



July 29, 2019

RSM US LLP

Secretary
U.S. Securities and Exchange Commission
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Washington, D.C. 20549-1090

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Re: File Number S7-06-19

RSM US LLP appreciates the opportunity to offer our comments on SEC Release No. 34-85814, *Amendments to the Accelerated Filer and Large Accelerated Filer Definitions* (the proposed rule). RSM US LLP is a leading provider of audit, tax and consulting services focused on the middle market. We have nearly 11,000 professionals in more than 90 cities in the U.S. and Canada. Our comments are based on our experience in working with registrants of all sizes—from smaller reporting companies to large accelerated filers.

We support the proposed amendments to 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. To provide an “evergreen” threshold going forward, we suggest the Commission consider indexing such thresholds to inflation, using an approach similar to that used in the definition of “emerging growth company.”¹

The remainder of our comments address the proposal to amend the accelerated and large accelerated filer definitions in Rule 12b-2 to exclude any issuer that is eligible to be a smaller reporting company (SRC) under the SRC revenue test. One of the effects of this proposal would be that such an issuer would not be subject to the requirement that its independent auditor attest to, and report on, management’s assessment of the effectiveness of the issuer’s internal control over financial reporting (ICFR) as required by Section 404(b) of the Sarbanes-Oxley Act of 2002.

Our views expressed in this letter explain that we do not support excluding from the current accelerated filer and large accelerated filer definitions any issuer that is eligible to be an SRC under the SRC revenue test because:

- Studies have documented that smaller issuers have more material weaknesses, restatements and incidences of fraudulent financial reporting.
- There is strong evidence that the auditor’s role in auditing the effectiveness of ICFR improves the reliability of internal control disclosures and financial reporting overall.
- Requirements for evaluating internal controls are different for audits of ICFR and audits of financial statements.
- We believe the retained lack of alignment between the nonaccelerated filer and SRC definitions causes unnecessary confusion.

¹ See the January 3, 2012 Jumpstart Our Business Startups Act Title I, “Reopening American Capital Markets to Emerging Growth Companies,” Sec. 101, “Definitions.”

Smaller issuers have more material weaknesses, restatements and incidences of fraudulent financial reporting

The proposal to amend the accelerated and large accelerated filer definitions to exclude any issuer that is eligible to be an SRC) under the SRC revenue test states:

...the benefits of the ICFR auditor attestation requirement may be smaller for issuers with low revenues because they may be less susceptible to the risk of certain kinds of misstatements, such as those related to revenue recognition. Also, it is possible that low-revenue issuers may have less complex financial systems and controls and, therefore, be less likely than other issuers to fail to detect and disclose material weaknesses in the absence of an ICFR auditor attestation.

In our experience, there are many factors to consider when determining risks related to whether issuers are able to maintain, in all material respects, effective ICFR. In addition to the size of the issuer, we consider several factors, such as the intricacies of the issuer's business and industry, the strength of its governance, the competency of its management, the complexity of their information technology systems, its international reach, etc. Also, we believe the implementation of complex new accounting requirements, such as those related to revenue recognition, leases and credit losses, can present new challenges for all financial reporting systems – especially those of smaller companies that may be less sophisticated or may not have the necessary resources to dedicate to such efforts.

In an April 2011 study² on Section 404(b), the Staff of the Office of the Chief Accountant (OCA) states:

Numerous research papers and studies address the benefits of compliance with Section 404. Considering Sections 302 and 404 of the Sarbanes-Oxley Act broadly, the research results suggest that unless the external auditor is involved in testing and reporting on the effectiveness of internal controls, as is the case under Section 404(b), the reliability of information about controls may be negatively affected. Auditor testing of accelerated filers' controls has generally resulted in the disclosure of internal control deficiencies ("ICDs") that were not previously disclosed by management, and the external auditor attestation appears to have a positive impact on the informativeness of internal control disclosures and financial reporting quality.

Studies also document that Section 404(a)-only issuers, comprised of mostly smaller issuers, have more material weaknesses, restatements, and incidences of fraudulent financial reporting as compared to most issuers that comply with Section 404(b).

The importance of the audit of the effectiveness of ICFR

In its release³ of rules requiring companies to file the registered public accounting firm's attestation report on management's assessment of the company's internal control over financial reporting, the SEC stated:

The amendments related to Section 404 are designed to enhance the quality and accountability of the financial reporting process and may help increase investor confidence, which implies increased efficiency and competitiveness of the U.S. capital markets. Increased market efficiency and investor confidence also may encourage more efficient capital formation.

² See April 2011 *Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 For Issuers With Public Float Between \$75 and \$250 Million* by the Staff of the Office of the Chief Accountant of the U.S. Securities and Exchange Commission.

³ See Final Rule Release No. 34-47986, *Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports*.

In the April 2011 study on Section 404(b), the OCA Staff stated:

There is strong evidence that the auditor's role in auditing the effectiveness of ICFR improves the reliability of internal control disclosures and financial reporting overall and is useful to investors...the Dodd-Frank Act already exempted approximately 60% of reporting issuers from Section 404(b), and the Staff does not recommend further extending this exemption.

We believe the auditor's attestation of ICFR provides a robust audit process that provides for a strong foundation in high-quality financial reporting.

Requirements for evaluating internal controls are different for audits of ICFR and audits of financial statement

The Release states, "in many cases auditors are testing operating effectiveness of certain internal controls even if they are not performing an integrated audit." Public Company Accounting Oversight Board (PCAOB) standards⁴ require the auditor to obtain a sufficient understanding of each component of ICFR to (a) identify the types of potential misstatements, (b) assess the factors that affect the risks of material misstatement and (c) design further audit procedures. However, in the audit of ICFR, the auditor's objective is to express an opinion on the effectiveness of the company's ICFR⁵ and thus generally the auditor's procedures encompasses a much broader range of accounts and disclosures than those for a financial statement audit.

Complex definitions of filer statuses

We believe the retained lack of alignment between the nonaccelerated filer and SRC definitions causes unnecessary confusion.

A "smaller reporting company" generally is a registrant with (a) less than \$250 million in common equity public float as of the last business day of the company's most recently completed second fiscal quarter, or (b) annual revenues of less than \$100 million in the most recently completed fiscal year and either no public float or a public float of less than \$700 million. Therefore, a smaller reporting company can be a non-accelerated filer or an accelerated filer. The smaller reporting company qualification relates to scaled disclosure and not filing status. Because the current definitions of *smaller reporting company* and *non-accelerated filer* overlap for some issuers, there can be confusion. We believe the proposed definition of *accelerated filer* will provide further overlap and cause for confusion.

We encourage the SEC to consider (a) defining the following terms using parameters that do not cause unnecessary overlap of the definitions and (b) including such definitions in one rule that provides scalability for all financial reporting regulations (e.g., scaled disclosures, filing deadlines, compliance with Section 404(b)):

- Emerging growth companies
- Smaller reporting companies
- Nonaccelerated filers
- Accelerated filers

⁴ See PCAOB Auditing Standard (AS) 2110, *Identifying and Assessing Risks of Material Misstatement*.

⁵ See AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

Secretary
U.S. Securities and Exchange Commission
July 29, 2019
Page 4

- Large accelerated filers

Potential adoption of the proposed rule

Estimated cost savings

The extent of internal control testing procedures performed by the auditor in a financial statement audit is impacted by the risk and complexity in auditing the company and the testing strategies of the auditor. Substantive testing performed by the auditor may be reduced when the auditor can rely on effective internal controls. Therefore, if an issuer no longer is subject to the requirements of Section 404(b) and if the auditor decides to maintain an audit testing strategy that relies on controls, a significant portion of the effort related to opining on ICFR would still be necessary in order to obtain an understanding of ICFR, evaluate the design and implementation of relevant controls, and test controls to support the financial statement audit.

It is unclear how the estimated savings per issuer (“audit fees that would typically not be incurred in audits in which an ICFR attestation is not required”) identified in the Release has taken into account the testing strategies that the auditor may use in the absence of a Section 404(b) attestation. We believe it is extremely difficult to accurately calculate such estimated savings.

Effective date

If the proposed rule is finalized, we recommend an effective date that would accommodate the time need for the auditor to adjust the audit scope and related testing strategies, as appropriate, for issuers who no longer are subject to the requirements of Section 404(b).

We would be pleased to respond to any questions the Commission or its staff may have about our comments. Please direct any questions to Jamie Klenieski – Partner, Audit Quality and Risk Management, at [REDACTED].

Sincerely,

RSM US LLP

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