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## CAQ Alert #2011-11 April 28, 2011

### DEAR CENTER MEMBERS

#### **SEC Study Concludes that Existing Investor Protections of SOX 404(b) for Accelerated Filers Should Continue to be Maintained**

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Securities and Exchange Commission (SEC or the Commission) was required to conduct a study to:

1. Determine how the Commission could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 (Section 404(b)) – the auditor’s attestation requirement with respect to an entity’s internal control over financial reporting (ICFR) – for companies whose market capitalization is between \$75 million and \$250 million, while maintaining investor protections for such companies; and
2. Consider whether any methods of reducing the compliance burden or a complete exemption for such companies from Section 404(b) compliance would encourage companies to list on exchanges in the United States in their initial public offerings (IPOs).

#### **Conclusion**

The SEC concluded that the information compiled for the study provided the SEC staff with an understanding that:

- The costs of Section 404(b) have declined since the Commission first implemented the requirements of Section 404, particularly in response to the 2007 reforms;
- Investors generally view the auditor’s attestation on ICFR as beneficial;
- Financial reporting is more reliable when the auditor is involved with ICFR assessments; and
- There is not conclusive evidence linking the requirements of Section 404(b) to listing decisions of the studied range of issuers.

## **Recommendations**

The SEC made the following recommendations after considering all the information they gathered from various sources including internal sources:

1. Maintain existing investor protections of Section 404(b) for accelerated filers, which have been in place since 2004 for domestic issuers and 2007 for foreign private issuers.
  - The Staff believes that the existing investor protections for accelerated filers to comply with the auditor attestation provisions of Section 404(b) should be maintained (i.e., no new exemptions).
  - 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 Staff did not find any specific evidence that potential savings would justify the loss of investor protections and benefits to issuers subject to the study, given the auditor's obligations to perform procedures to evaluate internal controls even when the auditor is not performing an integrated audit.
  - With regard to IPOs, while the research regarding the reasons for listing decisions is inconclusive, the evidence does not suggest that granting an exemption to issuers that would expect to have \$75-\$250 million in public float following an IPO would, by itself, encourage companies in the United States or abroad to list their IPOs in the United States.
2. Encourage activities that have potential to further improve both effectiveness and efficiency of Section 404(b) implementation.
  - The Staff recommends that the PCAOB monitor its inspection results and consider publishing observations, beyond the observations previously published in [September 2009](#), on the performance of audits conducted in accordance with [PCAOB Auditing Standard No. 5](#). These observations could assist auditors in performing top-down, risk based audits of ICFR. These communications could include the lessons that can be learned from internal control deficiencies identified through PCAOB inspections.
  - The Staff is observing [COSO's project](#) to review and update its internal control framework, which is the most common framework used by management and the auditor alike in performing assessments of ICFR. The Staff believes that this project can contribute to effective and efficient audits by providing management and auditors with improved internal control guidance that reflects today's operating and regulatory

environment and by allowing constituent groups to share information on improvements that can be made that enhance the ability to design, implement, and assess internal controls.

**Other Related Resources:**

- [CAQ Comment Letter](#) SEC File No. S-7-29-10 – Request for Comment Related to a Study Required by Section 989G(b) of the Dodd-Frank Act Regarding Compliance with Section 404(b) of the Sarbanes-Oxley Act, December 6, 2010
- [CAQ Public Policy Letters](#) CAQ letters to various agencies supporting the retention of Sarbanes-Oxley Section 404(b), various dates
- [CAQ Web Resource](#) Resources for Integrated Audits of Accelerated Filers and Audits of Non-Accelerated Filers

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