence that there is a stronger association with market prices for low-revenue issuers than for higher-revenue issuers. Therefore, we continue to believe that the evidence supports the supposition that relative to higher-revenue issuers, the value of low-revenue issuers, on average, hinges more on their future prospects than on their current financial performance, and that this consideration should mitigate the potential adverse effects of the amendments.

d. Potential economic costs of effects on ICFR, the reliability of financial statements, and potential fraud

A number of commenters indicated that we should make further attempts to quantify the potential costs of the amendments.[596] A few commenters further asserted that the costs of the amendments will significantly outweigh any benefits.[597] In the previous section, we estimated that the affected issuers that will newly be exempt from all ICFR auditor attestation requirements may eventually experience a 15 percentage point increase in ineffective ICFR and, for a given year of financial statements, an estimated 2 percentage point increase in restatements, a 0.5 percentage point increase in Item 4.02 restatements, and a 0.05 percentage point increase in "financial reporting fraud" associated with those financial statements. In this section, we provide additional monetized estimates of the impact, in dollar terms, which may be associated with

[595] *See* letter from CFA.

[596] *See, e.g.,* letters from Better Markets, CFA Inst., CII, Prof. Barth *et al*, and Prof. Ge *et al*.

[597] *See, e.g.,* letters from Better Markets and Prof. Barth *et al*.

certain potential adverse effects. As noted earlier, this discussion and these estimates are focused on affected issuers that will be newly exempt from the ICFR auditor attestation requirement and are not expected to be subject to the FDIC auditor attestation requirement.

Overall, as discussed in more detail below, we are able to quantitatively estimate, per year per affected issuer, a total of approximately $60,000 in costs and an additional approximately $10,000 in transfers across shareholders, which represent costs to some shareholders and benefits to other shareholders.[598] These estimates reflect our quantification, based on the available evidence and data, of potential effects related to operating performance, restatements, and financial reporting fraud. We note that we are unable to adjust the dominant component of the estimates (the estimated effect on operating performance) for the mitigating factors associated with low-revenue issuers that we discuss throughout this release, so the total estimate of costs may be inflated.

Given that our estimate of the cost savings per year per affected issuer is $210,000, we do not find evidence to support the views of the commenters that indicated that the costs of the amendments would significantly outweigh the benefits. However, we note two main caveats associated with our estimates of the costs and transfer that may result from the amendments, and with the underlying components of these estimates, which are discussed in more detail below. First, these estimates are necessarily more uncertain than our monetized estimates of cost savings to issuers because they are based on a larger number of assumptions. Secondly, we caution against attempts to over-interpret the relation between our quantitative estimates of monetized benefits and monetized costs, because neither of these measures is complete. For example, we

[598] The costs we estimate represent actual forgone value, while the transfers simply represent corrections to reflect an issuer's true financial position.

are not able to monetize the potential benefit of reduced management distraction from operating activities[599] or the potential market-level costs of reduced efficiency of investor allocation across investment opportunities or reduced investor confidence.[600] We therefore are not able to quantify the overall net benefit or cost of the amendments.

i. Computation of monetized estimates of costs

We provide further quantification of potential adverse effects of the amendments in this section, while the next section provides a discussion of these costs as well as other economic costs that we are unable to quantify. We begin by considering costs that may represent deadweight losses, or net costs to society, followed by a consideration of transfers across shareholders. First, we estimate the potential deadweight losses associated with a potential increase in the risk of fraud. In Section IV.C.3.b.iv. above, we estimated the magnitude of the potential increase in fraud risk to be about $17,500 in market capitalization per year per affected issuer that will be newly exempt from the ICFR auditor attestation requirements. A study that breaks down the equity market impact of fraud into deadweight losses (such as legal costs and impaired reputation) versus the effects that reflect the market adjusting to a more accurate representation of issuers' financial situations estimates that the former constitute approximately 75 percent of the total equity market loss.[601] We therefore estimate the potential average incremental deadweight loss associated with fraud to be $17,500 times 75 percent or roughly $13,000 per year per affected issuer. We consider the remainder of the estimated equity market effect, which represents a transfer from some investors to other investors, separately below.

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599 *See, e.g.,* letter from Sutro.

600 *See, e.g.*, letter from CII.

601 *See* Karpoff *et al.* 2008 Study, note 562 above.

Commenters suggested that we should quantify effects on operating performance associated with ICFR misreporting,[602] which are less likely to be corrected by remediation because the underlying material weaknesses are likely undetected. As discussed in the Proposing Release, potential effects of the amendments on operating performance are difficult to measure because the existing studies may not be generalizable to the affected issuers and the methods used in previous studies are difficult to apply to a comparable sample of low-revenue issuers in recent years.[603] However, in response to these comments, we rely on the results of a recent study[604] to provide an estimate of the possible loss in profits per year associated with ICFR misreporting. While we expect that the anticipated effect on the affected issuers would be reduced relative to those in the study given the mitigating factors specific to low-revenue issuers discussed above, we are unable to estimate an appropriate adjustment to reflect these factors. The study estimates that the difference in return on assets for issuers misreporting that they have effective ICFR versus those that properly report that they have ineffective ICFR (and thereby perhaps also work towards remediating their ICFR) is 3.3 percentage points over three years, or 1.1 percentage point per year. We multiply this difference by our estimate of the potential increase in misreporting of effective ICFR from Section IV.C.3.b.ii. above, which (based on statistics from the same study) is 3.5 percentage points, and the estimated average total assets of the affected issuers that will be newly exempt from all ICFR auditor attestation requirements from Section IV.C.1 above, which is $125 million. This results in an estimated reduction in potential earnings of about $48,000 per year on average for an affected issuer. As noted above, this estimate may be inflated, as it does not reflect any of the mitigating factors specific to low-

602 *See, e.g.,* letters from CII, Prof. Barth *et al*, and Prof. Ge *et al*.

603 *See* Section III.C.4.c. of the Proposing Release, note 4 above.

604 *See* Ge *et al.* 2017 Study, note 393 above.

revenue issuers discussed above.

In total, we estimate potential issuer-level costs of $48,000 in reduced earnings plus $13,000 in losses related to the increased risk of fraud, or roughly $60,000 in costs per year on average per affected issuer, though we view this estimate as conservative because it does not fully account for the mitigating factors discussed above. Next, we note that some of the potential adverse effects quantified in Section IV.C.3.b. above may be associated with stock market values that fail, at a given time, to reflect issuers' actual financial position. This potential inflation and later correction of stock market values would result in transfers that benefit some shareholders and harm other shareholders. Further, the same shareholder may benefit in certain of his shareholdings and be harmed in other shareholdings. Also, at any given time, the stock price may be inflated for certain reasons but have corrected for other prior inflation, depending on the timing of the revelation of the underlying issues. For the purpose of quantification of these potential transfers, we assume that issues are revealed gradually and smoothly over time, such that there is an even effect across years.

The first source of mispricing we consider is misstatements that later translate into restatements. In Section IV.C.3.b.iii. above, we estimated that the magnitude of the potential increase in Item 4.02 restatements represented -$5,000 in stock market impact per year per affected issuer. Secondly, we estimated earlier in this section that the magnitude of the potential increase in fraud risk is about -$17,500 in market capitalization per year per affected issuer, of which 25 percent or about -$4,500 reflects the market adjusting to a more accurate representation of issuers' financial situations.[605] Summing these quantified effects, and rounding up, we

[605] We note that some portion of this correction may already be incorporated in our estimate with respect to restatements given that we do no separately consider restatements that are associated with specific charges or allegations versus other statements.

estimate that there may be approximately $10,000 of pure transfers across shareholders per year per affected issuer representing these corrections in stock values to reflect issuers' actual financial positions.

As discussed above, these estimates are intended to be responsive to commenters who indicated that further quantitative analysis of the costs of the amendments would be appropriate. One commenter also provided alternative quantified estimates of the costs of expanding the exemption from the ICFR auditor attestation requirement, estimating a $1.7 million loss in future earnings and $2.2 million in forgone market value per issuer.[606] While we rely on evidence from the same underlying study that this commenter uses for some of our estimates, we do not rely on these specific estimates for two primary reasons. First, the underlying study indicates that these per issuer estimates apply not to all issuers but only to those issuers that are suspected of misreporting that their ICFR is effective when exempted from the ICFR attestation requirement, which the study estimates to be only 9.3 percent of the issuers.[607] Secondly, these estimates reflect aggregate effects over three years and we scale everything to annualized effects for better comparability.[608] We also note that the estimate described by the commenter as forgone market value is described in the underlying study as a delay in a market value decline that would otherwise happen currently, not as an increase in market capitalization that could be captured under the ICFR auditor attestation requirement.[609]

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606 *See* letter from Prof. Barth *et al*.

607 *See* Ge *et al. 20*17 Study, note 393 above.

608 *Id*.

609 *Id*. In particular, this study estimates a stock market value correction that would be delayed until ICFR misreporters experience the negative consequences of ineffective ICFR (such as restatements or lower operating performance), rather than resulting immediately because of a disclosure of ineffective ICFR. The study estimates that a $2.2 million stock market value correction would be delayed across a period of three years per suspected misreporter, who are estimated to represent 9.3 percent of the issuers exempt from the ICFR auditor attestation requirement. Annualizing and generalizing the study's estimate across issuers' results in an

Another commenter[610] cited the same underlying study's[611] estimates of quantified costs and benefits associated with the ICFR auditor attestation. As discussed above, the study estimates, in aggregate and in present value terms, a total of $388 million in aggregate audit fee savings and a total of $719 million in lower earnings associated with exempting non-accelerated filers.[612] While the commenter did not suggest that we adopt those specific estimates, we note that we do not rely directly on those estimates, which apply to a different context. In particular, the estimates in that study are intended to quantify the costs and benefits associated with the exemption that applies to all existing non-accelerated filers, versus those associated with extending the exemption to the smaller number and different type of affected issuers discussed in this release. However, as discussed in more detail throughout the release, we do rely on some results and approaches from that study in constructing our own estimates.

ii. Discussion of economic costs

While the previous section provided computations of monetary estimates of certain potential adverse effects of the amendments, this section provides further discussion of those costs as well as other economic costs that we are unable to quantify. Per the discussion in

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estimated delayed stock market correction per year per affected issuer of about $70,000 ($2.2 million divided by three years times 9.3 percent). We note that this estimate is similar to the likely stock market impact of the quantified costs and transfers that we estimate may result from the adverse effects of removing the ICFR auditor attestation requirement for the affected issuers (such as restatements and lower operating performance). In particular, our estimate of about $10,000 in potential transfers per year per affected issuer represents a $10,000 potential stock market correction per year per affected issuer. Our estimate of quantified potential costs of about $60,000 per year per affected issuer would likely be reflected in a similarly-sized stock market reaction, for a further potential stock market correction of about $60,000 per year per affected issuer, and a total of about $70,000 ($10,000 plus $60,000) in stock market effects per year per affected issuer, the same as the estimate implied by the study. That said, we differ somewhat in the attribution of this total to deadweight costs versus transfers, as the Ge *et al.* 2017 study, note 393 above, suggests that the total estimated stock market effect may represent only a difference in timing of the effect and thus a transfer across shareholders.

610 *See* letter from Prof. Ge *et al*.

611 *See* Ge *et al.* 2017 Study, note 393 above.

612 This study also estimates a delay over three years in the timing of a market value decline (that would otherwise have occurred at the beginning of this three year period) of $935 million associated with the exemption from the ICFR auditor attestation requirement. *See* Section IV.C.2.b.ii. above.

Section IV.C.3.a. above, any impact of the amendments on the effectiveness of ICFR and the reliability of financial statements may have issuer-level implications as well as market-level implications. At the issuer level, the potential increase, on average, in the rate of ineffective ICFR and restatements may lead investors to charge a somewhat higher average cost of capital for the affected issuers. An issuer's cost of capital, or the expected return that investors demand to hold its securities, determines the price at which it can raise funds. Thus, any such increase may be associated with a reduction in capital formation to the extent that it decreases the rate at which the affected issuers raise new capital towards new investments. Further, the affected issuers may also experience reduced operational efficiency because of the reduced reliability of financial information available to management for the purpose of making operating decisions. These potential effects are supported by a number of studies discussed above.[613] Finally, there may be legal and reputational costs associated with any increase in the risk of fraud, which would represent deadweight losses, or net costs to society.

Several commenters expressed the view that eliminating the ICFR auditor attestation requirement would increase the cost of capital for certain issuers because of the potential effects of this change on the reliability of the financial statements of the affected issuers.[614] The potential issuer-level effect on the cost of capital is difficult to confirm and to quantify for the affected issuers because the existing studies may not be generalizable to the affected issuers and to the current nature of ICFR auditor attestations (i.e., after the 2007 change in the ICFR auditing standard, the 2010 change in risk assessment auditing standards, and recent PCAOB inspections focused on these aspects of audits). Further, some of these studies provide mixed evidence, as

[613] *See* Section IV.C.3.a. above.

[614] *See, e.g.,* letters from BDO and CFA.

discussed in Section IV.C.3.a. above. Moreover, the methods used in previous studies are difficult to apply to a comparable sample of low-revenue issuers in more recent years because, for example, there would only be a small sample of such issuers that recently switched filing status and because methods of measuring the implied cost of capital are particularly problematic for such issuers.[615] Commenters did not provide us with estimates or data that could be used to estimate potential effects on the cost of capital.

The available evidence supports the qualitative, directional effects on cost of capital noted above. That is, some of the affected issuers could experience an increase in their cost of capital. However, the previous section demonstrated that the potential increase in material weaknesses in ICFR that we estimate could occur may translate into a more limited effect on the reliability of disclosures, as measured, for example, by the rate of restatements, for the affected issuers. Also, based on our analysis, the financial metrics of these issuers have lower explanatory power for investors' determination of their value than in the case of other issuers. These two factors may mitigate the potential adverse effects on the affected issuers' cost of capital.

In addition, some of the costs of extending the exemption from the ICFR auditor attestation requirement to additional issuers may be further mitigated by the fact that some issuers, even if exempted, may voluntarily choose to bear the costs of obtaining such an attestation.[616] Affected issuers that expect a lower cost of capital with an ICFR auditor

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615 *See* note 481 above.

616 Studies have associated voluntary compliance with the ICFR auditor attestation requirement with decreased cost of capital and value enhancements. *See, e.g.*, Cory Cassell, Linda Myers, & Jian Zhou, *The Effect of Voluntary Internal Control Audits on the Cost of Capital*, Working Paper (2013) (Cassell *et al.* 2013 Study), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1734300; Todd Kravet, Sarah McVay, & David Weber, *Costs and Benefits of Internal Control Audits: Evidence from M&A Transactions*, Rev. of Acct. Stud. (forthcoming 2018), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2958318; and Carnes *et al.*

attestation, such as those with effective ICFR,[617] and particularly those that will be raising new debt or equity capital,[618] are more likely to voluntarily obtain an ICFR auditor attestation. We note that low-revenue issuers have less access to internally-generated capital, as discussed above, so they may be more reliant on external financing for capital. Consistent with this argument, commenters suggested that issuers may voluntarily obtain an ICFR auditor attestation if it were demanded by investors,[619] not complying would have a negative impact on investment analysts' coverage,[620] or issuers deem it a good use of their capital resources.[621] Further, as discussed in Section IV.C.4.d. below, we note that the benefits and therefore likelihood of voluntarily obtaining ICFR auditor attestations may be increased by the new check-box disclosure on annual reports required by the amendments, in that investors should be more able to readily discern which issuers obtained an ICFR auditor attestation.[622] However, it is probably not the case that issuers would voluntarily obtain an ICFR auditor attestation in every case in which the total benefits of doing so would exceed the total costs.[623]

The available evidence also supports the qualitative, directional effects on operating

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2019 Study, note 397 above. We note that the latter two studies are not able to differentiate between the effects of the ICFR auditor attestation and of management's assessment of ICFR under SOX Section 404(a).

617 *See* Brown *et al.* 2016 Study, note 396 above.

618 *See* Cassell *et al.* 2013 Study, note 616 above.

619 *See, e.g.,* letters from BIO and Guaranty.

620 *See, e.g.,* letter from Guaranty.

621 *Id.*

622 *See* 2013 GAO Study, note 246 above.

623 There is substantial literature describing the fact that in certain circumstances the incentives of managers are not perfectly aligned with those of shareholders. *See, e.g.*, Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3(4) J. OF FIN. ECON. 305 (1976). Also, as discussed in Section IV.C.3.a. above, the ICFR auditor attestation requirement can have important market-level benefits through network and spillover effects that issuers are unlikely to internalize. That is, issuers are likely to balance the issuer-level benefits against the issuer-level costs of voluntary compliance without considering these externalities.

performance noted above. That is, some of the affected issuers could experience lower operating performance due to reliance on less reliable financial statements in their decision-making. Like the potential effects on the cost of capital, the potential effect on issuer operating performance associated with reported ineffective ICFR is also difficult to estimate and is likely to be mitigated by the multiple factors discussed above. Further, the point estimates in one study demonstrate that issuers that remediate their reported material weaknesses in ICFR might be able to make up a substantial amount of the previous operating underperformance.[624]

We do, however, quantify potential effects on operating performance associated with ICFR misreporting, which are less likely to be corrected by remediation because the underlying material weaknesses are likely undetected. We also estimate potential deadweight losses (e.g., legal and reputational costs) associated with a possible increase in the risk of fraud. In total, per Section IV.C.3.d.i. above, we estimate potential issuer-level costs of $48,000 in reduced earnings plus $13,000 in losses related to the increased risk of fraud, or roughly $60,000 in costs per year on average per affected issuer, though we view this estimate as conservative because it does not fully account for the mitigating factors specific to low-revenue issuers discussed above.

We note that issuers and other market participants may adapt to the proposed changes in various ways, which may serve to enhance or mitigate the anticipated issuer-level costs. However, these actions, and therefore their net effects, are difficult to predict. For example, it has been posited that issuers reacted to the requirements of SOX by reducing accruals-based earnings management and, in its stead, making suboptimal business decisions for the purpose of

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624 *See* Feng *et al.* 2015 Study, note 484 above, (with point estimates of a one percent reduction in ROA in years with material weaknesses in ICFR and a 2.6 percent increase in ROA upon remediation, though there is significant uncertainty around these rates).

real earnings management.[625] It is therefore possible that newly exempt issuers could, to some extent, reduce real earnings management in favor of accruals-based management. Another possibility is that scrutiny from analysts may provide an alternative source of discipline for some of the affected issuers, although there is evidence that analysts may stop covering issuers whose financial statements are deemed to have become less reliable.[626]

While the preceding analysis considers the average effects across the affected issuers on the effectiveness of ICFR and the reliability of financial statements, the potential issuer-level costs of the proposed extension of the exemption from the ICFR auditor attestation requirement likely vary across different types of affected issuers. For example, the effects may vary based on issuers' proclivity to detect and disclose material weaknesses in ICFR in the absence of an ICFR auditor attestation requirement and whether the issuers' have characteristics that the market associates with having such material weaknesses. We discuss this variation in detail in the Proposing Release.[627]

We next consider effects at the market-level. Some of these effects are associated with the transfers across shareholders that we estimated in Section IV.C.3.d.i. above. In total, we estimated that there may be approximately $10,000 of pure transfers across shareholders per year per affected issuer representing corrections in stock values to reflect issuers' actual financial positions. These transfers and the associated mispricing may reduce the efficient allocation of

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625 *See* Daniel Cohen, Aiyesha Dey, & Thomas Lys, *Real and Accrual-Based Earnings Management in the Pre- and Post-Sarbanes Oxley Periods*, 83(3) ACCT. REV. 757 (2008) (finding that an increase in real earnings management partially offset the decrease in accruals-based earnings management that followed SOX). *See also* Coates and Srinivasan 2014 Study, note 369 above, at 646-647.

626 *See* Sarah Clinton, Arianna Pinello, & Hollis Ashbaugh-Skaife, *The Implications of Ineffective Internal Control and SOX 404 Reporting for Financial Analysts*," 33(4) J. OF ACCT. AND PUB. POL'Y 303 (2013) (finding that the disclosure of internal control weaknesses is followed by a decline in analyst coverage).

627 *See* Section III.C.4.c. of the Proposing Release, note 4 above.

capital at the market level. Further, to the extent that the reliability of financial statements is somewhat reduced on average at the issuer level for the affected issuers, the efficient allocation of capital at the market level may be negatively affected given a diminished ability to reliably evaluate different investment alternatives.[628]

The reduced reliability of financial statements could also negatively impact capital formation through a reduction in investor confidence. Several commenters noted that they expected the amendments to have a negative effect on investor confidence.[629] In contrast, one commenter asserted that there is no correlation between a smaller company's compliance with the ICFR auditor attestation requirement and stronger markets in general, [630] while two others noted that they did not expect effects on investor confidence with respect to affected issuers that are banks.[631]

Section IV.C.3.a. provides additional discussion of these market-level factors. While we are unable to directly quantify the market-level effects on the efficient allocation of capital and on investor confidence, we anticipate that these effects may be limited due to the size of the expected effect on the reliability of these issuers' disclosures and potential transfers across shareholders as well as the small percentage of the total value of traded securities that is represented by the affected issuers. In particular, we estimate that the affected issuers that will be newly exempt from all ICFR auditor attestation requirements represent 0.2 percent of the total

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628 The efficient allocation of capital may be further reduced to the extent that the potential cost of capital effects discussed above operate through a reduction in the liquidity of the market for these issuers' shares, which increases the costs to investors looking to adjust their investments or redeploy their capital. *See* Diamond and Verrecchia 1991 Study, note 477 above.

629 *See, e.g.,* letters from Better Markets and CII.

630 *See* letter from BIO.

631 *See* letters from BSC and SCBA.

equity market capitalization of issuers.[632]

4. Potential Benefits and Costs Related to Other Aspects of the Amendments

In this section we consider the potential effects of the amendments with regard to other implications of accelerated filer status, specifically with respect to the timing of filing deadlines, certain required disclosures, and the determination of filer status. We also consider below some incremental effects of the amendments to the thresholds for exiting accelerated and large accelerated filer status and the new check-box disclosure required on the cover page of annual reports on Form 10-K, 20-F, or 40-F.

a. Filing deadlines

As discussed in Section IV.B.1. above, non-accelerated filers are permitted an additional 15 days and five days, respectively, beyond the deadlines that apply to accelerated filers, to file their annual and quarterly reports. Extending these later deadlines to the affected issuers may provide these issuers with additional flexibility in preparing their disclosures, while modestly decreasing the timeliness of the data for investors.

Table 6 in Section IV.B.3. demonstrates that while the filing deadlines are not a binding constraint for most accelerated filers, with 63 percent filing their annual reports over five days early in recent years, some accelerated filers are likely to benefit from the extended deadline. For example, filing Form NT automatically provides a grace period of an additional 15 days to file an annual report, and over the past four years, about four percent of accelerated filers filed their annual reports within this grace period rather than by the original deadline. A further five percent of accelerated filers filed their annual reports after these additional 15 days had passed.

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[632] This statistic is based on staff analysis of data from Compustat. The total population of issuers used to construct this estimate are those that have annual reports on Forms 10-K, 20-F, or 40-F in calendar year 2018 and data on market capitalization in Compustat. *See* above note 336 for detail on the identification of affected issuers.

Even affected issuers that would otherwise have filed by the accelerated filer deadline may avail themselves of the additional time provided under the amendments to balance other obligations or to prepare higher quality disclosures. The 2003 acceleration of filing deadlines for accelerated filers from 90 to 75 days was associated, at least initially, with a higher rate of restatements for the affected issuers.[633] This finding suggests that a later deadline may allow some issuers to provide more reliable financial disclosures. While these issuers could alternatively file Form NT to receive an automatic extension, studies have found that investors interpret such filings as a negative signal, resulting in a negative stock price reaction.[634] Issuers may thus prefer to meet the original deadline if possible.

On the other hand, allowing the affected issuers to file according to the later non-accelerated filer deadlines may reduce the timeliness and therefore usefulness of the disclosures to investors. Studies have found a reduction in the market reaction to disclosure when the reporting lag between the end of the period in question and the disclosure date is lengthy, as more of the information becomes available through other public channels.[635] Researchers have also questioned whether such lags increase information asymmetries, because some investors are more able to access or process information that could provide indirect insight into an issuer's

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633 *See, e.g.*, Colleen Boland, Scott Bronson, & Chris Hogan, *Accelerated Filing Deadlines, Internal Controls, and Financial Statement Quality: The Case of Originating Misstatements*, 29(3) ACCT. HORIZONS 551 (2015) ("Boland *et al.* 2015 Study"); and Lisa Bryant-Kutcher, Emma Yan Peng, & David Weber, *Regulating the Timing of Disclosure: Insights from the Acceleration of 10-K Filing Deadlines*, 32(6) J. OF ACCT. AND PUB. POL'Y 475- (2013).

634 *See* Joost Impink, Martien Lubberink, & Bart van Praag, *Did Accelerated Filing Requirements and SOX Section 404 Affect the Timeliness of 10-K Filings?*, 17(2) Rev. of Acct. Stud. 227 (2012) and Eli Bartov & Yaniv Konchitchki, *SEC Filings, Regulatory Deadlines, and Capital Market Consequences*, 31(4) ACCT. HORIZONS 109 (2017).

635 *See, e.g.*, Dan Givoly & Dan Palmon, *Timeliness of Annual Earnings Announcements: Some Empirical Evidence*, 57(3) ACCT. REV. 486 (1982).

financial status or performance through alternative channels.[636]

One study found that the 2003 acceleration of filing deadlines was associated with a decrease in the market reaction to the disclosure of annual reports for accelerated filers.[637] Based on this result and supplementary tests regarding the change in disclosure quality and change in timeliness after the acceleration of deadlines, the authors concluded that the negative effect of the shorter deadline on the quality of disclosure appeared to dominate the beneficial effect on the timeliness of the disclosure for these issuers.[638] While this finding might not be directly applicable 15 years later, and there is some evidence that some of these effects were temporary,[639] in the absence of other evidence we expect the net effect of the extended filing deadlines to be beneficial on average but modest overall. One commenter, citing the complexity of current accounting standards and the volume of disclosure requirements, agreed that the benefits of the extended deadlines for the affected issuers were likely to outweigh their costs.[640] Other commenters did not opine on the costs and benefits of the changes in filing deadlines for the affected issuers.

b. Disclosures required of accelerated filers

Non-accelerated filers are not required to provide disclosure regarding the availability of their filings under Item 101(e)(4) of Regulation S-K. While some investors may benefit from

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636 *See, e.g.*, Nils Hakansson, *Interim Disclosure and Public Forecasts: An Economic Analysis and a Framework for Choice*, 52(2) ACCT. REV. 396 (1977) and Baruch Lev, *Toward a Theory of Equitable and Efficient Accounting Policy*, 63(1) ACCT. REV. 1 (1988). We note that Regulation FD generally prohibits public companies from disclosing nonpublic, material information to selected parties unless the information is distributed to the public first or simultaneously. *See* 17 CFR 243.100 to 17 CFR 243.103.

637 *See* Jeffrey Doyle & Matthew Magilke, *Decision Usefulness and Accelerated Filing Deadlines*, 51(3) J. OF ACCT. RES. 549 (2013). We note that this study found the reverse to be true for large accelerated filers.

638 *Id*.

639 *See, e.g.*, Boland *et al.* 2015 Study, note 633 above.

640 *See* letter from BDO.

reduced search costs due to such disclosures, we do not expect that extending the exemption from these disclosures to the affected issuers will have significant economic effects.

Non-accelerated filers also are not required to provide disclosure required by Item 1B of Form 10-K or Item 4A of Form 20-F about unresolved staff comments on their periodic and/or current reports. Studies have found that the eventual disclosure of staff comments and related correspondence, as well as interim information about these comments before they are made public, are value-relevant (in that they affect the pricing of securities) for investors.[641] While our understanding is that Items 1B and 4A disclosures are relatively uncommon,[642] extending the exemption from the requirement to disclose unresolved staff comments to the affected issuers may, in some circumstances, prevent the timely disclosure of value-relevant information to public market investors. Moreover, because Item 1B of Form 10-K and Item 4A of Form 20-F requires unresolved staff comments to be disclosed if they were made not less than 180 days prior to the end of that fiscal year, issuers no longer subject to this disclosure requirement may have a reduced incentive to resolve comments in a timely manner, which could decrease the quality of reporting for the period over which comments continue to be unresolved. We did not receive any comments on these potential effects.

c. Transition thresholds

The amendments include revisions to the transition thresholds that address when an accelerated filer or large accelerated filer can transition into a different filer status. The amendments will allow accelerated or large accelerated filers to become non-accelerated filers if

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641 *See, e.g.*, Patricia Dechow, Alastair Lawrence, & James Ryans, *SEC Comment Letters and Insider Sales*, 91(2) ACCT. REV. 401 (2015) and Lauren Cunningham, Roy Schmardebeck, & Wei Wang, *SEC Comment Letters and Bank Lending*, Working Paper (2017), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2727860.

642 Based on staff analysis using the Intelligize database, approximately 20 issuers included Item 1B disclosures in Forms 10-K filed in 2017.

they qualify under the SRC revenue test or meet a revised public float transition threshold. An issuer whose revenues previously exceeded the SRC initial revenue threshold of $100 million will not qualify under the SRC revenue test unless its revenues fall below $80 million. The $80 million transition threshold for the SRC revenue test is 80 percent of the initial threshold of $100 million in revenue. An issuer whose public float previously exceeded the $75 million initial threshold for accelerated filer status will become a non-accelerated filer if its public float falls below $60 million, or 80 percent of that initial threshold, as opposed to the current threshold of $50 million. Finally, the amendments also revise the public float transition threshold for exiting large accelerated filer status and becoming an accelerated filer from $500 million to $560 million in public float, or 80 percent of the $700 million entry threshold, to align with the transition threshold for entering SRC status after having exceeded $700 million in public float.

The filer type exit thresholds in Rule 12b-2 are set below the corresponding entry thresholds to provide some stability in issuer classification given normal variation in public float and revenues. The exact placement of these thresholds involves a tradeoff between the degree of volatility in classification versus the extent to which the categories persistently include issuers that are below the initial entry thresholds. The Proposing Release presented a quantitative analysis of this tradeoff using 20 years of data on the evolution of market capitalizations (as a proxy for public float) and revenues.[643] In particular, this analysis demonstrated that a higher exit threshold is associated with more volatility in classification. For example, exit thresholds set at 100 percent of the public float entry thresholds would have led eight to ten percent of new entrants into a filer status to immediately exit the following year and then re-enter once again the year after that. Issuers and investors may be confused as a result of such frequent fluctuations in

[643] *See* Table 16 of the Proposing Release, note 4 above.

filer type. They may also bear resulting costs, such as (for issuers) the cost of frequently revising their disclosure schedules and continually considering the impact of whether they are subject to the ICFR auditor attestation requirement from one year to the next and (for investors) any incremental cost of evaluating the reliability of financial disclosures for an issuer that is not consistently subject to the ICFR auditor attestation requirement.

On the other hand, the analysis in the Proposing Release also illustrated that a lower exit threshold is associated with a greater number of issuers remaining in a particular category despite falling below the entry threshold. For example, exit thresholds set at 60 percent of the public float entry thresholds would have prevented four to six percent of the new entrants into a filer status from exiting that status despite being below the entry threshold in the next two years. A low exit threshold can thus risk having a filer status effectively apply to a broader group of issuers than intended.

The analysis in the Proposing Release further demonstrated that the balance between limiting filer status volatility while enabling filer status mobility provided by an exit threshold of 80 percent is similar around a $250 million, $75 million, and $700 million market capitalization. In particular, while five to six percent of the new entrants into a filer status would be expected to transition out and back into the status in the following two years, one to two percent of those entrants would be expected to remain within the same filer status despite being below the entry threshold for the two following years. We therefore expect the increase in the public float thresholds to exit accelerated and large accelerated filer status to $60 and $560 million, or 80 percent of the entry threshold in each case, to lead to a similar tradeoff in these factors as the 80 percent public float threshold to re-enter SRC status.

One commenter noted that certain of the affected issuers may recognize revenues

unevenly across periods due to certain collaborative arrangements.[644] When considering issuers that have empirically crossed a $100 million revenue entry threshold in the past, the analysis in the Proposing Release demonstrated that, on average, these issuers would not be subject to significant volatility in classification. Thus, while some issuers may be subject to such volatility,[645] this does not appear to be a widespread concern. In fact, the analysis in the Proposing Release demonstrated that revenue is on average more stable than market capitalization, so the 80 percent threshold in the revenue test for exiting accelerated and large accelerated filer status is expected to provide a lower degree of filer status fluctuations for a comparable degree of filer status mobility. Overall, we expect the amended transition thresholds to provide a tradeoff between filer status mobility and volatility that is consistent with the tradeoff provided by the recently revised SRC transition provisions.

d. Disclosure

The amendments add a check box to the cover pages of Forms 10-K, 20-F, and 40-F to indicate whether an ICFR auditor attestation is included in the filing. While filer status is reported prominently on the cover page of annual reports for most issuers, there is currently not similarly prominent disclosure of whether an ICFR auditor attestation is provided. Such disclosure has been recommended by the GAO,[646] as well as some commenters.[647]

Investors can already ascertain whether an ICFR auditor attestation is included by

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644 *See* letter from EY.

645 Issuers that expect significant volatility in their classification could consider voluntarily obtaining an ICFR auditor attestation in years where one is not required, given that commenters suggested that there would be no significant cost savings from obtaining an ICFR auditor attestation every three years as opposed to annually. *See, e.g.,* letters from Crowe and KPMG.

646 *See* 2013 GAO Study, note 246 above.

647 *See, e.g.,* letters from CAQ, CFA Inst., CII, Grant Thornton, and KPMG.

searching within an issuer's annual report, and including additional items on the annual report cover page could marginally decrease the salience of each item already reported there. However, several commenters noted that it is currently difficult for investors to easily determine whether an issuer's filing includes an ICFR auditor attestation.[648] The cover page check box disclosure requirement will make it easier for investors to identify issuers that undergo an ICFR auditor attestation with only minimal additional disclosure expense for registrants. This may, on the margin, increase the efficiency of investment decisions and the allocation of capital across the market. It may also enhance the value to issuers of pursuing an ICFR auditor attestation, even when one is not required, by making it more likely that investors recognize that an issuer has obtained an ICFR auditor attestation and therefore account for this factor in their investment decisions. While issuers that voluntarily obtain an ICFR auditor attestation would bear additional costs to do so, we expect they would voluntarily bear these costs only if they believe that the associated issuer-level benefits (*e.g.*, a reduced cost of capital) would more than offset those costs. Thus, to the extent that more prominent disclosure would enhance these benefits, it may be a positive factor in the decision of additional firms to voluntarily obtain an ICFR auditor attestation. Such voluntary action by some of the issuers for which the requirement will be eliminated could, as discussed above, mitigate some of the potential negative effects of the amendments, although it is difficult to predict the frequency with which voluntary compliance might occur.

5. Alternatives to the Amendments

Below we consider the relative costs and benefits of reasonable alternatives to the implementation choices in the amendments.

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[648] *See, e.g.,* letters from CAQ, CFA Inst., and Grant Thornton. *See also* 2013 GAO Study, note 246 above.

a. Exclude all SRCs from accelerated filer category

We considered excluding all SRCs from the accelerated filer definition, consistent with the past alignment of the SRC and non-accelerated filer categories. This alternative would include SRCs that meet the revenue test, as under the adopted amendments, as well as those that have a public float of less than $250 million when initially determining SRC status. Several commenters supported this approach.[649]

This alternative would have several benefits, such as promoting regulatory simplicity and reducing any frictions or confusion caused by issuers having to make multiple determinations of their filer type. This alternative would also expand the benefits of the amendments to additional issuers. We estimate that 268 additional issuers[650] would be non-accelerated filers rather than accelerated filers under this alternative, of which 48 are EGCs and 220 would newly be exempt from the ICFR auditor attestation requirement under SOX Section 404(b) (although we estimate that six of these newly exempt filers would still be subject to the FDIC auditor attestation requirement). In the Proposing Release,[651] we performed an analysis of the audit fees of lower-float issuers of different types and estimated an average compliance cost savings of $415,000 per year for the additional issuers that would be affected under this alternative, with some of these issuers experiencing lesser or greater savings. This likely represents a significant cost savings

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649 *See, e.g.,* letters from ASA, Guaranty, NAM, and Nasdaq.

650 This estimate is based on staff analysis of the number of accelerated filers in 2018 with public float of at least $60 million but less than $250 million and prior fiscal year revenues (or, in the case of BDCs, investment income) of at least $100 million and that are eligible to be SRCs (*i.e.*, excluding ABS issuers, RICs, BDCs, subsidiaries of non-SRCs, and FPIs filing on foreign forms or using IFRS) or are BDCs (though we estimate that there are no BDCs that meet these criteria). Revenue data is sourced from XBRL filings, Compustat, and Calcbench. *See* note 298 above for details on the identification of the population of accelerated filers. We note that the incremental number of affected issuers could be higher than this estimate because there are approximately 65 issuers for which filer status and/or public float data are not available (and revenue data is either unavailable or revenues are at least $100 million).

651 *See* Section III.C.6.a. of the Proposing Release, note 4 above.

for issuers with less than $250 million in public float and may thus have beneficial economic effects on competition and capital formation. As discussed above, smaller issuers generally bear proportionately higher compliance costs than larger issuers. Reducing these additional issuers' costs would reduce their overhead expenses and may enhance their ability to compete with larger issuers. To the extent that the cost savings for the additional affected issuers enable capital investments that would not otherwise be made, this alternative would also lead to additional benefits in capital formation.

However, we expect the costs of this alternative to be greater than for the amendments, primarily due to the broader application of the exemption from the ICFR auditor attestation requirement and the diminished impact of some of the mitigating factors discussed in Section IV.C.3. above on SRCs that meet the public float test rather than the revenue test. In particular, we estimated in the Proposing Release[652] that extending the exemption from the ICFR auditor attestation requirement to issuers that are eligible to be SRCs based on their public float may result in an average increase in the rate of ineffective ICFR of about 25 percentage points among these issuers, somewhat higher than our estimate for low-revenue issuers. The analysis in the Proposing Release[653] also demonstrated that low public float issuers restate their financial statements at rates comparable to higher public float issuers, unlike low-revenue issuers, whose restatement rates were three to nine percentage points lower than for higher-revenue issuers of the same filer status. We therefore believe that the proposition that low-revenue issuers may, on average, be less susceptible to certain kinds of misstatements may not apply to the same extent to issuers with low public float. We estimated in the Proposing Release that the increase in

652 *Id*.

653 *Id*.

restatement rates for the additional affected issuers may be comparable to the two percentage points we estimated for low-revenue issuers, but that, in contrast to the results for low-revenue issuers, this would likely result in higher restatement rates for the additional affected issuers than for the higher public float issuers that would remain accelerated filers.

The Proposing Release also tested whether the potential adverse impact of such a change may be mitigated by a lower empirical relevance of financial statements for the market valuation of these issuers. However, we did not find evidence that the market relies on financial statements to a lesser extent for the valuation of issuers with public float less than $250 million (as compared to issuers with a larger public float), and so this further mitigating factor that applies to low-revenue issuers likely does not apply equally to lower public float issuers.

Finally, as in Section IV.C.3., we re-examined responses to the 2008–09 Survey. When asked about the net benefits of complying with SOX Section 404, 16 percent of respondents at accelerated filers with public float of less than $250 million claimed that the costs far outweighed the benefits, in contrast to, as reported above, 30 percent of respondents at accelerated filers with revenues of less than $100 million.[654] While this survey data is somewhat dated, it provides an indication as to the perception by executives at issuers at that time of the relative costs and benefits of the ICFR auditor attestation requirement. To the extent that this perception is borne out by the actual costs and benefits of the ICFR auditor attestation requirement for issuers that meet the SRC revenue test and for those that would otherwise be SRCs under the public float test, this data may suggest that low-revenue issuers would benefit

[654] These estimates are based on staff analysis of data from the 2008-09 Survey. The analysis considers responses pertaining to the most recent year for which a given respondent provided a response. We note that the rate of responses to the question about net benefits was lower than for other questions. *See* 2009 SEC Staff Study, note 304 above, and Alexander *et al.* 2013 Study, note 401 above, for details on the survey and analysis methodology.

more from qualifying as non-accelerated filers than would other types of SRCs.

We did not receive any comments on our analysis of the benefits and costs of extending non-accelerated filer status to all SRCs.

b. Include or exclude certain issuer types

Alternatively, we considered approaches that would include or exclude additional issuer types, or apply different requirements to particular issuer types. For example, we could extend non-accelerated filer status to other issuers with between $75 million and $700 million in public float that meet the SRC revenue test but would not be eligible to be SRCs because they are majority-owned subsidiaries of non-SRCs. However, in the Proposing Release, we estimated that only one majority-owned subsidiary of a non-SRC parent would meet the same public float and revenue thresholds as the affected issuers. Given the minimal number of such issuers and the responsibilities of the parent of any such issuers with respect to the ICFR of their subsidiaries, we expect the incremental costs and benefits of this alternative to be minimal.

As discussed above, in a change from the proposal, the final amendments also exclude BDCs from the accelerated and large accelerated filer definitions under circumstances that are analogous to the exclusions for other issuers under the amendments. We estimate that approximately 28 BDCs will therefore be affected by the amendments, of which seven are EGCs and therefore already exempt from the ICFR auditor attestation requirement.

We recognize, as stated in the Proposing Release, that investors in BDCs generally may place greater significance on the financial reporting of BDCs relative to low-revenue non-investment company issuers. However, given the small number of BDCs, it is difficult to assess to what extent our findings with respect to the anticipated costs and benefits of the amendments for the broader pool of affected issuers would apply similarly to BDCs as an isolated subset of

these issuers.[655] We note, however, that one commenter urged that we pursue the adopted approach, stating that, among other reasons, "[a]llowing smaller BDCs to benefit from non-accelerated filer status, and thereby ease regulatory costs and burdens, could encourage more BDCs to enter the public markets, creating greater access to capital for small operating companies and expanding investment opportunities for retail investors.".[656] Given the limited number of affected issuers that are BDCs, we preliminarily expect the aggregate incremental costs and benefits of this alternative relative to the adopted approach to be modest, as compared to the universe of Form 10-K filers, although they could be significant for any particular issuer and significant for traded BDCs as a class of Form 10-K filers as we estimate the total number of traded BDC filers to be 51 (of which seven have a market capitalization below $75 million and would be already considered non-accelerated filers).[657]

We also considered alternative thresholds for BDCs, given that BDCs do not report revenue on their financial statements. The amendments exclude a BDC from the accelerated and large accelerated filer definitions in Rule 12b-2 if the BDC: (1) has a public float of $75 million or more, but less than $700 million; and (2) has investment income of less than $100 million. Table 16 below provides statistics from the Proposing Release on other income-related metrics for BDCs with between $70 million and $700 million in public float.[658]

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[655] While more refined analysis is difficult, we note that, for the 54 to 75 BDCs for which a management report on ICFR is available in Audit Analytics for years 2014 through 2017, the rate of ineffective ICFR reported by management is 9.0 percent, the rate of restatements is 9.8 percent, and the rate of Item 4.02 restatements is 2.3 percent on average across these years, which are comparable to the corresponding rates for all accelerated filers other than EGCs under the baseline. *See* Section IV.B.4. above.

[656] *See* letter from Proskauer.

[657] Nontraded BDCs also file on Form 10-K, but these issuers are already non-accelerated filers because they do not have public float.

[658] This analysis used market capitalization valuations as of February 2019 to determine the set of potentially affected BDCs under different alternatives. While this methodology is different than the approach used by Rule 12b-2, which uses the aggregate worldwide market value of the voting and non-voting common equity held by

Table 16: Characteristics of BDCs with Market Capitalization between $75 and $700 Million

(in millions)

	Market Capitalization as of February 2019	Investment Income for most recent fiscal year	Net Realized and Unrealized Gains and Losses for most recent fiscal year	Net Increase in Net Assets Resulting from Operations for most recent fiscal year
High	$507.91	$108.28	$43.12	60.69
Low	$89.69	$1.62	(-$123.33)	(-$114.28)
Average	$255.30	$49.37	(-$11.15)	$7.70
Median	$244.72	$47.67	(-$4.44)	$13.01

The commenter that supported expanding the proposed amendment to the definition of accelerated filer and large accelerated filer to exclude BDCs suggested that we exclude entities with total investment income of less than $80 million in the most recently completed fiscal year for which audited financial statements are available and either no public float or public float of less than $700 million. Of the 29 BDCs identified in the Proposing Release with a market capitalization between $75 million and $700 million, 28 had investment income of below $100 million and 26 had investment income of below $80 million. We therefore anticipate that the incremental costs and benefits of a threshold of $80 million in investment income as compared to the adopted threshold of $100 million in investment income would be limited.

We also considered whether to require or permit BDCs to provide an independent public

non-affiliates as of the last business day of the issuer's most recent second fiscal quarter, we do not believe that it would substantially change our analysis. This analysis did not remove BDCs who may qualify as non-accelerated filers based on their status as EGCs. After identifying the set of potentially affected BDCs, our staff manually reviewed the then-most recent Form 10-K filed on our EDGAR system for each BDC. The affected parties estimates in Section IV.C.1. above uses self-identified filer status to identify affected BDCs (as well as other affected issuers), rather than using market capitalization data for this purpose. In particular, current status as an accelerated filer implies that the issuer's Rule 12b-2 public float does not exceed $700 million. *See* above note 336. Also, the public float of the affected BDCs was manually collected for the purpose of related statistics in Section IV.C.1. *See* notes 356, 366, and 367 above.

accountant's report on internal controls, similar to the one required by RICs on Form N-CEN, since both RICs and BDCs prepare financial statements under Article 6 of Regulation S-X, in place of the auditor attestation required by SOX Section 404(b). We considered whether such a substitution should be permitted for all BDCs or only required for those BDCs that would no longer be required to provide a report under SOX Section 404(b). We do not have any data and did not receive any public comment, however, regarding the potential benefits and costs of using a Form N-CEN-type report on internal controls as compared to the auditor attestation required by SOX Section 404(b).

We also considered excluding all FPIs, which are included in the affected issuers to the extent that they meet the required thresholds and other qualifications, from the amendments. Researchers have found that the restatement rates of foreign issuers may be artificially depressed due to a lower likelihood of detection and disclosure of misstatements for these issuers.[659] It is therefore possible that encouraging more effective ICFR through an ICFR auditor attestation requirement may be particularly important for such issuers. On the other hand, because low-revenue FPIs may have similar characteristics to low-revenue domestic issuers, including them in the group of affected issuers may help to maintain an even playing field for competition amongst these issuers and avoid discouraging foreign companies from issuing securities in U.S. public markets. The amendments attempt to strike a balance between these considerations by allowing FPIs to avail themselves of the amendments only if they file on domestic forms and present their financial statements pursuant to U.S. GAAP, as well as meeting the required

[659] *See, e.g.*, Suraj Srinivasan, Aida Sijamic Wahid, & Gwen Yu, *Admitting Mistakes: Home Country Effect on the Reliability of Restatement Reporting*, 90(3) ACCT. REV. 1201 (2015).

thresholds and other qualifications.[660] Because of limitations in the availability of data such as filing status or public float for many FPIs, we are unable to reliably measure the potential effects for this subset of issuers. Commenters did not provide data that would allow us to further analyze the potential effects for these issuers.

c. Alternative threshold

We considered alternative levels at which a revenue threshold could be set. A $100 million dollar revenue threshold was recommended, in conjunction with a public float threshold, for the accelerated filer definition as well as the SRC definition by the 2017 Small Business Forum and a participant at the September 2017 meeting of the former Advisory Committee on Small and Emerging Companies ("ACSEC").[661] The $100 million threshold is also aligned with the SRC revenue test. Empirically, we find no obvious break in the distribution of revenue or in the results of our analysis. In general, lowering the revenue threshold would reduce the expected benefits of the amendments by reducing the number of issuers that would experience cost savings, while also reducing the expected costs of the amendments by reducing the potential adverse impact on the reliability of financial statements. Increasing the threshold would increase the expected benefits while also increasing the expected costs. We did not receive comments on the costs or benefits of alternative levels of a revenue threshold or of alternative metrics that should be used instead of revenue (except in the case of BDCs, as discussed above).

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660 While we currently estimate that no FPIs would currently qualify based on these requirements, we note that there are FPIs that otherwise meet the required thresholds and other qualifications and that might choose to file on domestic forms using U.S. GAAP in order to benefit from the amendments as well as the scaled disclosure accommodations available to SRCs if these benefits outweigh the costs of changing their disclosure regime.

661 *See* Final Report of the 2017 SEC Government Business Forum on Small Business Capital Formation (Mar. 2018), available at https://www.sec.gov/files/gbfor36.pdf; and William J. Newell, Presentation at the ACSEC Meeting, *Sarbanes-Oxley Section 404(b): Costs of Compliance and Proposed Reforms*, (Sept. 13, 2017), available at https://www.sec.gov/info/smallbus/acsec/william-newell-acsec091317.pdf.

V. PAPERWORK REDUCTION ACT

A. Summary of the Collections of Information

Certain provisions of our rules and forms that would be affected by the amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act ("PRA"). The Commission published a notice requesting comment on the collection of information requirements in the Proposing Release, and submitted the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[662] While several commenters provided comments on the possible costs of the proposed amendments,[663] no commenters specifically addressed our PRA analysis. Where appropriate, we have revised our burden estimates after considering these comments as well as differences between the proposed and final rules.

The hours and costs associated with preparing and filing the forms and reports constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number. Compliance with the information collections is mandatory. Responses to the information collections are not kept confidential and there is no mandatory retention period for the information disclosed. The titles for the affected collections of information are:

- "Form 10-K" (OMB Control No. 3235-0063);[664] and

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662 44 U.S.C. 3507(d) and 5 CFR 1320.11.

663 *See, e.g.*, letters from Ardelyx Presentation, Cerecor, CFA, CFA Inst., CII, Concert, Corvus, Guaranty, ICBA, Nasdaq, Pieris, Prof. Barth *et al.*, Prof. Ge *et al.*, Summit, Syros, and Terra Tech.

664 The paperwork burden from 17 CFR 240.12b-1 through 240.12b-37 ("Regulation 12B") is imposed through the forms that are subject to the requirements in that regulation and is reflected in the analyses of those forms. Our estimate for Forms 10-K takes into account the burden that will be incurred by including the disclosure in the applicable annual report. After the Proposing Release, note 4 above, was issued, the Office of Management and

- "Form 10-Q"[665] (OMB Control No. 3235-0070).[666]

The regulation and forms listed above were adopted under the Exchange Act. The regulation and forms set forth the disclosure requirements for periodic reports filed by registrants to help investors make informed investment decisions. A description of the final amendments, including the need for the information and its use, as well as a description of the likely respondents, can be found in Section II above, and a discussion of the economic effects of the final amendments can be found in Section IV above.

B. Burden and Cost Estimates Related to the Final Amendments

We estimate that the final amendments will result in approximately 527 additional issuers being classified as non-accelerated filers.[667] Accelerated filers are subject to the ICFR auditor attestation requirement and shorter deadlines for filing their Exchange Act periodic reports.[668] Additionally, accelerated filers must provide disclosure regarding the availability of their filings and the disclosure required by Item 1B of Form 10-K and Item 4A of Form 20-F about unresolved staff comments on their periodic and/or current reports.[669]

Budget ("OMB") discontinued the OMB control number for Regulation 12B, so that the PRA inventory would not reflect duplicative burdens.

665 17 CFR 249.308a.

666 The only revision to this form will be changing filing deadlines, which will neither increase nor decrease the burden hours necessary to prepare the filing because there will be no change to the amount of information required in the filing.

667 *See* Section IV.C.1. above. We estimate that there are no FPIs that file on domestic forms and present their financial statements pursuant to U.S. GAAP that would meet the required thresholds and other qualifications of the amendments. However, there are an estimated 31 FPIs that file on forms only available to FPIs, but otherwise meet the required thresholds and other qualifications. In the Proposing Release, note 4 above, we included FPIs that file the forms available only to FPIs, but otherwise meet the required thresholds and other qualifications, in the number of affected issuers. While these issuers could become subject to the amendments by changing their reporting regime, it is difficult to predict how many would do so, as a result, we do not include them in the number of affected issuers in this release. Accordingly, we do not estimate any effect on the collections of information corresponding to Forms 20-F or 40-F.

668 *See* Section II.A. above.

669 *See* note 25 above.

1. ICFR Auditor Attestation Requirement

We believe that expanding the exemption from the ICFR auditor attestation requirement would reduce the PRA burden for 373 of the 527 affected issuers.[670] An ICFR auditor attestation is required only in annual reports. Table 17, below, shows the estimated number of affected issuers that are subject to the ICFR auditor attestation requirement that file on each of these forms and the average estimated audit-fee and non-audit costs, as described above,[671] to comply with the ICFR auditor attestation requirement.

Table 17. Estimated Annual Costs Per Issuer of ICFR Auditor Attestation Requirement for Specified Forms

Form Type	Number of Affected Issuers	Audit-Fee Costs Per Issuer	Non-Audit Costs Per Issuer
Form 10-K	373	$110,000	$100,000

Because these issuers would no longer be subject to the ICFR auditor attestation requirement under the final amendments, they would no longer incur these costs. For purposes of the PRA, this reduction in total burden is to be allocated between a reduction in internal burden hours and a reduction in outside professional costs. Table 18, below, sets forth the percentage estimates we typically use for the burden allocation for each form.

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670 We estimate that the remaining 154 of the 527 affected issuers are EGCs, which are not required to comply with the ICFR auditor attestation requirement under SOX Section 404(b). *See* Section IV.C.1. above. In addition to the 154 EGCs, we estimate that a further 78 of the 527 affected issuers are currently also subject to the FDIC's auditor attestation requirement. *See* Section 18A of Appendix A to FDIC Rule 363. These issuers would continue to incur burden hours and costs associated with an auditor attestation requirement even under the final amendments. However, the FDIC's auditor attestation requirement is not part of our rules. For purposes of considering the PRA effects of the final amendments, therefore, we have reduced the burden hours and costs for these 78 issuers as we would for the other affected issuers that are not EGCs.

671 *See* Sections IV.C.3. and IV.C.5. above.

Table 18. Standard Estimated Burden Allocation for Specified Forms

Form Type	Internal	Outside Professionals
Form 10-K	75%	25%

For the $100,000 reduction in annual non-audit costs,[672] we allocate the burden based on the percentages in Table 18 above. However, we believe that 100 percent of the $110,000 annual burden reduction for audit-fee costs related to the ICFR auditor attestation requirement should be ascribed to outside professional costs because that amount is an estimate of fees paid to the independent auditor conducting the ICFR attestation audit. Table 19, below, shows the resulting estimated reduction in cost per issuer associated with outside professionals.

Table 19. Estimated Reduction in Outside Professional Costs from Elimination of ICFR Auditor Attestation Requirement

Issuer Type (Form Used) [A]	Outside Professional Costs Per Issuer (Non-Audit) [B]	Outside Professional Costs Per Issuer (Audit Fees) [C]	Total Outside Professional Costs Per Issuer (Non-Audit + Audit Fees) [D]	Number of Affected Issuers [E]	Total Reduction in Outside Professional Costs (D x E) [F]
Form 10-K	$25,000	$110,000	$135,000	373	$50,355,000

For PRA purposes, an issuer's internal burden is estimated in internal burden hours. We are, therefore, converting the internal portions of the non-audit costs to burden hours. These activities would mostly be performed by a number of different employees with different levels of knowledge, expertise, and responsibility. We believe these internal labor costs will be less than

672 As discussed in Section IV.C.3, above, in deriving this estimate of the reduction in non-audit costs, we have looked to outside vendor and internal labor costs, and not to non-labor costs, because we believe that those non-labor costs (such as software, hardware, and travel costs) are primarily attributable to management's ICFR responsibilities under SOX Section 404(a) and thus would continue to be incurred. To the extent elimination of the auditor attestation requirement also results in a reduction in management's time burden, we believe this reduction generally would be captured by the estimated $100,000 reduction, as this amount reflects an overall reduction in non-audit costs.

the $400 per hour figure we typically use for outside professionals retained by the issuer. Therefore, we use an average rate of $200 per hour to estimate an issuer's internal non-audit labor costs. Table 20, below, shows the resulting estimated reduction in internal burden hours from the elimination of the ICFR auditor attestation requirement.

Table 20. Estimated Reduction in Internal Burden Hours from Elimination of ICFR Auditor Attestation Requirement

Issuer Type (Form Used) [A]	Internal Cost Per Issuer (Non-Audit) [B]	Burden Hours Per Issuer (B / $200) [C]	Number of Affected Issuers [D]	Total Reduction in Internal Burden Hours (C x D) [E]
Form 10-K	$75,000	375	373	139,875

2. Filing Deadlines, Disclosure Regarding Filing Availability, and Unresolved Staff Comments

As the Commission has recognized previously, changing filing deadlines neither increases nor decreases the burden hours necessary to prepare the filing because there is no change to the amount of information required in the filing.[673] Therefore, we do not believe that the change to the filing deadlines will affect an issuer's burden hours or costs for PRA purposes.

We believe that eliminating the requirements to provide disclosure regarding the availability of their filings and the disclosure required by Item 1B of Form 10-K and Item 4A of Form 20-F about unresolved staff comments on their periodic and/or current reports will reduce their burden hours and costs, but we do not expect that reduction to be significant. For purposes of the PRA, we estimate the reduction to be approximately one hour for each affected issuer.[674] However, as opposed to the burden reduction resulting from the elimination of the ICFR auditor

[673] *Revisions to Accelerated Filer Definition and Accelerated Deadlines for Filing Periodic Reports*, Release No. 33-8644 (Dec. 21, 2005) [70 FR 76634 (Dec. 27, 2005)].

[674] We believe that this one-hour reduction will be solely for an issuer's internal burden hours.

attestation requirement, which would apply only to 373 of the 527 total affected issuers that are not EGCs, the burden reduction from eliminating these disclosure requirements will apply to all the 527 affected issuers, including the 154 affected issuers that are EGCs. That reduction is allocated by form as shown in Table 21, below.

Table 21. Estimated Reduction in Internal Burden Hours Per Issuer from Elimination of Disclosure Requirements Regarding Filing Availability and Unresolved Staff Comments

Form Type [A]	Burden Hours Per Issuer [B]	Number of Affected Issuers [C]	Reduction in Internal Burden Hours (B x C) [D]
Form 10-K	1	527	527

3. Check Box Disclosure

In a change from the proposed amendments, the final amendments add a check box to the cover pages of their annual reports on Forms 10-K, 20-F, and 40-F for issuers to indicate that they included an ICFR auditor attestation in the filing. In addition, if the issuer is otherwise required to tag cover page disclosure data using Inline XBRL, it must also to tag the cover page check box disclosure using Inline XBRL. Issuers must already determine whether they are subject to the ICFR auditor attestation requirement, so requiring issuers to add a check box to the cover pages of their annual reports on Forms 10-K, 20-F, and 40-F, and check that box if they provide the ICFR auditor attestation, will not substantively modify existing collection of information requirements or otherwise affect the overall burden estimates associated with these forms. Therefore, we are not adjusting any burden or cost estimates in connection with the check box requirement in the final amendments.

4. Total Burden Reduction

Table 22, below, shows the total estimated reduction in internal burden hours and outside professional costs for all aspects of the final amendments.

Table 22. Requested Paperwork Burden Under the Final Amendments

	Current Burden			Burden Change					
	Current Annual Responses (A)	Current Burden Hours (B)	Current Cost Burden (C)	Change in Company Hours from Auditor Attestation (D)	Change in Company Hours from Disclosure Requirement Elimination (E)	Total Change in Company Hours (F) = (D) + (E)	Change in Professional Costs (G)	Burden Hours for Affected Responses (H) = (B) + (F)	Cost Burden for Affected Responses (I) = (C) + (G)
10-K	8,137	14,198,780	$1,895,224,719	(139,875)	(527)	(140,402)	($50,355,000)	14,058,378	$1,844,869,719

VI. REGULATORY FLEXIBILITY ACT ANALYSIS

The Regulatory Flexibility Act ("RFA")[675] requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[676] to consider the impact of those rules on small entities. We have prepared this Final Regulatory Flexibility Analysis ("FRFA") in accordance with Section 604 of the RFA.[677] This FRFA relates to the amendments to the accelerated filer and large accelerated filer definitions in Rule 12b-2 under the Exchange Act and the addition of a check box to the cover pages of Forms 10-K, 20-F, and 40-F to indicate whether an ICFR auditor attestation is included in the filing. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Proposing Release.

A. Need for, and Objectives of, the Final Amendments

The purpose of the amendments to the accelerated filer and large accelerated filer

675 5 U.S.C. 601 *et seq.*

676 5 U.S.C. 553.

677 5 U.S.C. 604.

definitions in Rule 12b-2 is to promote capital formation by more appropriately tailoring the types of issuers that are included in the category of accelerated filers and revising the transition thresholds for accelerated and large accelerated filers. The addition of the check box to the cover pages of Forms 10-K, 20-F, and 40-F is intended to provide more prominent and easily accessible disclosure of this information for investors and market participants while imposing only minimal burdens on issuers. The need for, and objectives of, the amendments are discussed in more detail in Sections I and II above.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on all aspects of the IRFA, including the number of small entities that would be affected by the proposed amendments, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis, and how to quantify the impact of the proposed amendments. We did not receive any comments specifically addressing the IRFA. However, we received a number of comments on the proposed amendments, generally,[678] and have considered all of these comments in developing the FRFA because the final amendments are focused on smaller issuers.

We believe that the final amendments will reduce disclosure burdens by expanding the number of registrants that will no longer qualify as accelerated or large accelerated filers, which will eliminate the ICFR auditor attestation requirement for those issuers, while maintaining investor protections.

C. Small Entities Subject to the Amendments

The final amendments will affect some registrants that are small entities. The RFA

[678] *See* Section II.B.2. above.

defines "small entity" to mean "small business," "small organization," or "small governmental jurisdiction."[679] For purposes of the RFA, under our rules, an issuer, other than an investment company, is a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year.[680]

We estimate that there are 1,171 issuers that file with the Commission, other than investment companies, which may be considered small entities and are potentially subject to the final amendments.[681] Investment companies, which include BDCs, qualify as small entities if, together with other investment companies in the same group of related investment companies, they have net assets of $50 million or less as of the end of their most recent fiscal year.[682] Commission staff estimates that, as of June 2019, approximately 16 BDCs are small entities.[683] We believe it is likely that virtually all issuers that would be considered small businesses or small organizations, as defined in our rules, are already non-accelerated filers and would continue to be encompassed within that category. To the extent any such issuers are not already non-accelerated filers, we believe it is likely that the final amendments will capture those entities.

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

As noted above, the final amendments will reduce the number of accelerated and large accelerated filers, which will reduce the compliance burden for those issuers, some of which may be small entities, because they would no longer have to satisfy the ICFR auditor attestation

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679 5 U.S.C. 601(6).

680 *See* 17 CFR 240.0-10(a) under the Exchange Act.

681 This estimate is based on staff analysis of issuers, excluding co-registrants, with EDGAR filings of Form 10-K, 20-F and 40-F, or amendments, filed during the calendar year of January 1, 2018 to December 31, 2018. This analysis is based on data from XBRL filings, Compustat, and Ives Group Audit Analytics.

682 17 CFR 270.0–10(a).

683 These estimates are based on staff analysis of Morningstar data and data submitted by investment company registrants in forms filed on EDGAR as of June 2019.

requirement, comply with accelerated deadlines for filing their Exchange Act periodic reports, provide disclosure regarding the availability of their filings, or provide disclosure required by Item 1B of Form 10-K and Item 4A of Form 20-F about unresolved staff comments on their periodic and/or current reports.[684] The ICFR auditor attestation requirement applies only to accelerated and large accelerated filers, and most small entities would not qualify for either filer status. Compliance with certain rules affected by the amendments require the use of professional skills, including accounting and legal skills. The final amendments are discussed in detail in Sections I and II above. We discuss the economic effect including the estimated costs and burdens, of the final amendments on all registrants, including small entities, in Section IV above.

E. Agency Action to Minimize Effect on Small Entities

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse effect on small entities. Accordingly, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements for small entities under our rules as revised by the amendments;
- Using performance rather than design standards; and
- Exempting small entities from coverage of all or part of the amendments.

We do not believe that establishing different compliance or reporting obligations in conjunction with the final amendments is necessary. The final amendments would not impose

[684] The amendments to include a check box on Forms 10-K, 20-F, and 40-F are not expected to affect the overall burden estimates associated with these forms. *See* Section V.C.3. above.

any significant new compliance obligations. In fact, the final amendments would reduce the compliance obligations of affected issuers by increasing the number of issuers, including small entities, that are subject to the different, less burdensome, compliance and reporting obligations for non-accelerated filers. Similarly, because the final amendments would reduce the burdens for these issuers, we do not believe it is appropriate to exempt small entities from all or part of the proposed amendments.

We believe that some of the issuers that would become eligible to be non-accelerated filers under the final amendments may be smaller entities. Therefore, to the extent that any small entities would become newly eligible for non-accelerated filer status under the final amendments, their compliance and reporting requirements would be further simplified. We note in this regard that the Commission's existing disclosure requirements provide for scaled disclosure requirements and other accommodations for small entities, and the final amendments would not alter these existing accommodations.

The check box requirement should not affect small entities unless they voluntarily choose to comply with the ICFR auditor attestation requirements. Further, we note that the compliance burden associated with the check box is expected to be minimal, and establishing a different compliance requirement, providing additional clarification of the requirement, or exempting a small entity would not, therefore, have a meaningful impact on the small entity.

Finally, with respect to the use of performance rather than design standards, because the final amendments are not expected to have any significant adverse effect on small entities (and may, in fact, relieve burdens for some such entities), we do not believe it is necessary to use performance standards in connection with this rulemaking.

STATUTORY AUTHORITY AND TEXT OF RULE AMENDMENTS

The rule amendments described in this release are being adopted pursuant to Sections 7, 10, 19(a), and 28 of the Securities Act, as amended, and Sections 3(b), 12, 13, 15(d) and 23(a) of the Exchange Act, as amended.

List of Subjects in 17 CFR Part 229, 230, 240, and 249

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Commission is proposing to amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K

1. The authority citation for part 229 continues to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78*l*, 78m, 78n, 78n-1, 78*o*, 78u-5, 78w, 78*ll*, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; 18 U.S.C. 1350; sec. 953(b), Pub. L. 111-203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012).

* * * * *

2. Amend § 229.10 by adding Instruction 2 to paragraph (f) to read as follows:

§ 229.10 (Item 10) General.

* * * * *

(f) * * *

Instruction 2 to paragraph (f): A foreign private issuer is not eligible to use the requirements for smaller reporting companies unless it uses the forms and rules designated for

domestic issuers and provides financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles.

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

3. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78*l*, 78m, 78n, 78*o*, 78*o*-7 note, 78t, 78w, 78*ll*(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

Sections 230.400 to 230.499 issued under secs. 6, 8, 10, 19, 48 Stat. 78, 79, 81, and 85, as amended (15 U.S.C. 77f, 77h, 77j, and 77s).

* * * * *

4. Amend § 230.405 by adding Instruction 2 to the definition of "smaller reporting company" to read as follows:

§ 230.405 Definitions of terms.

* * * * *

Smaller reporting company. * * *

Instruction 2 to definition of "smaller reporting company": A foreign private issuer is not eligible to use the requirements for smaller reporting companies unless it uses the forms and rules designated for domestic issuers and provides financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

5. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78*l*, 78m, 78n, 78n-1, 78*o*, 78*o*-4, 78*o*-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78*ll*, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*, and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, secs. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

Sections 240.12b-1 to 240.12b-36 also issued under secs. 3, 12, 13, 15, 48 Stat. 892, as amended, 894, 895, as amended; 15 U.S.C. 78c, 78*l*, 78m, and 78*o*.6.

* * * * *

6. Amend § 240.12b-2 by:

a. In the definition of "Accelerated filer and large accelerated filer" by:

i. Removing "." at the end of paragraph (1)(iii) and adding in its place "; and";

ii. Adding paragraph (1)(iv);

iii. Removing "." at the end of paragraph (2)(iii) and adding in its place "; and";

iv. Adding paragraph (2)(iv);

v. Revising paragraphs (3)(ii) and (3)(iii);

vi. Adding paragraph (4); and

b. After the definition of "smaller reporting company," by adding Instruction 2 to the end of the definition.

The addition and revisions read as follows:

§ 240.12b-2 Definitions.

* * * * *

Accelerated filer and large accelerated filer—(1) * * *

(iv) The issuer is not eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, as applicable.

(2) * * *

(iv) The issuer is not eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, as applicable.

(3) * * *

(ii) Once an issuer becomes an accelerated filer, it will remain an accelerated filer unless: the issuer determines, at the end of a fiscal year, that the aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates was less than $60 million, as of the last business day of the issuer's most recently completed second fiscal quarter; or it determines that it is eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, as applicable. An issuer that makes either of these determinations becomes a non-accelerated filer. The issuer will not become an accelerated filer again unless it subsequently meets the conditions in paragraph (1) of this definition.

(iii) Once an issuer becomes a large accelerated filer, it will remain a large accelerated filer unless: it determines, at the end of a fiscal year, that the aggregate worldwide market value

of the voting and non-voting common equity held by its non-affiliates ("aggregate worldwide market value") was less than $560 million, as of the last business day of the issuer's most recently completed second fiscal quarter or it determines that it is eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, as applicable. If the issuer's aggregate worldwide market value was $60 million or more, but less than $560 million, as of the last business day of the issuer's most recently completed second fiscal quarter, and it is not eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, as applicable, it becomes an accelerated filer. If the issuer's aggregate worldwide market value was less than $60 million, as of the last business day of the issuer's most recently completed second fiscal quarter, or it is eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, it becomes a non-accelerated filer. An issuer will not become a large accelerated filer again unless it subsequently meets the conditions in paragraph (2) of this definition.

* * * * *

(4) For purposes of paragraph (1), (2), and (3) only, a business development company is considered to be eligible to use the requirements for smaller reporting companies under the revenue test in paragraph (2) or (3)(iii)(B) of the "smaller reporting company" definition in this section, provided that the business development company meets the requirements of the test using annual investment income under Rule 6-07.1 of Regulation S-X (17 CFR 210.6-07.1) as the measure of its "annual revenues" for purposes of the test.

* * * * *

Smaller reporting company. * * *

Instruction 2 to definition of "smaller reporting company": A foreign private issuer is not eligible to use the requirements for smaller reporting companies unless it uses the forms and rules designated for domestic issuers and provides financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles.

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

7. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* 18 U.S.C. 1350; Sec. 953(b), Pub. L. 111-203, 124 Stat. 1904; Sec. 102(a)(3), Pub. L. 112-106, 126 Stat. 309 (2012); Sec. 107, Pub. L. 112-106, 126 Stat. 313 (2012), and Sec. 72001, Pub. L. 114-94, 129 Stat. 1312 (2015), unless otherwise noted.

* * * * *

Section 249.220f is also issued under secs. 3(a), 202, 208, 302, 306(a), 401(a), 401(b), 406 and 407, Pub. L. 107-204, 116 Stat. 745.

Section 249.240f is also issued under secs. 3(a), 202, 208, 302, 306(a), 401(a), 406 and 407, Pub. L. 107-204, 116 Stat. 745.

* * * * *

Section 249.310 is also issued under secs. 3(a), 202, 208, 302, 406 and 407, Pub. L. 107-204, 116 Stat. 745.

* * * * *

8. Amend Form 20-F (referenced in § 249.220f) by adding a field to the cover page to include a check box indicating whether the registrant has included an ICFR auditor attestation in

the filing:

Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

* * * * *

†The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (§ 15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. □

* * * * *

9. Amend Form 40-F (referenced in § 249.240f) by adding a field to the cover page to include a check box indicating whether the registrant has included an ICFR auditor attestation in the filing:

Note: The text of Form 40-F does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 40-F

* * * * *

†The term "new or revised financial accounting standard" refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (§ 15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. □

* * * * *

10. Amend Form 10-K (referenced in § 249.310) by adding a field to the cover page to include a check box indicating whether the registrant has included an ICFR auditor attestation in the filing:

Note: The text of Form 40-F does not, and this amendment will not, appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

* * * * *

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. □

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (§ 15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. □

* * * * *

By the Commission.

Dated: March 12, 2020.

Vanessa A. Countryman,

Secretary.