May 1, 2017

The Honorable Jeb Hensarling
Chairman
House Financial Services Committee
2128 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Financial Services Committee
4340 Thomas P. O'Neill, Jr. Federal Office Building
Washington, DC 20515

Dear Chairman Hensarling and Ranking Member Waters:

The Center for Audit Quality ("CAQ") is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs ("AICPA"). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The Council of Institutional Investors ("CII") is a nonprofit nonpartisan association of public, corporate, and union pension funds, and other employee benefit plans, foundations and endowments with combined assets that exceed $3 trillion. CII member funds are major, long-term investors committed to protecting the retirement savings of millions of American workers. CII also has associate members, including the CAQ, the CFA Institute and asset managers with more than $20 trillion in assets under management. CII is the leading voice for effective corporate governance and strong shareowner rights.

CFA Institute is a global, not-for-profit professional association of more than 148,000 investment analysts, advisers, portfolio managers, and other investment professionals in approximately 160 countries, of more than 141,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 148 member societies in 73 countries and territories.

The CAQ, CII, and CFA Institute welcome the opportunity to comment on the Financial CHOICE Act 2017 Discussion Draft (the "Act"), released April 19, 2017. We write to express our shared opposition to any legislation that would erode Section 404(b) of the Sarbanes-Oxley Act of 2002 ("SOX" or "Sarbanes-Oxley Act") or revise the definition of accelerated filer as defined in SEC Exchange Act Rule 12b-2 (17 C.F.R. 240.12b-2). Companies that meet the current definition benefit from enhanced market confidence because their financial information is communicated to investors on a timely basis, which, research shows, can lead to a lower cost of capital.

We commend efforts to strengthen the U.S. economy and help companies raise capital; however, we do not believe Section 404(b) of SOX is a regulatory burden or impediment to capital formation. In fact, we refer you to academic research that indicates that any increase in the public float threshold *would not* spur capital formation, and could have the unintended consequence of eroding investor confidence and the quality of public company financial reporting. Additionally, as discussed below, two recent surveys of financial advisors and chief financial officers ("CFOs") demonstrate that Section 404(b) is beneficial to our markets and investors.

Initial Public Offering Activity

A precipitous drop in initial public offerings ("IPOs") occurred in 2001, *prior to* the adoption and enactment of SOX. Major, macroeconomic factors—such as the "dot-com bust" and the September 11 terrorist attacks—contributed to this decline. Since then, competition from international marketplaces, mergers, acquisitions, and other economic factors, such as growth in the private equity markets, continue to drive down IPO activity and have led to a decline in the number of public companies in the United States.

These additional factors were explored in depth at a recent meeting of the Securities and Exchange Commission's ("SEC") Advisory Committee on Small and Emerging Companies. Glen Giovannetti, Global Biotechnology Sector Leader at EY, explained that while listing as a public company offers some advantages—such as a lower cost of capital, wider diversity of shareholders, and higher liquidity and brand identity—there are numerous factors that lead companies to remain private. Compared to just 15 years ago, companies have more ways to access significant capital without utilizing the public markets. Venture capitalists, private equity firms, and sovereign funds have considerable capital to invest in private companies. The amount of capital that these firms have invested in privately-held technology companies has nearly tripled from 2013 to 2015. This is further highlighted by some cutting-edge, startup companies that are built upon business models that require less capital than resource-intensive industrial-economy companies. Additionally, interest rates have remained at historic lows over the past decade, which could also be a contributing factor to the decrease in IPOs in the United States.

Given the various choices companies have for funding, they can choose to remain private longer. It is also important to note that the 2012 Jumpstart Our Business Startups ("JOBS") Act increased the accredited investor limit for registering with the SEC from 500 to 2,000 persons and excluded employees receiving exempt equity awards, both of which also could be a factor in a private company determining to delay listing as a public company.[1]

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[1] Section 12(g) of the 1934 Exchange Act requires issuers of securities to register with the SEC and thereby become public reporting companies within 120 days of the end of any fiscal year in which they first have total assets exceeding $1 million and any class of equity securities held of record by 500 or more persons. The JOBS Act amended this within 120 days after the last day of its first fiscal year ended on which the issuer has total assets exceeding $10,000,000 and a class of equity security (other than an exempted security) held of record by either—(i) 2,000 persons, or (ii) 500 persons who are not accredited investors (as such term is defined by the Commission).

Positive Impact of 404(b) on Capital Formation

As outlined in the CAQ's August 30, 2016 letter to the SEC: Amendments to Smaller Reporting Company Definition, academic research has demonstrated that the cost of capital for companies that voluntarily comply with Section 404(b) is lower than peer companies that do not, and the cost of capital has decreased for public companies since enactment of SOX, especially for smaller companies. [2, 3]

A 2014 study of the seven-year period from 2007-2013 found that companies subject to 404(b), experienced higher credit ratings, which resulted in overall lower costs of debt and higher valuation premiums.[4]

The enactment of SOX, a law aimed at fostering more reliable financial reporting and enhancing audit quality, was a watershed moment for investors and the capital markets. The 2002 law, which passed both chambers of Congress nearly unanimously, has stood the test of time.[5] Its benefits are recognized by investors and others in the financial reporting supply chain.

Section 404(b), one of SOX's key provisions, provides investors with confidence regarding a CEO's and CFO's representations about the effectiveness of their company's internal control over financial reporting ("ICFR"). The ICFR audit, performed by an independent, objective auditor, is an important driver of trust in the integrity of financial reporting and helps facilitate capital formation in U.S. markets. Section 404(b) requires auditors to help in identifying weaknesses in a company's internal controls that could eventually lead to fraud and a loss in shareholder value. Embedded in SOX 15 years ago, these simple principles remain as true as ever today and are important components of investor protection.

Since the adoption of SOX, financial restatements have steadily declined. According to an analysis by Audit Analytics, an independent research provider, the total number of financial reporting restatements decreased in the United States from 756 in 2015 to 671 in 2016. The study also shows that the number of accelerated filers disclosing restatements dropped for the second year, following a four-year trend of increases. From 2010 to 2014, restatements among accelerated filers climbed from 174 to 352, then tapered to 284 in 2015 and 255 in 2016.[6]

Recent surveys conducted by independent, third-party research firms on behalf of the CAQ show that both companies and investors recognize the value and importance of Section 404(b) and ICFR audits. An April 2017 poll of CFOs of publicly traded companies revealed that 85 percent of the CFOs surveyed believe the ICFR audit function has either greatly (34 percent) or somewhat (51 percent) helped their company, because it builds trust among stakeholders and customers (26 percent of respondents), helps to produce accurate financial reporting (21 percent of respondents), and makes the process more streamlined (21 percent of respondents).

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[2] Cory A. Cassell, Linda A. Myers, Roy Schmardebeck, and Jian Zhou. "The Effect of Voluntary SOX Section 404(b) Compliance on the Cost of Capital" Working paper, 2017.

[3] Stephen, Sheryl-Ann and de Jong, Pieter J, The Impact of Sarbanes-Oxley Act on the Cost of Equity Capital of S&P Firms (2012). Journal of Applied Business and Economics vol. 13(2) 2012.

[4] An Analysis of the Costs and Benefits of Auditor Attestation of Internal Control over Financial Reporting (October 2014); available at https://business.lsu.edu/Accounting/Documents/Seminar%20Series/20141027%20JXZ.PDF.

[5] On July 25, 2002, the Senate voted on final passage of H.R. 3763, 99-0. The House voted on final passage on the same day, 423-3. https://www.congress.gov/bill/107th-congress/house-bill/3763/actions.

[6] Tammy Whitehouse – "Restatement study will show second year of decline in 2016" https://www.complianceweek.com/blogs/accounting-auditing-update/restatement-study-will-show-second-year-of-decline-in-2016#.WP9tK_krKUl.

A February 2017 CAQ survey of 300 certified financial advisors found that nearly three-quarters of financial advisors support Section 404(b), with 26 percent indicating they "strongly favor" it. Seventy-three percent of financial advisors surveyed also said that it would benefit their clients if all public companies were required to have an independent ICFR audit.

The Sarbanes-Oxley Act, including Section 404(b), stands as an exemplar of bipartisan policymaking achieved with wisdom and foresight. For the sake of investors and the capital markets broadly, CAQ, CII, and CFA Institute, oppose any efforts to weaken Section 404(b). We urge Congress to recognize that capital formation is impacted by many factors and to preserve Section 404(b) on behalf of all investors. Shareholders in public companies of all sizes should benefit from the same protections, including the beneficial, third-party inspection of a company's ICFR that is mandated under SOX Section 404(b).

The CAQ, CII, and CFA Institute appreciate the opportunity to provide these views and would be pleased to discuss our comments with you.

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cc: Members of the House Financial Services Committee
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