



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

July 29, 2019

Re: Amendments to Accelerated Filer and Large Accelerated Filer Definitions (File No. S7-06-19)

Dear Ms. Countryman:

The American Securities Association (ASA)¹, representing our nation’s Main Street and regional financial services companies, appreciates the opportunity to comment on the Securities and Exchange Commission’s (“SEC” or “Commission”) proposal to expand eligibility for an exemption from the auditor attestation requirements under Section 404(b) of the 2002 Sarbanes-Oxley Act (the “Proposal”). While the ASA strongly supports the Proposal and believes it is an important policy change that will help to revitalize the IPO market, we also share some of the concerns raised by Commissioner Peirce that it could further add complexity to the maze of issuer definitions under the securities laws.

The Proposal represents the latest initiative by the SEC to expand upon the success of the 2012 Jumpstart our Business Startups (JOBS) Act and modernize regulations to meet the needs of today’s capital markets. For too long, the SEC paid lip service to its statutory duty to facilitate capital formation. That is not the case today, and the ASA appreciates the work of Chairman Clayton and others to help re-focus the Commission on this prong of its mandate.

The ASA has long been concerned about the decline in public companies over the last two decades, and the impact this has had on innovation, growth, job creation, and the ability of Main Street households to invest in the growth stage of American businesses. In 2018, the ASA – along with the U.S. Chamber of Commerce and six other organizations – released a report entitled *Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public*. (Report)² This report included 22 specific recommendations for how the SEC and Congress can modernize the regulatory regime that applies to public companies, including

¹ The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA’s mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

² Report available at https://www.uschamber.com/sites/default/files/ipo_report_expanding_the_on-ramp.pdf



reforms to market structure, proxy advisory firms, disclosure obligations, rules governing equity research, and financial reporting.

The Report cited some of the concerns about the costs that certain provisions of Sarbanes-Oxley have imposed on small and mid-size companies. The report stated that “many market participants believe that the costs associated with Section 404(b) have not been scalable largely due to the manner in which the law has been implemented.” It also called on the SEC to consider adopting a revenue-only test to determine which issuers should be eligible for an exemption from Section 404(b).

We commend the SEC for listening to the concerns of market participants on this critical issue, and for recognizing the Sarbanes-Oxley albatross that continues weigh on smaller public companies and their shareholders.

Section 404(b) of the Sarbanes-Oxley Act

Sarbanes-Oxley was passed in 2002 in a frenzied response to a number of high-profile accounting scandals at public companies. While the law was intended to improve the quality of financial reporting and boost investor confidence, there is no disputing that it has also imposed unnecessary costs upon small issuers and made it less attractive to be a public company.

Section 404(a) of Sarbanes-Oxley requires issuers to establish internal controls over financial reporting (ICFR), and have management assess the effectiveness of those controls. Then, just to add more unnecessary costs and support a new revenue stream for the accounting industry, Section 404(b) requires an independent auditor to examine and attest to management’s assessment of ICFR (auditor attestation). The costs related to the 404(b) auditor attestation have not been scalable for small and mid-size companies and they are often cited by such companies as a significant burden that does not provide a corresponding benefit to investors.

Interestingly, the SEC knew that Section 404 would discourage IPOs when it issued rules implementing those provisions in 2003. In that rulemaking, the SEC stated “the final rules increase the cost of being a public company; therefore the final rules may discourage some companies from seeking capital from the public markets.”³ Even with that warning, the SEC significantly underestimated the costs that companies would pay to comply with auditor attestation: the SEC initially estimated that the cost of compliance for Section 404(a) would be \$91,000 per year; a study later done by Financial Executives International found that total Section 404 compliance costs were \$4.36 million/year.⁴ There is no excuse for such a difference in costs except to say that is what happens when you create a new mandatory business line for the oligopoly that is the accounting industry.

³ Management’s Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports (June 5th, 2003)

⁴ Financial Executives International, FEI Special Survey on SOX 404 Implementation (March 2005).



The impact of Sarbanes-Oxley has not been lost on Congress. The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act exempted non-accelerated filers from the auditor attestation requirement, and the JOBS Act exempted emerging growth companies (EGCs) from the requirement as well. Congress has already shown that tailored exemptions to the auditor attestation requirement are necessary and can be enacted without compromising investor protections.

The Proposal would extend the “revenue test” of the newly adopted definition for a smaller reporting company (SRC), so that issuers with less than \$100 million in revenue would be exempt from the 404(b) auditor attestation requirements. (The Proposal estimates that 282 current issuers would be eligible under this threshold.) Importantly, the Proposal allows companies to choose whether to use exemption. Companies who qualify have the *option* to elect to use the exemption. This allows companies to continue compliance with Section 404(b) if they believe it to be in their long-term best interest. The Proposal provides the flexibility necessary for companies to make that decision. This is a revelation in regulation.

Regardless of whether a company obtains an auditor attestation, *all* issuers would still be required to comply with the ICFR and disclosure requirements of Section 404(a). In addition to Section 404(a) compliance, the Proposal also maintains the obligation for independent auditors to consider ICFR when conducting financial statement audits of issuers. Put simply, robust investor protections would remain in place even if a subset of low-revenue issuers were exempted from Section 404(b).

Give our support for the Proposals approach, we do share some of the concerns that Commissioner Peirce raised in her statement of support for the Proposal regarding the conflicting definitions of a non-accelerated filer and a small reporting company. An issuer can now be an SRC (and thus benefit from certain scaled disclosure requirements) if they have below \$250 million in public float. So, a non-EGC issuer with between \$75 million and \$250 million in public float – and greater than \$100 million in revenue – would be classified as both an SRC and an accelerated filer. This runs contrary to the goal of aligning the SRC and non-accelerated filer definitions so small issuers can determine their exact compliance obligations and budget accordingly.

As Commissioner Peirce explained: “there still will be many SRCs that are also accelerated filers. The process of determining whether a company is an SRC and a non-accelerated filer, or an SRC and an accelerated filer, or outside of both categories is so complicated that even we at the SEC need diagrams to figure it out. *The fact that we ourselves struggling to understand our own regime does not bode well for smaller companies trying to follow our rules without the benefit of a staff of seasoned securities attorneys.*” (emphasis added)

While adopting the revenue-only test would undoubtedly make great progress for our public markets, we believe the SEC should consider going further and align the non-accelerated filer and SRC definitions to provide regulatory certainty for small companies.



Conclusion

We appreciate the SEC's work to help American businesses raise capital and to reduce some of the unnecessary regulatory burdens small public companies face. The Proposal is an important step to address a costly unintended consequence of Sarbanes-Oxley. The ASA looks forward to working with the Commission as it moves towards finalizing these rules.

Sincerely,

Christopher A. Iacovella
Chief Executive Officer
American Securities Association