August 22, 2019

Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File Number S7-06-19, Release No. 34-85814  
Amendments to the Accelerated Filer and Large Accelerated Filer Definitions

Dear Madam Secretary:

CFA Institute, in consultation with its Corporate Disclosure Policy Council (“CDPC”), appreciates the opportunity to comment on the Proposed Rule, Amendments to the Accelerated Filer and Large Accelerated Filer Definitions (“Proposed Rule”). We offer comments that we believe should be considered by the SEC as it considers adoption of this Proposed Rule.

CFA Institute1 is comprised of more than 160,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

OVERALL POSITION

The mission of the SEC is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.” We understand that the proposal is intended to support that goal and promote capital formation. We do not, however, believe that the Proposed Rule will achieve that result. On the contrary, we believe it will weaken investor protections. CFA Institute supports preserving the current accelerated filer definition. We outline our reasoning in the sections that follow. Most importantly, we note that the industry deriving the most benefiting from this Proposed Rule change – the banking industry – is subject to current concerns regarding its ability to adopt a new critical audit matter that requires strong internal controls.

It is important for investors to have high quality, reliable financial statements in order to have trust and confidence in the capital markets. Providing investors with reliable financial statements depends in part on the effectiveness of the controls and safeguards management has over

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1 With offices in Charlottesville, New York, Washington D.C., Hong Kong, London, Brussels, Mumbai, Beijing and Abu Dhabi, CFA Institute is a global, not-for-profit professional association of more than 166,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 162 markets, of whom more than 160,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 74 markets.
accounting and financial reporting and the audit over the controls. Data shows\(^2\) that the emphasis on internal controls – both management’s responsibility to assess and report on the effectiveness of internal control and the auditor’s responsibility to perform an audit of management’s assessment of the effectiveness of the controls – has had a positive impact on both financial reporting and audit quality by substantially reducing the risk of material misstatement of a company’s financial statements.

**REQUIREMENTS RELATED TO INTERNAL CONTROLS:**

**AUDITORS OBTAINING AN UNDERSTANDING VS. EXPRESSING AN OPINION, MANAGEMENT’S ASSESSMENT LESS LIKELY TO BE CHALLENGED**

The Proposed Rule would significantly alter the level of assurance that investors obtain about the effectiveness of internal controls over financial reporting (ICFR) of the companies impacted by the proposal. This is because, in a financial statement only audit, the auditor obtains an understanding of internal control that is sufficient to assess the factors that affect the risks of material misstatement and to design further audit procedures. However, in an audit of ICFR, the auditor’s objective is to express an opinion on the effectiveness of the company’s ICFR.

If the Proposed Rule is finalized, certain SRCs (smaller reporting companies) would qualify as non-accelerated filers and would no longer be subject to auditor attestation of ICFR under SOX Section 404(b). Proponents argue that the Proposed Rule would not relieve management of its obligation to assess ICFR nor would it relieve an independent auditor of its obligation to consider ICFR in the performance of its financial statement audit of an issuer. For instance, in a financial statement audit, the auditor is required to identify and assess the risks of material misstatement. The auditor is therefore required, in accordance with PCAOB AS 2110.18 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.”

In our view, the requirement to eliminate the expression of an opinion on the audit of internal controls, substantially lessens the auditors’ responsibilities in protecting investors. Further, the ICFR assessments by management are weakened by the fact that management knows such assessments will not be challenged by the auditors with the removal of the Section 404(b) requirement.

\(^2\) See footnotes 3, 17 and 18.
EFFECTIVE INTERNAL CONTROLS: ESSENTIAL FOR SMALLER COMPANIES
CFA Institute agrees with Commissioner Jackson’s Statement that smaller companies may have a greater need for audits of internal controls:

The proposal rolls back 404(b) only for smaller companies on the theory that these are the firms for which the costs of attestation are most burdensome. But it’s equally possible that these are the firms—high-growth companies where the risk, and consequences, of fraud are greatest—where the benefits of the auditor’s presence are highest. The proposal uses decade-old data to examine the costs of attestation and makes no serious effort to evaluate the benefits. So, my Office conducted an original analysis that shows, for two reasons, why this proposal has little basis in evidence from today’s marketplace.

First, the proposal’s analysis of the costs of Section 404(b) relies heavily on a study using data from 2004 to show that companies with a public float under $75 million—the level under which auditor attestation is not required—seemed to “bunch” under that threshold. In other words, in 2004, companies and their investors found ways to keep their public float beneath the threshold—suggesting that the costs of 404(b) were meaningful for those companies.

The proposal makes no effort to update these studies, simply claiming that old data is enough basis for new rules.

While the costs of Section 404(b) might have driven the decisions of small firms and their investors fifteen years ago, they don’t do so today. That makes sense, since Commissioners have worried aloud about these costs since SOX became law, and we have taken several steps to minimize them. That’s why, in 2011, the Office of our Chief Accountant examined the costs of the attestation requirement and reported to the Commission that there was no longer any “specific evidence that [any savings from rolling back 404(b)] would justify the loss of investor protections.” I cannot see why we should disregard our Staff’s careful recommendation without updating our evidence for today’s markets.

Second, because this proposal makes no serious attempt to evaluate the benefits of attestation, my Office produced an original analysis on that question, too. We examined how investors react to news of an internal control failure in two groups of companies: those that would receive a rollback of 404(b) under today’s proposals and those who would not. The evidence is striking. The data show we are proposing today to roll back 404(b) for exactly the group of companies where investors care about the benefits of auditor attestation most.

Investors are concerned that companies of this size are particularly prone to accounting issues. Indeed, the benefits of focusing on ICFR, including auditor attestation, are more pronounced for smaller companies. Research has shown that the risk of a material restatement is higher at smaller companies. Since 2003, non-accelerated US filers (companies with public float less than $75 million) have accounted for 62% of the total US financial statement restatements. The annual independent audit of ICFR is, therefore, essential as it highlights issues before they lead to material weaknesses and restatements. Because research demonstrates the heightened need for attestation of internal controls, investors are likely to price the loss of the internal controls audit in their equity risk premium. In other words, eliminating the attestation requirement may reduce the cash outflow associated with the audit of internal controls, but it is likely to be more than offset by a higher discount rate because of a rise in the equity risk premium required by investors when companies seek capital in the public market. As we discuss more extensively in the section on the Need for Better Cost Benefit Analysis, the SEC’s anticipated cost savings is minor as a percentage of the public float, revenue or total assets of the companies to be exempted.

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4 Equity risk premium is the return over the risk-free rate that compensates investors for taking the higher risk of equity investing. The amount of the premium correlates to the risk of the equity investment. With less assurance over internal controls, investors will require a higher return for investing in these equity securities.
from the audit requirement. And such analysis does not offset such costs with the potential benefits (i.e. losses prevented) derived by investors from the execution of such audits.

**CONTEXT TO ASCERTAIN IMPACT TO AFFECTED COMPANIES**
The Proposed Rule seeks to allow companies with public float of $75 million or more but less than $700 million, and with revenues of less than $100 million to be exempted from the Section 404(b) requirement as shown in the table to the right.

We note that the SEC estimates that 539 more issuers would be classified as non-accelerated filers and 358 would be newly exempted from the Section 404(b) requirement after excluding 181 EGCs.

**SEC Should Provide Data Set for Analysis**
Using Calcbench we extracted all Form 10-K filings made in calendar year 2018 (that would include some companies with a 2017 calendar year-end and some with a 2018 fiscal year-end). We sorted those registrants by self-identified public float of $75 million and greater but less than $700 million and with annual revenues less than $100 million. We extracted emerging growth companies (EGCs) from that population. We also extracted from the data all 17 entities with an SIC code of 6200 as they were likely broker dealers exempt from the Section 404(b) requirement or have ICFR audits only because they are part of a larger consolidated group.

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6 Appendix A provides an excerpt of the affected companies from pages 59-64 of the Proposed Rule.

7 We noted in the performance of this sort that some companies were not as diligent as would be expected in the computation and discussion of the public float as this is not a required XBRL tagged data point. That said, the overall conclusions with respect to the use of the data to demonstrate the importance of assets was not obviated by the anomalies noted with respect to public float. Please also see comment about SEC providing data set for public review.

8 Page 14, Footnote 47 of the Proposed Rule states: An EGC is defined as an issuer that had total annual gross revenues of less than $1.07 million during its most recently completed fiscal year. See Rule 405; Rule 12b-2; 15 U.S.C. 77b(a)(19); 15 U.S.C. 78c(a)(80); and Inflation Adjustments and Other Technical Amendments under Titles I and II of the JOBS Act, Release No. 33-10332 (Mar. 31, 2017) [82 FR 17545 (Apr. 12, 2017)].

9 Our data extract showed 17 entities with SIC code 6200 (Security & Commodity Brokers, Dealers, Exchanges and Services). These entities had $3.7 billion in public float, $234.5 million in revenue and $3.6 billion in assets.
This left us with 382 domestic filers as shown in the chart which follows in the section on the analysis which follows.

We were not able to perfectly replicate the SEC’s 539 estimated companies to be additionally classified as non-accelerated filers nor the 358 they say will be newly exempted from the Section 404(b) requirement after excluding 181 EGCs\textsuperscript{10}. We also recognize our total of 399 did not include the 36 foreign private issuers. If our data included foreign private issues our population would have included 435 companies in contrast to the SEC’s 358, possibly because our extract identified substantially fewer EGCs to be removed from the population. Further, our data was based upon filings in 2018 rather than in 2017, as used by the SEC, and was done using self-reported public floats.

We note that the work of Barth, Landsman, Schroeder and Taylor\textsuperscript{11} was performed using Standard & Poor’s Capital IQ data and found 385 affected companies\textsuperscript{12}.

\textit{We would suggest as a part of future proposed rules, the SEC release a data file that allows those seeking to comment to either utilize, or better understand how to replicate, the SEC’s analysis. Providing the data set should become a standard SEC protocol in an era where the SEC has substantial data using XBRL that investors have paid to be gathered. Providing the data would reduce the time and cost to comment by – and the quality of the responses of – preparers, auditors, investors and other stakeholders.}

\textbf{Our Analysis}

We obtained and attempted to replicate the data set such that we could better contextualize the application of this Proposed Rule. Overall, we found the economic analysis in the Proposed Rule was an application of the “rule” rather than an analysis that provided “context” useful in enabling investors to understand the consequences of the Proposed Rule change.

We did not find the economic analysis of the affected companies provided a sufficiently clear analysis and vivid depiction for potential respondents of the affected companies and the potential impact of removing the ICFR attestation. Analysis of the impact by number of companies in an industry – or the number of companies by revenue or public float, much of which is done in text

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\textsuperscript{10} Appendix A provides an excerpt of the affected companies from pages 59-64 of the Proposed Rule.

\textsuperscript{11} Letter from Mary Barth, Graduate School of Business, Stanford University, et al. to Securities and Exchange Commission (July 11, 2019), \url{https://www.sec.gov/comments/s7-06-19/s70619-5802113-187069.pdf}.

\textsuperscript{12} We could not readily ascertain whether the Barth et al population included the 36 foreign filers the SEC includes in their analysis.
rather than charts – is not a helpful analysis or visualization of the data that enables respondents to quickly and readily assess the impact of the Proposed Rule change.

As investors, we want to understand how the removal of the ICFR attestation requirement increases audit risk and the potential exposure to loss. For that reason, we sought to gain not only an appreciation for the percentage of companies – or a distribution of their public float or revenues – that would be affected by the Proposed Rule as included in the SEC’s economic analysis. We sought to understand the impact by industry relative to the number of companies in the industry, their public float, revenues and total assets. Providing data by industries contextualized with these parameters assisted us in better understanding the drivers of audit risk and ICFR fees by industries as well as the potential for capital formation in the respective industries. For example, materiality, audit risk and ICFR fees are dependent upon assets rather than revenue or public float for asset intensive industries.

Our analysis indicates that financial institutions – more specifically depository institutions – are the most significant beneficiaries of the Proposed Rule change followed by the chemical and allied products industry – most specifically the pharmaceutical preparations sub-industry. We consider these further in the pages that follow.

The SEC’s economic analysis does nothing to link the number of companies affected by the Proposed Rule to audit risks in those industry or companies. We excerpted the economic analysis of the affected companies from pages 59-64 of the Proposed Rule at Appendix A. As we highlight in our footnotes to Appendix A, the relative impact on the financial institutions industry is not vividly illustrated and there is no connection to audit risks. Any rule that impacts an asset intensive industry such as banking must consider the impact to assets not simply revenue or public float. We don’t believe an economic analysis of a Proposed Rule that doesn’t link to audit risks when the rule is related to increasing audit risk for investors is sufficient. We believe even more detailed analysis than we provide here that looks at the nature of the revenues, assets and liabilities for the effected industries could be done – as the data is tagged in XBRL – to ascertain the audit risks impacted by the removal of the rule. Though time did not allow, we believe this would be a useful analysis.

Further, the SEC economic analysis doesn’t highlight how reducing audit fees in these most affected industries will spur capital formation in those industries other than by saving the audit fees, whether capital formation is desired in those industries, and whether capital formation beyond the savings of the ICFR fees in these industries will be triggered in these or other industries by the elimination of the audit requirement for these size companies (i.e. are there companies of this size seeking to enter the public market).

Though our data cannot be precisely reconciled to the numbers presented in the SEC’s Proposed Rule, we believe the findings from our analysis accurately reflect the industries most significantly benefiting from the Proposed Rule change as these are the industries providing comment letters in support of the Proposed Rule on the SEC website.
The table that follows provides an analysis of those 382 domestics registrants by SIC code including the total public float, annual revenues and total assets by respective industry code. For comparative/reference purposes, we also extracted, and included in the table, those companies that would remain exempt (those with public float less than $75 million).

<table>
<thead>
<tr>
<th>SIC Code</th>
<th># of Companies</th>
<th>Public Float</th>
<th>Annual Revenues</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1311</td>
<td>8</td>
<td>$1,739,284,017</td>
<td>2%</td>
<td>$516,089,288</td>
</tr>
<tr>
<td>2833</td>
<td>2</td>
<td>$265,800,000</td>
<td>0%</td>
<td>$35,152,000</td>
</tr>
<tr>
<td>2834</td>
<td>82</td>
<td>$22,240,886,353</td>
<td>26%</td>
<td>$2,037,177,187</td>
</tr>
<tr>
<td>2835</td>
<td>5</td>
<td>$1,135,639,008</td>
<td>1%</td>
<td>$130,028,351</td>
</tr>
<tr>
<td>2836</td>
<td>16</td>
<td>$4,413,941,001</td>
<td>5%</td>
<td>$419,122,551</td>
</tr>
<tr>
<td>Subtotal</td>
<td>105</td>
<td>$28,056,266,362</td>
<td>33%</td>
<td>$2,621,480,089</td>
</tr>
<tr>
<td>3600</td>
<td>21</td>
<td>$4,183,579,791</td>
<td>5%</td>
<td>$1,186,929,690</td>
</tr>
<tr>
<td>3800</td>
<td>23</td>
<td>$5,411,680,875</td>
<td>6%</td>
<td>$1,162,958,515</td>
</tr>
<tr>
<td>4900</td>
<td>8</td>
<td>$2,454,446,695</td>
<td>3%</td>
<td>$418,842,792</td>
</tr>
<tr>
<td>Subtotal</td>
<td>167</td>
<td>$32,977,807,287</td>
<td>39%</td>
<td>$9,330,240,808</td>
</tr>
<tr>
<td>6000</td>
<td>119</td>
<td>$20,275,482,534</td>
<td>24%</td>
<td>$6,775,214,568</td>
</tr>
<tr>
<td>6100</td>
<td>2</td>
<td>$454,904,922</td>
<td>1%</td>
<td>$122,322,576</td>
</tr>
<tr>
<td>6300</td>
<td>3</td>
<td>$312,864,956</td>
<td>0%</td>
<td>$166,708,731</td>
</tr>
<tr>
<td>6500</td>
<td>13</td>
<td>$3,076,969,113</td>
<td>4%</td>
<td>$543,644,664</td>
</tr>
<tr>
<td>6700</td>
<td>30</td>
<td>$8,857,585,762</td>
<td>11%</td>
<td>$1,722,350,269</td>
</tr>
<tr>
<td>Subtotal</td>
<td>167</td>
<td>$32,977,807,287</td>
<td>39%</td>
<td>$9,330,240,808</td>
</tr>
<tr>
<td>7300</td>
<td>13</td>
<td>$2,564,241,348</td>
<td>3%</td>
<td>$826,095,777</td>
</tr>
<tr>
<td>Others</td>
<td>37</td>
<td>$77,387,977,357</td>
<td>92%</td>
<td>$16,062,546,759</td>
</tr>
<tr>
<td>Others</td>
<td>37</td>
<td>$6,697,759,028</td>
<td>8%</td>
<td>$1,695,903,454</td>
</tr>
<tr>
<td>$75M to $700M Public Float &amp; $100M Revenue</td>
<td>382</td>
<td>100%</td>
<td>$84,084,890,403</td>
<td>100%</td>
</tr>
<tr>
<td>$75M to $700M Public Float &amp; $100M Revenue</td>
<td>382</td>
<td>100%</td>
<td>$84,084,890,403</td>
<td>100%</td>
</tr>
<tr>
<td>Less Than $75M Public Float</td>
<td>1,688</td>
<td>100%</td>
<td>$105,123,628,056</td>
<td>100%</td>
</tr>
</tbody>
</table>

The Proposed Rule would exclude approximately 382 companies with $84.1 billion of public float and $17.7 billion of revenue from an ICFR audit. Companies with total assets of $273.5 billion would also be exempted from the audit of internal controls under Section 404(b).
**Financial Institutions: The Most Affected Industry**

Based upon our analysis of the SIC codes above, the industry that will benefit most from the ICFR audit exemption would be the financial services industry. As shown in the table above, 167 small financial institutions with $33.0 billion in public float, $9.3 billion in revenue and $236.2 billion of total assets would be excluded from the Section 404(b) auditor ICFR attestation. These entities represent 44% of the number of companies, 39% of the public float, 53% of the revenues but 86% of the assets of the population to be excluded from the Section 404(b) ICFR attestation.

Small depository institutions would account for $178.7 billion (65%) of assets, $20.3 billion (24%) of public float, $6.8 billion (38%) of revenue and 119 (31%) of the entities. We note that the SEC Proposed Rule does not communicate to stakeholders that $178.7 billion of assets in depository institutions – 65% of all assets in the affected companies – will be exempt from the Section 404(b) attestation. We believe this is an important and relevant omission\(^{13}\) that investors must consider – particularly in light of recent events surrounding the debate over implementation of the credit loss impairment model. Appendix A provides an excerpt of the affected companies from Page 59-64 of the Proposed Rule. We note in the footnotes to Appendix A the degree to which the impact on the banking sector was noted, but the impact is not vividly illustrated by an analysis of the impact on assets of the organizations relative to the other industries. Visual inspection of our table on the preceding page relative to the information in Appendix A, highlights the difference the visual display and context provides in conveying meaning to the impact of the Proposed Rule change.

We think the SEC must reconsider whether excluding such depository institutions should be exempt from the Section 404(b) ICFR audit attestation given:

a) the recent financial crisis (and the potential for an upcoming recession) where there was not sufficient focus on impairment of assets;

b) the challenges these banks and depository institutions have recently professed – to the SEC, FASB, banking regulators and Congress – regarding the challenge in adopting the new financial instruments credit impairment standard, the cumulative expected credit losses (CECL) standard;

c) the FASB’s newly released proposal that will likely give many of these very same depository institutions, particularly if they are moved to non-accelerated filers, an additional 2-3 years to complete the adoption of CECL;

d) the importance internal controls will play in the adoption and audit of the new CECL impairment model\(^{14}\);

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\(^{13}\) Appendix A provides an excerpt of the affected companies from Page 59-64 of the Proposed Rule. We note in the footnotes to Appendix A the degree to which the impact on the banking sector was noted but the impact not vividly illustrated by an analysis of the impact on assets of the organizations.

\(^{14}\) Audits of loan impairments involve significant data capture and assumptions that place heavy reliance on the internal controls around the creation of such estimates. This is not an audit area that can be addressed entirely substantively and will likely be a critical audit matter in the newly revised auditor’s report.
the PCAOB’s 2018 preliminary inspection findings that show loan impairments remain a key inspection finding;

f) the impairment model, both old and new, will almost certainly be a critical audit matter for these institutions under the new auditor’s report; and

g) the new capital these banks and depository institutions have said CECL will require them to support the credit reserves. (The Proposed Rule doesn’t explain how the capital demands of CECL will benefit from a reduction in ICFR fees and if this is the definition of capital formation the SEC is seeking to promote through the Proposed Rule change.)

The potential risks of removing the attestation seem substantial relative to any capital formation spurred by reducing audit fees by $210,000 for some (those under $1 billion in assets) of these institutions.

We note the Proposed Rule states on Page 60 with respect to the affected issuers:

*The total number of affected issuers includes an estimated 36 foreign private issuers and 181 EGCs. It also includes an estimated 76 banks with $1 billion or more in total assets that are not EGCs. Because the estimated 181 EGCs are not required to comply with the ICFR auditor attestation requirement under SOX Section 404(b), we estimate that the remaining 358 affected issuers would be newly exempt from this requirement. Of these 358 issuers, we expect that the 76 banks identified above would be subject to the FDIC auditor attestation.*

With this information from the Proposed Rule in mind, we further disaggregated the information for depository institutions as noted below:

<table>
<thead>
<tr>
<th>SIC Code</th>
<th># of Companies</th>
<th>Public Float</th>
<th>Annual Revenues</th>
<th>Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depository Institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6020 Commercial Banks</td>
<td>93</td>
<td>16,127,745,812</td>
<td>5,391,237,568</td>
<td>142,707,447,652</td>
</tr>
<tr>
<td>6030 Savings Institutions</td>
<td>26</td>
<td>4,147,736,722</td>
<td>1,363,977,000</td>
<td>35,995,526,000</td>
</tr>
<tr>
<td></td>
<td>119</td>
<td>20,275,482,534</td>
<td>6,755,214,568</td>
<td>178,702,973,652</td>
</tr>
<tr>
<td></td>
<td>31%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6020 Over $1 Billion</td>
<td>76</td>
<td>14,487,801,462</td>
<td>4,803,706,070</td>
<td>129,474,916,154</td>
</tr>
<tr>
<td>6020 Under $1 Billion</td>
<td>17</td>
<td>1,639,944,350</td>
<td>587,531,498</td>
<td>13,232,531,498</td>
</tr>
<tr>
<td></td>
<td>93</td>
<td>16,127,745,812</td>
<td>5,391,237,568</td>
<td>142,707,447,652</td>
</tr>
<tr>
<td></td>
<td>24%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Savings Institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6030 Over $1 Billion</td>
<td>23</td>
<td>3,883,436,722</td>
<td>1,257,353,000</td>
<td>33,251,876,000</td>
</tr>
<tr>
<td>6030 Under $1 Billion</td>
<td>3</td>
<td>264,300,000</td>
<td>106,624,000</td>
<td>2,745,650,000</td>
</tr>
<tr>
<td></td>
<td>26</td>
<td>4,147,736,722</td>
<td>1,363,977,000</td>
<td>35,995,526,000</td>
</tr>
<tr>
<td></td>
<td>7%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

We find there to be a greater number of commercial banks and depository institutions with over $1 billion in assets than did the SEC. We noted 99 entities compared with the SEC’s 76 entities. The Proposed Rule notes that the SEC expects banks with over $1 billion of assets will be subject to the FDIC auditor attestation. The Proposed rule states this expectation regarding the

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15 We note that Note 155 in the Proposed Rules states: 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, fed-chartered) or 6036 (savings institutions, not fed-chartered).
continued need for FDIC auditor attestation\textsuperscript{16}, as if a positive to investors, without providing additional information to investors regarding:

\begin{itemize}
\item[a)] how investors will be advised of the existence of this attestation in registration statements;
\item[b)] how such attestation will be accessible, or made available, to investors;
\item[c)] how such attestation compares with that of Section 404(b). The attestation will likely be prepared under attestation standards for non-public entities;
\item[d)] whether such attestation will cover only the bank subsidiary or the holding company and other subsidiaries in the consolidated group of the registrant;
\item[e)] the extent to which such FDIC attestation provides the same legal protections as are afforded investors under Section 404(b) and through inclusion in the registration statements;
\item[f)] the fact that the aforementioned banks (25\% of affected companies) will still incur the cost of the ICFR audit irrespective of the Proposed Rule change; and
\item[g)] why – if investors are paying for the FDIC attestation, and it is presumed to be equivalent to the Section 404(b) attestation requirement – the Proposed Rule does not exempt these institutions from this requirement (i.e. why isn’t this Section 404(b) attestation retained for these companies).
\end{itemize}

It seems likely given the exclusion and the difference in purpose (regulatory) that investors will pay for this regulatory attestation without the benefit being accorded to them as investors. We think the SEC must provide investors with answers to the questions as they further consider this rule.

\textit{Chemical \& Allied Products, Specifically Pharmaceutical Preparations, Benefits Substantially}

The second largest beneficiary of the Proposed Rule would be the chemical and allied products industry (SIC 2800) with 105 (27\%) of entities, $28.1 billion (33\%) in public float, $2.6 billion (15\%) in revenue and $19.1 billion (7\%) in total assets excluded from internal control evaluation. The pharmaceutical preparations industry (SIC 2834) in particular has 82 (21\%) of entities, $22.2 billion (26\%) in public float, $2.0 billion (12\%) in revenue and $15.0 billion (5\%) in total assets excluded from internal control evaluation.

We reviewed the balance sheets of several of such entities, and while we noted substantial assets in cash and short-term investments, certain entities had substantial intangible assets that would now no longer be subject to an ICFR audit evaluation. Consider, for example, Melinta

\textsuperscript{16} CFA Institute attempted to locate the FDIC attestation on the FDIC website and several bank websites but was unsuccessful. It is not clear if, or where, such attestations and the information they cover will be made available to investors. We investigated the FDIC attestation and found guidance on the FDIC website and some non-authoritative private interpretative guidance. Based upon review of that guidance, it would appear that the Section 404(b) attestation of many affected registrants has also been used to meet the FDIC requirement of the subsidiary FDIC insured banks. As such, the removal of the Section 404(b) attestation requirement under public company standards (Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with an Audit of Financial Statements (AS 5)) will be replaced by an attestation using a non-public attestation requirement (American Institute of Certified Public Accountants’, Reporting on an Entity’s Internal Control Over Financial Reporting (AT 501)). For the entities affected this raises a series of questions as we outline in the body of the text following this footnote regarding the sufficiency, equivalence and cost savings of the Proposed Rule.
Therapeutics, Inc. After completing an acquisition in 2018, Melinta’s total assets rose from $160 million to $442 million. The increase was attributable most significantly to an increase in intangibles and goodwill of approximately $250 million. Liabilities also increased with the establishment of a deferred purchase price accrual of $78 million – also very subjective and judgmental, like the intangible assets – and an increase in debt of $100 million. The complexity of such business combinations and the resulting intangibles create significant internal control and audit risks that must be evaluated. While the company is currently subject to a Section 404(b) internal controls audit that covers these high-risk assets and liabilities. Should the Proposed Rule be adopted, the requirement to test the internal controls associated with such high-risk balances would be eliminated. The PCAOB’s 2018 preliminary inspection findings show business combinations such as these result in inspection findings, likely because management’s assessment and documentation is not sufficient which impacts the quality of the auditors’ work. Removing the ICFR audit requirement for entities within a sector that is developing or acquiring intangibles is a consideration the SEC must make in moving forward with this proposal.

Deeper Analysis & Context Necessary
As we note above, we believe the Proposed Rule consultation document focuses more on the application of the “rule” rather than giving “economic context” to the population of affected companies such that respondents can understand the impact of the rule. Respondents to this consultation are left to sift through 150 pages of text and footnotes to glean that, for example, banks are the most significantly impacted industry. This should have been immediately obvious to all readers of the Proposed Rule. And if an asset intensive industry is significantly impact, there should be consideration of whether the rule is appropriate for such an industry. We believe the SEC should provide better analysis and visualization of their textual discussion to provide context for respondents such that they can judge the impact on audit risk and risk of loss relative to the ICFR audit fees saved and the potential for capital formation in the respective industries most impacted. We believe our analysis only further demonstrates the Proposed Rule is not beneficial to investors or the broader economy (given the heavy concentration of beneficiaries in the banking industry) relative to capital formation.

Challenges Adopting New Accounting Standards
The Proposed Rule rightly highlights that new GAAP requirements, such as revenue recognition, leases, and credit losses are an important consideration in evaluating the Proposed Rule. These new accounting standards are complex and strong internal controls are critical to successful implementation, and ongoing application, of these new standards.

While public companies adopted the revenue recognition standard in 2018 and the leases standard in 2019, the credit losses (CECL) standard will not be adopted until 2020 for public companies. And, under a recent proposal issued recently by the FASB, possibly not until 2022 or 2023 for smaller reporting companies – those likely impacted by this Proposed Rule. If the FASB delays the adoption date of the credit losses model until 2022 or 2023 for small issuers, it is likely the SEC’s Proposed Rule eliminating the ICFR audit will come into effect before the need for these banks to adopt CECL. Accordingly, our consideration of the implications of the Proposed Rule on the banking industry are even more relevant. It is antithetical to exempt these institutions from the ICFR audit requirement at a time when the institutions themselves have expressed concern over their ability to adopt a standard where internal controls over financial reporting will be very
important to their investors. It is counterintuitive to reduce attestation over internal controls at a
time when they may become most important.

Need for Better Cost-Benefit Analysis

Studies Consider the Costs of ICFR Attestations Over Time – Reductions in the cost of ICFR audits have occurred over time as auditors have gained experience and refined their approaches and closely aligned the control audit with the financial statement audit. We know that, historically, companies required to comply with SOX Section 404(b) have fewer financial statement restatements, which helps foster orderly markets. From 2007 to 2017, restatements have generally declined. Effective ICFR and the auditor attestation results in fewer restatements thereby increasing investor confidence.

SEC and Government Accountability Office (GAO) studies regarding Section 404(b) audits have generally shown reductions in the cost of Section 404(b) audits over time as well as other benefits: Per the 2011 SEC Staff study:\footnote{SEC Study: Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 for Issuers with Public Float Between $75 and $250 Million (April 2011).}

- Section 404(b) costs have declined since implementation, particularly with the 2007 reforms;
- Investors generally view the auditor’s attestation on ICFR as beneficial; and
- Financial reporting is more reliable when the auditor is involved with ICFR assessments.

Per the 2013 GAO study:\footnote{GAO Study: Internal Controls – SEC Should Consider Requiring Companies to Disclose Whether They Obtained an Auditor Attestation (July 2013).}

- Companies exempt from Section 404(b) have had more restatements, and the percentage of exempt companies restating generally has exceeded that of non-exempt companies;
- Costs associated with Section 404(b) have declined since 2004; and
- Companies and others reported benefits of compliance, including improved reliability of financial reports.

Costs of ICFR Attestations, But Not Benefits Assessed – Further, we believe the work of Commissioner Jackson cited above shows the analysis of the costs and benefits is incomplete. So too does the work of notable academics Barth, Landsman, Schroeder and Taylor\footnote{Letter from Mary Barth, Graduate School of Business, Stanford University, et al. to Securities and Exchange Commission (July 11, 2019), \url{https://www.sec.gov/comments/s7-06-19/s70619-5802113-187069.pdf}.} presented in their letter to the SEC on this Proposed Rule where they note:

- The analysis quantifies the cost of ICFR audits, but does not attempt to quantify the benefits of the audits;
- The analysis focuses on the rate of restatements among affected companies and does not consider the magnitude of the restatements; and
- The analysis does not consider the historical rate of fraud or SEC Accounting and Enforcement Actions within the set of affected companies.
Are Cost Savings Significant? – Professors Barth, Landsman, Schroeder and Taylor also note that the Commission’s estimate of cost savings at the companies forgoing internal control audits “amounts to less than 0.1% of the average affected company’s equity market value,” and should be “weighed against the potentially large social costs created by weaker internal controls and elevated levels of accounting restatements.”

The Commission notes on Page 25 of the Proposed Rule:

As discussed in more detail in the Economic Analysis section below there are a number of component costs of the ICFR auditor attestation requirement. In general, the largest individual cost component relates to audit fees that would typically not be incurred in audits in which an ICFR attestation is not required. **We estimate that such audit fees would average approximately $110,000 per year for accelerated filers with revenues of less than $100 million.** The ICFR auditor attestation requirement is also associated with additional costs, and we estimate that these non-audit costs would average approximately $100,000 per year for accelerated filers. We believe that the proposed amendments would eliminate these two types of costs for issuers that are eligible to be an SRC under the SRC revenue test.

The Commission notes on Page 80 of the Proposed Rule:

**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. This represents a significant cost savings for issuers with less than $100 million in revenue and may thus have beneficial economic effects on competition and capital formation.

Assuming the SEC’s estimate of cost savings per company is correct at $210K per registrant, the total savings is somewhere between $75-$88 million. This amounts to approximately .1% of the public float, .45% of total revenues and .03% of total assets of the affected companies. If banks with over $1 billion in assets are excluded from the analysis – because they still require a FDIC attestation – the savings decreases by approximately $16-$22 million or a total cost savings to affected companies of $64-66 million – approximately .08% of the public float, .36% of total revenues and .02% of total assets. Barth et al, as well a Commission Jackson, rightly note that investors can easily be subject to losses more significant than this annual cost by investing in companies with weak internal controls.

As we highlight in the preceding paragraphs, the Proposed Rule focuses on the anticipated cost savings for issuers and the assumption that these cost savings will result in more companies entering the public market and greater capital formation. However, the proposal does not demonstrate how this will happen – it only presumes so. We, therefore, urge the Commission to demonstrate the removal of this rule will have this effect.

**Overall** – Overall, the cost savings do not appear to justify the increased risks of the Proposed Rule. The cost-benefit analysis must be based on an updated data on the costs to issuers as well as consider the benefits of Section 404(b) on the financial reporting ecosystem – including the costs and benefits to investors, not simply issuers. The analysis we provide above with respect to the

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20 The $75-88 million figure was arrived at by multiplying the SEC affected companies estimate of 358 by $210K for a total of $75 million and then the Barth (385) and CFA Institute (382) plus 36 foreign filers times $210K or approximately $88 million.

21 The $16-22 million figure was arrived at by multiplying the SEC estimated 76 banks still expected to have a FDIC attestation by $210K for a total of $16 million and then the 99 CFA Institute estimated banks times $210K for a total of $22 million.
withdrawal of the Section 404(b) attestation on banks is but one example of the incomplete nature of the analysis. Further, the notion that this elimination of ICFR reporting will increase capital formation, a perceived benefit, needs to be more thoroughly justified – particularly in light of the industry context highlighted herein.

**Additional Regulatory Complexity & Need for Labelling**

The Proposed Rule will result in additional regulatory complexity as the definitions of smaller reporting companies and non-accelerated filers still overlap for some issuers. Further, the complexity of various filer definitions (EGCs, SRCs, accelerated vs. non-accelerated filers, the unique treatment of broker-dealers) makes it challenging for investors to easily identify which companies are exempt from SOX Section 404(b) requirements – without clear study of the rules and searching for the ICFR attestation opinion in filing documents.

While the information is disclosed in management’s annual report on ICFR and is visible by review and comparison of the auditor’s report, we believe it would useful to disclose the fact that the registrant is not subject to the requirement more prominently and explicitly on the face of the registration or filing documents. Should a company opt to voluntarily comply with Section 404(b), this too should be specifically articulated. In this way, investors seeking to price such risk have a clearly visible marker regarding the additional risk of the registrant relative to other investment options.

Overall, increased rules that segment filers even further makes labelling such filers even more important.

**Additional Thoughts on Capital Formation**

As we noted above, the SEC economic analysis does not demonstrate how reducing audit fees in these most affected industries will spur capital formation in such industries – other than by saving the ICFR audit fees. Neither does it detail whether capital formation is desired in those industries. The economic analysis also does not consider how a small reduction in ICFR fees will counterbalance the capital necessary to support the capital needed upon adoption of the CECL model in the most impacted industry – depository institutions.

Further, the proposal’s analysis doesn’t demonstrate how capital formation – beyond the savings of the ICFR fees in these industries – will be triggered in these or other industries by the elimination of the audit requirement for these size companies (i.e. are there companies of this size seeking to enter the public market).

Still further, we don’t believe the SEC has demonstrated that the regulatory burden of ICFR attestation is substantially responsible for reducing the number and size of new registrants or why this regulatory burden narrative seems to be more in favor than an economic analysis on capital formation that considers the persistent impact of ultra-low interest rates, high availability of private equity money (at seemingly unrealistic valuations), and the impact growing passive investment has had on enhancing large-cap and reduced small-cap liquidity.
Summarizing Our Views

We do not support the Proposed Rule for the following reasons:

- There is compelling evidence that such small reporting entities require even greater focus on internal controls over financial reporting;
- The cost/benefit analysis focuses more on the cost savings to issuers than it does to the benefits of the ICFR attestation to investors;
- The ICFR costs to be saved are not significant relative to the measures of public float, revenue or assets of the affected companies;
- The potential cost to investors of internal control errors and restatements could easily be multiples of the aforementioned ICFR costs;
- The SEC’s economic analysis does not sufficiently communicate to potential respondents to the Proposed Rule the industries (banking and pharmaceuticals) that are likely to benefit most from the rule change. Most significantly, the SEC’s economic analysis does not:
  - clearly articulate that the industry mostly likely to benefit from the Proposed Rule is the asset intensive banking industry that suffered most substantially during the financial crisis;
  - explain that such industry is on the cusp of a change in a critical accounting policy (adoption of the CECL impairment model) which is heavily dependent on effective internal controls;
  - address the fact that the industry itself has expressed concern – including lobbying the SEC, banking regulators, Congress and the FASB to repeal the standard – because of its complexity and capital requirements;
  - highlight that the Proposed Rule exempting such banks from ICFR attestations would likely come into effect before these same depository institutions – given the FASB’s new proposed delayed implementation date – would be required to adopt the CECL standard;
  - highlight that assets no longer subject to ICFR attestation are amongst those audit regulators have found to have the most significant audit deficiencies;
  - explain why investors will pay for a FDIC control attestation (that investors may not have access to) of the largest of the entities affected but not receive a Section 404(b) attestation; or
  - whether capital formation in the banking industry is an objective and benefit of the Proposed Rule.
- The Proposed Rule also adds to the complexity of the issuer status for investors and labelling of whether the issuer is subject to Section 404(b) should be more visible for investors.
- The Propose Rule does not demonstrate – relative to the industries most impacted – how it will result in the stated benefit of capital formation.

While investors are always criticized for wanting more transparency – always labeled as expensive – we believe this Proposed Rule doesn’t work once one looks more deeply at the data and the context of the Proposed Rule and for that reason we do not support.

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If you or your staff have questions or seek further elaboration of our views, please contact Sandra J. Peters at [email redacted] or Mohini Singh at [email redacted].

Sincerely,

/s/ Kurt N. Schacht
Kurt N. Schacht, JD, CFA
Managing Director, Advocacy
CFA Institute

/s/ Sandra J. Peters
Sandra J. Peters, CPA, CFA
Head, Global Financial Reporting Policy
CFA Institute

cc: Corporate Disclosure Policy Council
SEC Commissioners
PCAOB Board Members
Affected Issuers

We estimate that the proposed amendments would result in 539 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.

Of these issuers, an estimated 525 issuers are accelerated filers (or large accelerated filers that have public float of less than $560 million) that would be newly classified as non-accelerated filers because they have annual revenues of less than $100 million and are eligible to be SRCs. An additional 14 issuers are accelerated filers that would 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.

The total number of affected issuers includes an estimated 36 foreign private issuers and 181 EGCs. It also includes an estimated 76 banks with $1 billion or more in total assets that are not EGCs. Because the estimated 181 EGCs are not required to comply with the ICFR auditor attestation requirement under SOX Section 404(b), we estimate that the remaining 358 affected issuers would be newly exempt from this requirement. Of these 358 issuers, we expect that the 76 banks identified above would be subject to the FDIC auditor attestation requirement, while the remaining 282 issuers would not be subject to any such auditor attestation requirement. 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 100 affected issuers.

We estimate that approximately 90% of the affected issuers (whether including or excluding EGCs) have securities that are listed on national exchanges. The affected issuers represent a type of 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%, 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%, and the number of listed issuers with less than $100 million in revenue has decreased by about 60%.

Figure 4 presents the distribution of public float across the full sample of affected issuers. 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 approaching the top of the range for accelerated filers. Figure 5 presents the distribution of revenues across the 525 accelerated filers (or large accelerated filers with public float of less than $560 million) that would be newly classified as non-accelerated filers because they have revenues of less than $100 million.

Other than a concentration of issuers with zero or near zero revenues, these affected issuers are fairly evenly distributed over different levels of revenue up to $100 million in revenues. The additional 14 affected issuers with revenues of at least $100 million but a public float of less than $60

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22 The term banks (11), banking (4), bank (2), bankers (1) and bank’s (1) are used 19 times in the Proposed Rule. See pages 11, 16, 45, 46, 52, 60, 61, and 64. Of those 19 mentions 7 are in body of the text and 12 are in footnotes. This section of the Proposed Rule (Pages 60-64) accounts for 13 of the 19 mentions with 4 in the body of the text and 9 in the footnotes.
million have revenues ranging from $120 million to $1.2 billion, with a mean of about $500 million in revenues. The affected issuers are estimated to have median total assets of about $175 million, a median number of employees of about 125, and a median age of about 11 years. For those issuers that would be newly exempt from the SOX Section 404(b) ICFR auditor attestation requirement, the median total assets, median number of employees and median issuer age are estimated to be slightly higher at about $190 million, 160 employees and about 18 years. The affected issuers are heavily concentrated in the “Pharmaceutical Products” (30.2%), “Banking” (20.2%), and “Financial Trading” (10.2%) industries, followed by “Medical Equipment” (5.2%), “Business Services” (4.3%), “Electronic Equipment” (3.9%) and “Petroleum and Natural Gas” (3.0%).

The number of affected issuers is based on staff estimates of: (i) the number of accelerated filers in 2017 that have prior fiscal year revenues of less than $100 million and are eligible to be SRCs (i.e., excluding ABS issuers, RICs, BDCs, and subsidiaries of non-SRCs); (ii) the number of large accelerated filers in 2017 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 2017 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 proposed 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 98 above (describing the accommodation provided in the SRC Adopting Release). Revenue data is sourced from XBRL filings, Compustat, and Calcbench. See note 116 above for details on the identification of the population of accelerated and large accelerated filers.

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, fed-chartered) or 6036 (savings institutions, not fed-chartered).

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. 

The majority of these potential additional issuers are Canadian MJDS filers that are not required to disclose filer type or public float, though there are also domestic issuers and other foreign issuers for which some of the required data is not available. See note 116 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 151 above for details on the identification of the population of affected issuers.

The estimates in this figure are based on staff analysis of data from XBRL filings. See note 151 above for details on the identification of the population of affected issuers.

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 2017, because the SRC revenue test is based on the prior year’s revenues. See note 151 above for details on the identification of the population of affected issuers.

Approximately 13% of the estimated 525 affected issuers with revenues of less than $100 million and approximately 11% of the estimated 347 non-EGC affected issuers (which would be newly exempt from the SOX Section 404(b) ICFR auditor attestation requirement) with revenues of less than $100 million have zero revenues. 

These estimates are based on staff analysis of data from Compustat. See note 151 above for details on the identification of the population of affected issuers. 

For the 282 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 total assets and median number of employees are somewhat lower at about $110 million and 110 employees, and the median issuer age is similar at about 19 years.

For the 282 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 5.7%. By contrast, the proportion in other industries does not change by more than a few percentage points.

These estimates are based on staff analysis of data 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 151 above for details on the identification of the population of affected issuers.

The analysis of median total assets of $170 million does not meaningfully convey the impact to the banking industry which we estimate has approximately $180 billion in total assets with average total assets of $1.5 billion per entity affected.

It should be noted that when one compares the language here from Page 64 to the language below from Page 52 of the Proposed Rule, one can see that the banking industry which accounts for 14.2% of all accelerate filers is 20.2% of the affected population – resulting in an greater than average impact on the banking industry.

Excerpt from Page 52 of Proposed Rule: 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 14.2% of accelerated filers, followed by “Pharmaceutical Products” (12.8%), “Financial Trading” (7.7%), “Business Services” (6.7%), “Computer Software” (4.5%), “Electronic Equipment” (4.3%) and “Petroleum and Natural Gas” (4.0%).