

[Securities Regulation Daily Wrap Up, TOP STORY—SEC relieves more small companies from auditor attestation requirements, \(May 9, 2019\)](#)

Securities Regulation Daily Wrap Up

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The amendments affect the accelerated filer and large accelerated filer definitions, building on last year's amendments to the smaller reporting company definition.

The SEC voted 3-1 to approve a proposal exempting certain companies from the auditor attestation requirement of Sarbanes-Oxley Section 404(b). At the [open meeting](#), staff from the Division of Corporation Finance explained that the amendments would free smaller companies to use the money they would otherwise spend for attestation on research and development or other initiatives. But Commissioner Jackson, the lone dissenter, questioned the relevance of the old data used in the analysis of the proposal's effects and said the amendments would deny protections to the investors who care the most.

Overview. Last year the SEC adopted amendments to the smaller reporting company (SRC) definition to expand the number of companies that qualify for certain existing scaled disclosure accommodations. Today's vote also changes the accelerated filer and large accelerated filer thresholds to exclude SRC-eligible companies with annual revenues under \$100 million for the last fiscal year. These companies will not be required to provide an auditor attestation of management's assessment of internal control over financial reporting (ICFR) as previously required under Section 404(b) of SOX.

Chairman Clayton [praised](#) the proposal, saying it built on Congress's work in tailoring 404(b) by creating emerging growth companies (EGCs) and exempting them from some requirements. CorpFin Director Bill Hinman said that the relief is targeted at companies that have aged out of EGC status but still have smaller revenues and less complex financials—companies that are valued less on their current financial reports and more on their potential prospects. Over a third of the issuers affected by the amendment are pharmaceutical products or medical equipment companies, Hinman said, suggesting that the issuers and investors would rather spend the money on research and development than on the auditor attestation.

The chairman also shared an anecdote that came out of last week's inaugural meeting of the Small Business Capital Formation Advisory Committee. At the meeting was a representative of a company that had timed out of EGC status, still had very low revenue, but was required to have a 404(b) attestation. Not one person in the company's ecosystem, whether an investor, management, or otherwise, thought the attestation was a good use of the company's money, but the company had to spend \$600,000 per year on the requirement. Clayton said that the SEC should listen to these investors and companies.

The Division of Economic and Risk Analysis estimates that the median affected issuer has \$40 million in revenues and 125 employees, said DERA Chief Economist and Director S.P. Kothari. The costs of attestation do not scale perfectly and represent a meaningful percentage of cash flows of affected issuers, while at the same time having smaller benefits as compared to other issuers. DERA found preliminary evidence that lower-revenue issuers may be less susceptible to certain types of misstatements, specifically revenue recognition. DERA does expect, however, that exempting affected issuers could weaken the effectiveness of their ICFR and affect their restatement rates, but not to the point that the restatement rates would exceed those of issuers that would remain accelerated filers.

Jackson's dissent. Jackson had a different [take](#). He went back to the genesis of Sarbanes-Oxley—abuses at Enron and Worldcom enabled by the failure of checks on management. To fix this, Congress both imposed certification requirements on management and required outside auditors to weigh in, reasoning that

management would be more honest about controls from the beginning if they knew auditors would be taking a look. “Paying auditors is not free, but neither is fraud,” Jackson asserted.

Jackson said that the proposal's analysis of costs relied heavily on a study using data from 2004 that showed companies tended to bunch just below the then-existing threshold for the attestation requirement, suggesting that companies and investors were working to keep below that threshold. Jackson's office analyzed current data and found no evidence of this bunching today. He said this makes sense because the SEC has been concerned about the compliance costs of the attestation requirement and have taken steps to minimize the costs. In 2011 the Office of Chief Accountant reported that there was no specific evidence that the savings from rolling back 404(b) requirements would justify the loss of investor protections.

His office also looked at how investors react to internal control failures in companies that would and would not receive a rollback under the SEC's proposal. The analysis revealed that the proposal would affect the exact companies whose investors care the most, he said, concluding that his “colleagues propose to solve a decades-old policy debate with data from another era.” On a later query by Clayton, Hinman called back to Jackson's invocation of Enron and Worldcom, saying that these are not companies that would be eligible for relief. “You read my mind,” said Clayton, laughing. “These Fortune 500 companies are not the companies we are targeting for relief today.”

Other commissioners weigh in. Although she voted for the proposal, Commissioner Peirce had reservations of her own. She said she had concerns about the scope of the amendments, just as she had when she voted in favor of the amendments for SRC last year. She also wondered if the SEC wasn't undoing the work that it did by breaking the link between SRCs and non-accelerated filers, adding complexity in this area. Now the SEC will have to track which company fits into which bucket, and smaller companies will need “Waze navigation” to figure out which bucket it falls into. She welcomed feedback on whether the system is unduly complex.

To Jackson's point about the data, Peirce said that while she hadn't seen his office's analysis, it is important to remember that there are costs other than those that he mentioned. There are always tradeoffs, she said, but she often speaks to investors who say they want all the money going to R&D.

Commissioner Roisman also said he was happy to vote in favor of the amendments. The cost of compliance with the attestation requirement disproportionately affects smaller companies at the expense of R&D and other initiatives, he said. He questioned whether the benefits of 404(b) outweigh the burdens for smaller companies; even those that are exempt have to maintain ICFR and have management report on its effectiveness. Attestation is not the only reason investors' trust in companies and financial statements have increased. However, though, he questioned whether there is more recent data that was not taken into account and said he looked forward to seeing Jackson's analysis.

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