AUDIT ANALYTICS®

SOX 404 DISCLOSURES

A SEVENTEEN-YEAR REVIEW

October 2021

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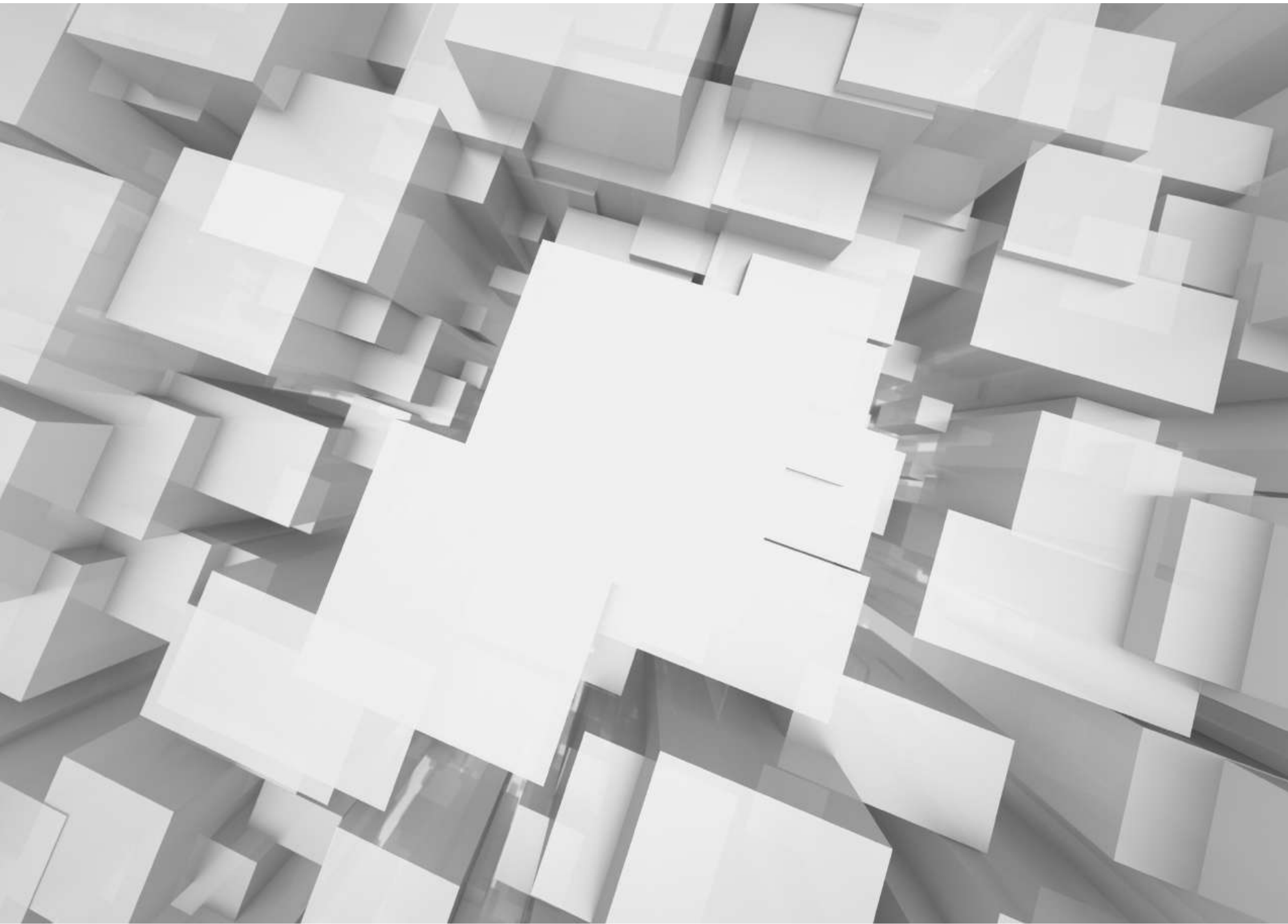
INTRODUCTION

Congress passed the Sarbanes-Oxley Act of 2002 (SOX) to better protect investors. Section 404 of SOX (SOX 404) required companies to review their internal controls over financial reporting (ICFR) and declare whether their ICFR are "effective" or "ineffective." In other words, companies must determine if their ICFR are adequate to produce financial statements that are complete and accurate.

SOX 404 has two requirements: an auditor attestation and a management report assessing ICFR. The requirements apply to issuers based on filer status, as determined by public float and revenue. Large accelerated and accelerated filers must have their independent auditor attest to management's assessment of ICFR. Smaller companies identifying as non-accelerated filers are required to maintain ICFR and have management assess and report on ICFR effectiveness, but are not required to obtain an auditor attestation.

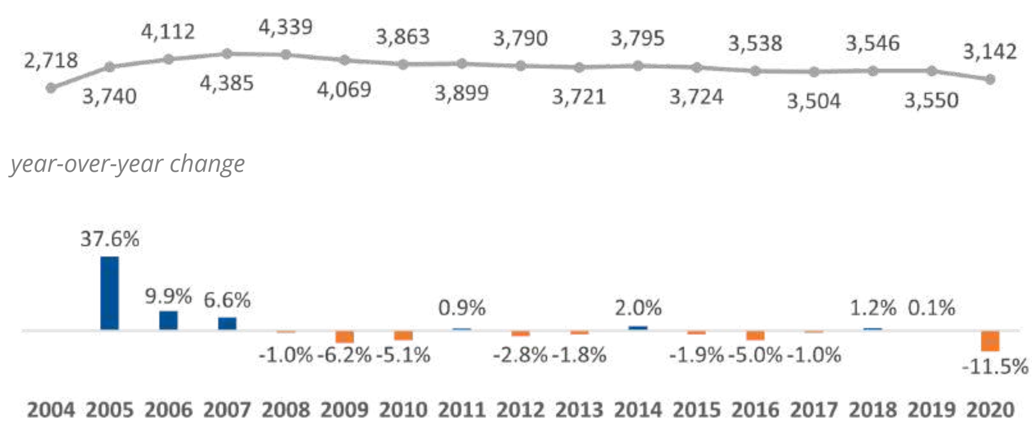
Aligning with the effective implementation dates of the SOX requirements, this report looks at ICFR auditor attestations beginning in 2004 and management reports on ICFR beginning in 2007. Management reports are further divided into two groups: all management reports and management-only reports.



Population: All SOX 404 Assessments

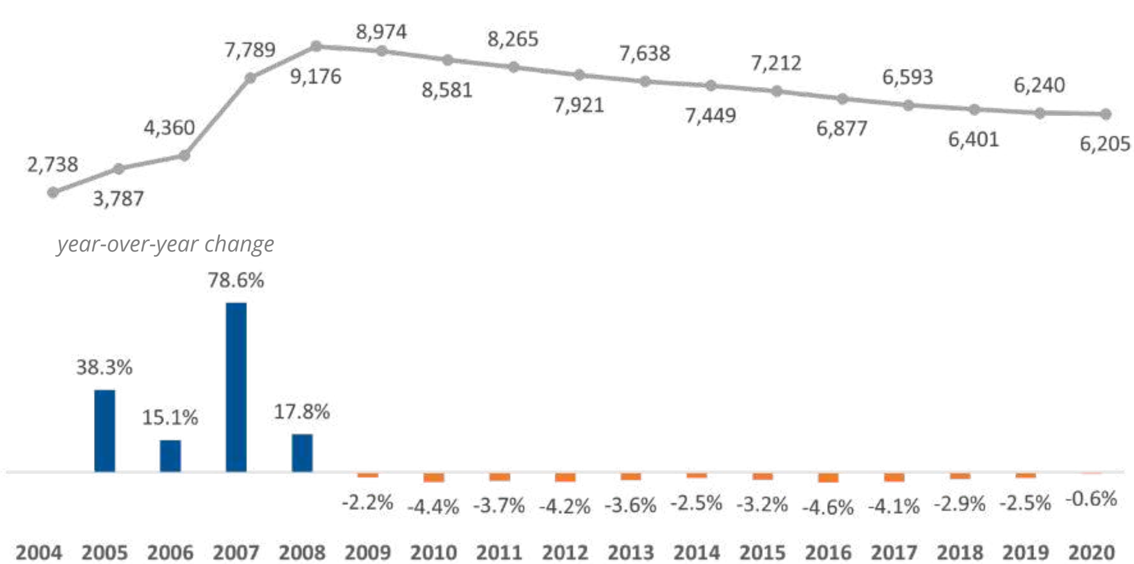
Accelerated filers are required, pursuant to SOX 404(b), to provide an auditor attestation of management's assessment of ICFR. Therefore, a review of ICFR auditor attestations primarily relates to disclosures provided by larger companies. These requirements came into effect for companies with fiscal years ending on or after November 15, 2004, making 2005 the first full year of implementation.

Total ICFR Audit Attestations Filed



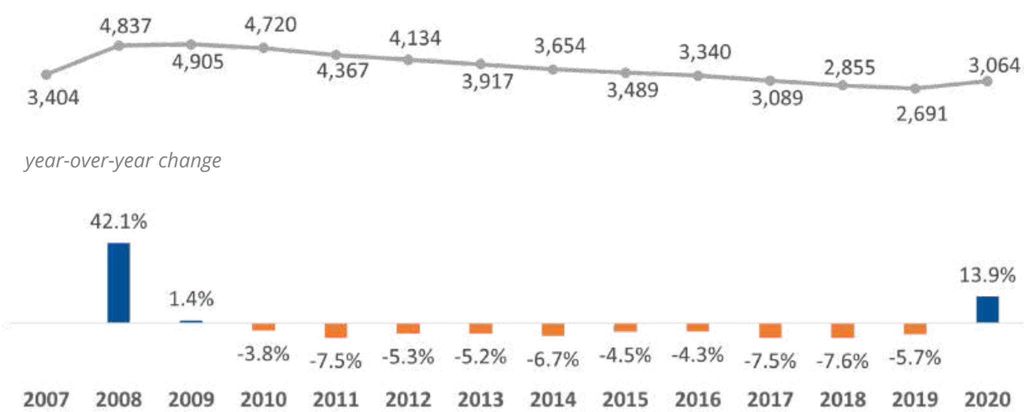
Both accelerated filers and non-accelerated filers are required, pursuant to SOX 404(a), to provide a management assessment of ICFR. Emerging growth companies are also required to provide a management report. Therefore, a review of total ICFR management reports provides a look at all disclosures required under SOX 404(a), regardless of company size.

Total ICFR Management Reports Filed



Non-accelerated filers are required to provide a management assessment (but not an auditor attestation) in their annual reports for fiscal years ending on or after December 15, 2007. A review of companies that file only management reports provides a focus on disclosures by smaller companies.

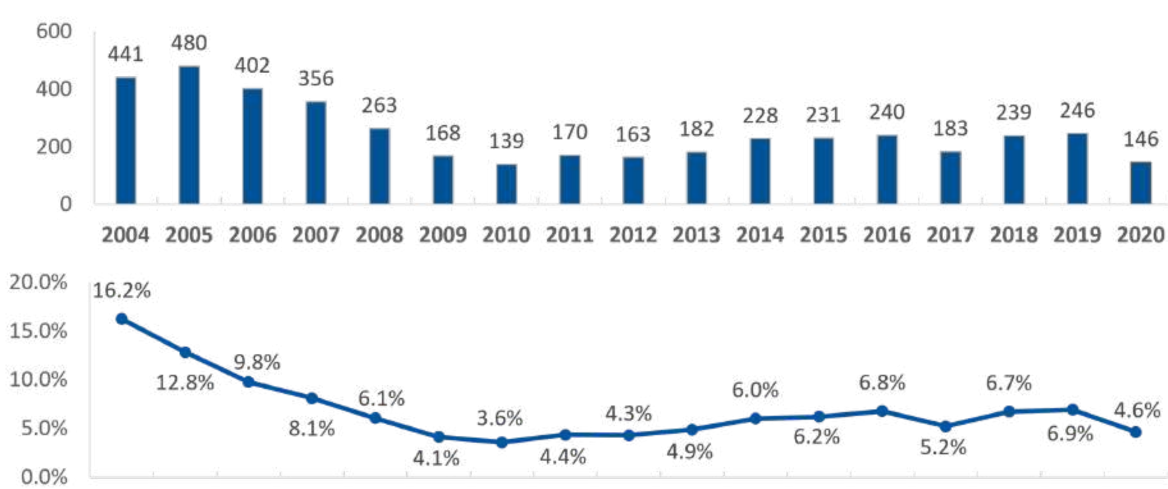
Total ICFR Management-Only Reports Filed



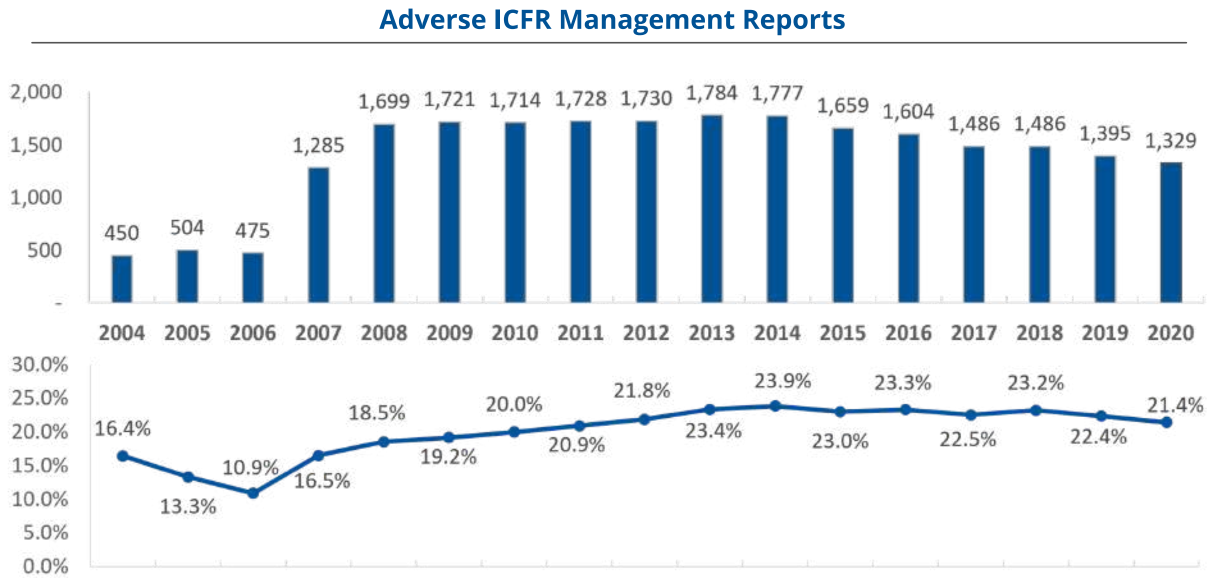
Population: Adverse SOX 404 Assessments

The number of adverse ICFR auditor attestations dropped to 146 in 2020. Since the inception of SOX requirements in 2004, 2020 had the second-lowest number of adverse auditor attestations, after the 139 adverse attestations in 2010. After 2010, there was a six-year upward trend in the number of ineffective ICFR auditor attestations, partially related to oversight activities of the PCAOB and other regulators. The number of adverse auditor attestations represents 4.6% of all auditor attestations filed for the fiscal year 2020, a decrease from the 6.9% seen in 2019. This is the lowest percentage of total reports containing an adverse auditor attestation since 2012.

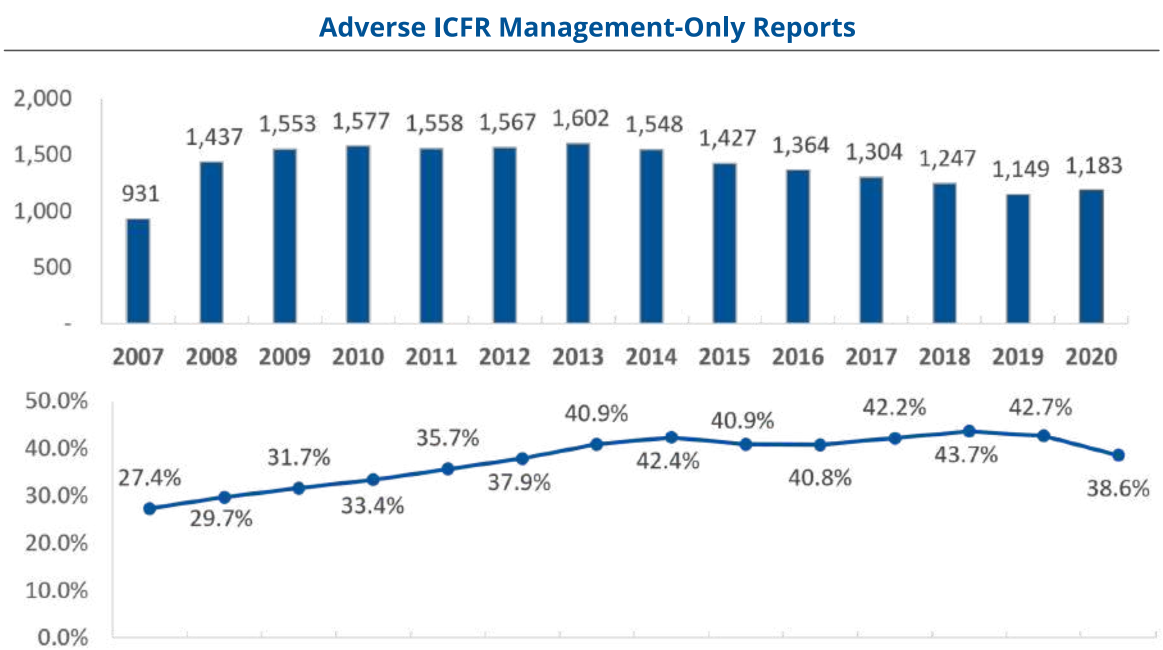
Adverse ICFR Auditor Attestations



The number of adverse ICFR management reports dropped to 1,329 in 2020. This represents 21.4% of all management reports filed for the year, down from 22.4% in 2019. The number of adverse management reports has been steadily declining since a high point of 23.9% in 2014. Between 2013 and 2020, the percentage of adverse management reports has minimally fluctuated between 21.4% and 23.9%.



In 2020, the number of adverse ICFR management-only reports increased to 1,183. This represents 38.6% of all management-only reports filed for the year, down from 42.7% in 2019. The number of companies eligible to file a management-only report under SOX 404(a) increased in 2020, corresponding with amendments to the SEC's accelerated filer definition that became effective in April 2020.



BACKGROUND OF SOX 404

The collapses of both Enron and Worldcom culminated from a practice of disguising the true operating performance of the companies. In response to these meltdowns, Congress passed the Sarbanes-Oxley Act of 2002 (SOX). The declared purpose of SOX is to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes."

One section of SOX, Section 404 (SOX 404), furthers this goal by instructing the Securities and Exchange Commission (SEC) to prescribe rules imposing a duty on officers and management to implement, review, and certify the effectiveness of a company's internal controls for financial reporting (ICFR).[1] In addition, the registered public accountant must attest to and report on the management's assessment. In short, SOX 404(a) requires management to assess a company's ICFR, while SOX 404(b) requires a registered public accountant to attest to the management's report.

History of Implementation

SOX 404 began to apply to different categories of companies at different times. Moreover, as summarized in the table on the right, the two subsections of SOX 404 did not necessarily come into effect at the same time. United States accelerated filers were first required to provide SOX 404 certifications in annual reports for fiscal years ending on or after November 15, 2004.

SOX 404 Compliance Dates: Fiscal Year End Date of Annual Reports

SOX 404 Provision	Accelerated Filers			Non-Accelerated Filers
	United States	Foreign		
		Large Accelerated	Accelerated	
SOX 404(a)	Nov. 15, 2004 (both required)	July 15, 2006 (both required)	July 15, 2006	Dec. 15, 2007
SOX 404(b)			July 15, 2007	n/a

At that time, both provisions were required: the management assessment (404(a)) and the auditor attestation (404(b)). The provisions did not go into effect for foreign large accelerated filers until July 15, 2006. A gradual, two-tier implementation was provided for foreign accelerated filers who were not required to obtain an auditor attestation under SOX 404(b) until July 15, 2007.

In a similar fashion, the SEC initially intended to apply a two-step approach to non-accelerated filers. Non-accelerated filers were required to provide a management assessment (but not an auditor attestation) in their annual reports for the fiscal years ending on or after December 15, 2007. Before subsection 404(b) became effective, however, the Dodd-Frank Act exempted the non-accelerated filers from the auditor attestation requirement.[2]

Therefore, except for asset-backed securities and registered investment companies,[3] all SEC registrants are required to provide at least a management report and accompanying certifications[4] in their annual reports unless, pursuant to the SEC relief for newly public companies, the company falls within the first annual report transition period.[5] Accelerated filers that qualify as 'emerging growth companies' are given further relief from SOX 404(b) by the Jumpstart Our Business Startups (JOBS) Act of 2012.

Emerging Growth Companies (EGCs):

Exempt from SOX 404(b) auditor attestation of ICFR for five years after their IPO, or until they exit EGC criteria (i.e. annual revenues over $1.07 billion or become large accelerated filer)

[1] In general, Section 404 requires that each annual report contain an "internal control report" that (1) acknowledges management's responsibility to maintain adequate internal controls, (2) identifies the "framework" used to evaluate the effectiveness of the internal controls over financial reporting, and (3) provides an assessment of the effectiveness of these internal controls as of the end of the fiscal year.

[2] See Section 989G of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[3] Registered investment companies are expressly exempt from Section 404 by Section 405 of SOX.

[4] The SEC provides a form entitled "CERTIFICATIONS" to be attached to the annual report that contains the necessary language for a 404 certification. A separate copy of this form must be signed by both the CEO and CFO without any change in the language and attached as Exhibit 31.

[5] https://www.sec.gov/news/press/2006/2006-210.htm

A company passing the threshold of an accelerated filer triggers the SOX 404(b) requirement for an auditor attestation of ICFR. As of April 27, 2020, the SEC amended the accelerated filer definition with an intent "to promote capital formation and reduce compliance costs for smaller companies while maintaining appropriate investor protections."[6] Under the previous definition, a company qualified as an accelerated filer with a public float of $75 million or greater. Under the new definition, accelerated filers must have a public float between $75 million and $700 million, in addition to at least $100 million in annual revenue; the requirement for an auditor attestation remains. Under the new definition, some companies that previously qualified as accelerated filers may fall under the expanded definition of a non-accelerated filer, therefore no longer requiring an auditor attestation.[7]

Filer Status Determination

	Public Float [i]	Revenue [ii]	SOX404(a) Management Report	SOX404(b) Auditor Attestation
Non-accelerated filer and SRC	Less than $75 million	n/a	Yes	No
	$75 million - $700 million	Less than $100 million	Yes	No
Accelerated filer and SRC	$75 million - $250 million	$100 million or more	Yes	Yes
Accelerated filer	$250 million - $700 million	$100 million or more	Yes	Yes
Large accelerated filer	$700 million or more	n/a	Yes	Yes

Filer status thresholds reflect criteria as of April 2020 filer definition amendments enacted by SEC.

[i] Public float measured at the end of the company's second fiscal quarter.
[ii] Annual revenue is based on company's most recently completed fiscal year.

Standards and PCAOB Oversight

To guide an independent auditor's review of a company's ICFR, the Public Company Accounting Oversight Board (PCAOB) issued *Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements (AS 5)*. The standard applied to audits for fiscal year ends on or after November 15, 2007. During 2008 and 2009, PCAOB inspections of audits evaluated, among other things, the auditor's implementation of the new standards. The following year, the PCAOB shifted the review to determine if the audit process obtained adequate evidence to substantiate the auditor's attestation of the management's assessment regarding the effectiveness of ICFR.[8]

After discovering several deficiencies during the 2010 and 2011 inspections, the PCAOB published a report in December 2012 titled "*Observations from 2010 Inspections of Domestic Annually Inspected Firms Regarding Deficiencies in Audits of Internal Control over Financial Reporting.*" In October 2013, the PCAOB published Staff Audit Practice Alert No. 11, "*Considerations for Audits of Internal Control Over Financial Reporting*," to highlight the deficiencies observed and the responsibilities dictated by AS 5.

[6] See SEC Adopts Amendments to Reduce Unnecessary Burdens on Smaller Issuers by More Appropriately Tailoring the Accelerated and Large Accelerated Filer Definitions (March 12, 2020) https://www.sec.gov/news/press-release/2020-58
[7] For more information on the amended definition, see the SEC's final rule.
[8] See transcript of Jeanette M. Franzel's speech, Effective Audits of Internal Control in the Current "Perfect Storm," given on March 26, 2014: www.pcaobus.org/News/Speech/Pages/0326204_IIA.aspx

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) provided further guidance in May 2013. In 2013, COSO published the Internal Control — Integrated Framework which, as stated by COSO, "is expected to help organizations design and implement internal control in light of many changes in business and operating environments since the issuance of the original Framework, broaden the application of internal control in addressing operations and reporting objectives, and clarify the requirements for determining what constitutes effective internal control."[9]

In 2016, the Chief Accountant of the SEC publicly stated that ICFR is a focus and that both the SEC and PCAOB "encourage regular discussions between management, auditors, and audit committees on existing and emerging issues in assessments of ICFR."[10]

SEC Enforcement of SOX 404

The SEC, which has regulatory authority over public companies (unlike the PCAOB), maintains a watchful eye over the status of ICFR. The SEC has demonstrated that it will not tolerate companies that are unable or unwilling to correct ineffective internal controls.

The SEC's Financial Reporting and Audit (FRAud) Group, established in 2013, operates under mandates that include uncovering and preventing fraudulent financial reporting, including related internal controls. As a part of the FRAud Group's ICFR Initiative, the SEC has taken action against several companies with longstanding ICFR failures. A press release issued In January 2019 announced an investigation conducted by the FRAud Group that resulted in fines imposed on four companies with longstanding ICFR failures.[11] The ongoing failures lasted between seven to ten consecutive years and resulted in civil penalties ranging from $35,000 to $200,000.

[9] See COSO website: http://www.coso.org/ic.htm.

[10] See transcript of James V. Schnurr's speech, Remarks before the 12th Annual Life Sciences Accounting and Reporting Congress, given on March 22, 2016: www.sec.gov/ news/speech/schnurr-remarks-12th-life-sciences-accounting-congress.html.

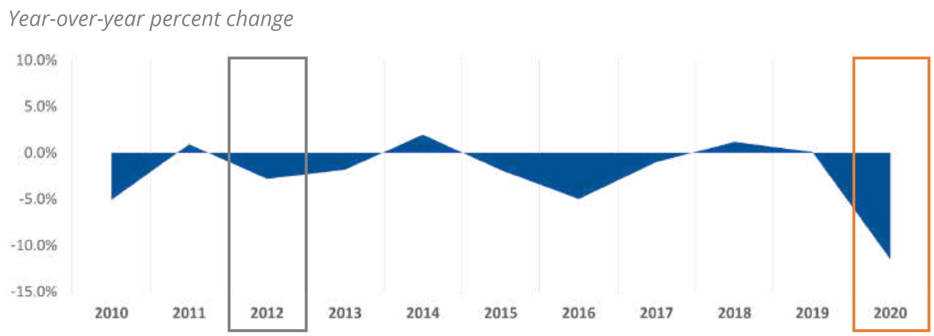
[11] https://www.sec.gov/news/press-release/2019-6

2020 TREND HIGHLIGHTS

1. Change in the number of ICFR auditor attestations and management-only reports in 2020 corresponds to SEC's amendments to the accelerated filer definition. Between 2019 and 2020, there was a decrease of 11.5% in the number of SOX 404(b) auditor attestations filed and an increase of 13.0% in the number of SOX 404(a) management-only reports filed. The decrease in auditor attestations and the increase in management-only reports relate to the SEC's amended accelerated filer definition that became effective on April 27, 2020.

The amendment added a revenue test to the transition thresholds for exiting from both accelerated and large accelerated filer status. The definition change made it possible for certain low-revenue issuers to transition from an accelerated filer to a non-accelerated filer, and therefore be exempt from the auditor attestation requirement. This expanded the eligibility for companies that previously had to obtain an auditor attestation to file management-only reports in 2020.

Total ICFR Auditor Attestations Filed



Emerging growth company classification: Exempted companies from auditor attestation for 5 years after becoming public.

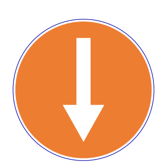
Accelerated filer definition amendments: Expanded population of companies eligible for exemption from auditor attestation.

Past changes in regulations, including the 'emerging growth company' designation established by the JOBS Act in 2012, have expanded exemptions from SOX 404(b) auditor attestations without resulting in a significant decrease in the number of auditor attestations or any increase to the number of management-only reports.

2. A decrease in the percent of adverse management-only reports in 2020 aligns with the changes to filer status definitions. A decrease in the percent of adverse management-only reports, despite an increase in the overall number of reports, relates to the type of companies that became eligible to transition filer status under the amended filer definitions. Companies that formerly qualified as an accelerated filer under the previous filer definitions, and subsequently qualified as a non-accelerated filer under the filer status definition amendments, became exempt from the auditor attestation requirement in 2020. This increased the total number of management-only ICFR reports filed.

As previously mentioned, smaller companies, which typically lack resources to develop robust control systems, file most of the management-only reports. As a result, the accelerated filers that transitioned to a non-accelerated filer status under the amended definition had already expended resources to establish an effective control system, and they additionally benefited from having an independent auditor review their control systems for deficiencies. Therefore, those companies are more likely to operate with effective controls after their transition, decreasing the percent of adverse ICFR in management-only reports in 2020.

Increase in total number of management-only ICFR reports filed in 2020 due to expanded filer status eligibility



Decrease in percent of total management-only reports containing adverse ICFR assessment

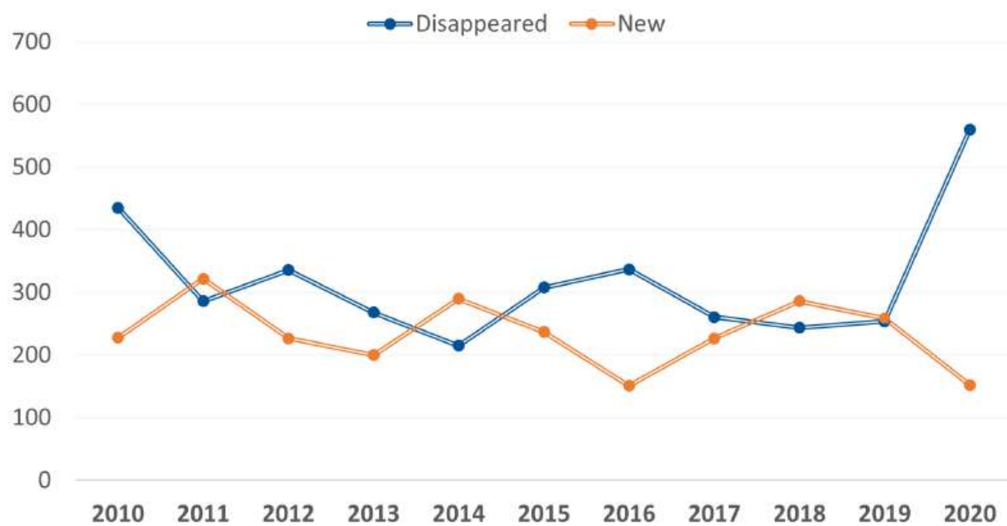
3. The number of companies that ceased filing auditor attestations between 2019 and 2020 more than doubled, with a corresponding decrease in new auditor attestations. There are many different reasons why an issuer may cease filing ICFR auditor attestations from one year to the next: a change in filer status, de-registration, failure to timely file, etc.

As previously noted, the amendments to the accelerated filer definition expanded the number of companies not required to obtain an ICFR auditor attestation, partially contributing to an increase in the number of auditor attestations that disappeared in 2020. Roughly one-quarter of 'disappeared' attestations relate to SEC de-registrations. This includes de-registrations associated with a merger or acquisition, bankruptcy, or liquidation.

Change in Number of ICFR Auditor Attestations Filed: Disappeared vs. New

Disappeared: Companies that filed an auditor attestation in previous year, but not present year.

New: Companies that filed an auditor attestation in present year, but not the previous year



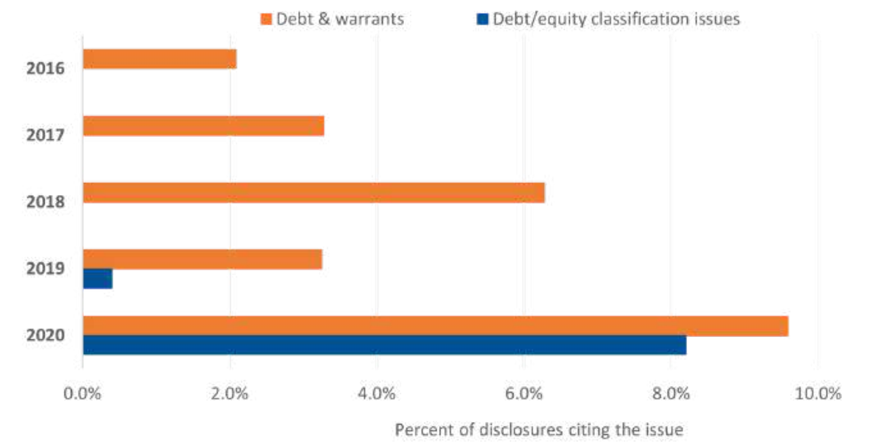
4. An increase in accounting issues related to debt and/or equity classification in adverse assessments of ICFR reflects the SEC's statement in April 2021 regarding SPAC warrants. Accounting issues cited in adverse ICFR reports related to the recording of debt and warrants and debt/equity classification issues increased significantly in 2020. In auditor attestations, the recording of debt and warrants became the sixth most common issue; in the previous five years, issues related to debts and warrants were outside of the top ten most common accounting issues. In both management reports and management-only reports, debt and warrants took over as the most common accounting issue cited. Meanwhile, debt/equity classification – previously far outside the most common issues – ranked as the fifth most common issue in management reports and the fourth most common issue in management-only reports.

This is notable, as, in April 2021, the SEC issued a statement addressing whether warrants issued by a SPAC should be classified as equity or liability under the guidance in ASC 815-40, Derivatives and Hedging: Contracts in Entity's Own Equity.[12] In terms of reporting considerations, companies had to reevaluate their warrants and, if necessary, amend or restate previous financial statements, including a reassessment of ICFR.

[12] See SEC Staff Statement on Accounting and Reporting Considerations for Warrants Issued by Special Purpose Acquisition Companies https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs

In adverse ICFR auditor attestations for 2020 reports, issues related to debt/equity classification and the recording of debt and warrants were the top two accounting issues cited. This reflects that companies re-evaluating the accounting for warrants did not effectively apply the provisions of ASC 815-40, as further interpreted by the SEC on April 12, 2021, and that companies' controls were not appropriately designed to reassess the classification of the warrants at each reporting date thereafter.

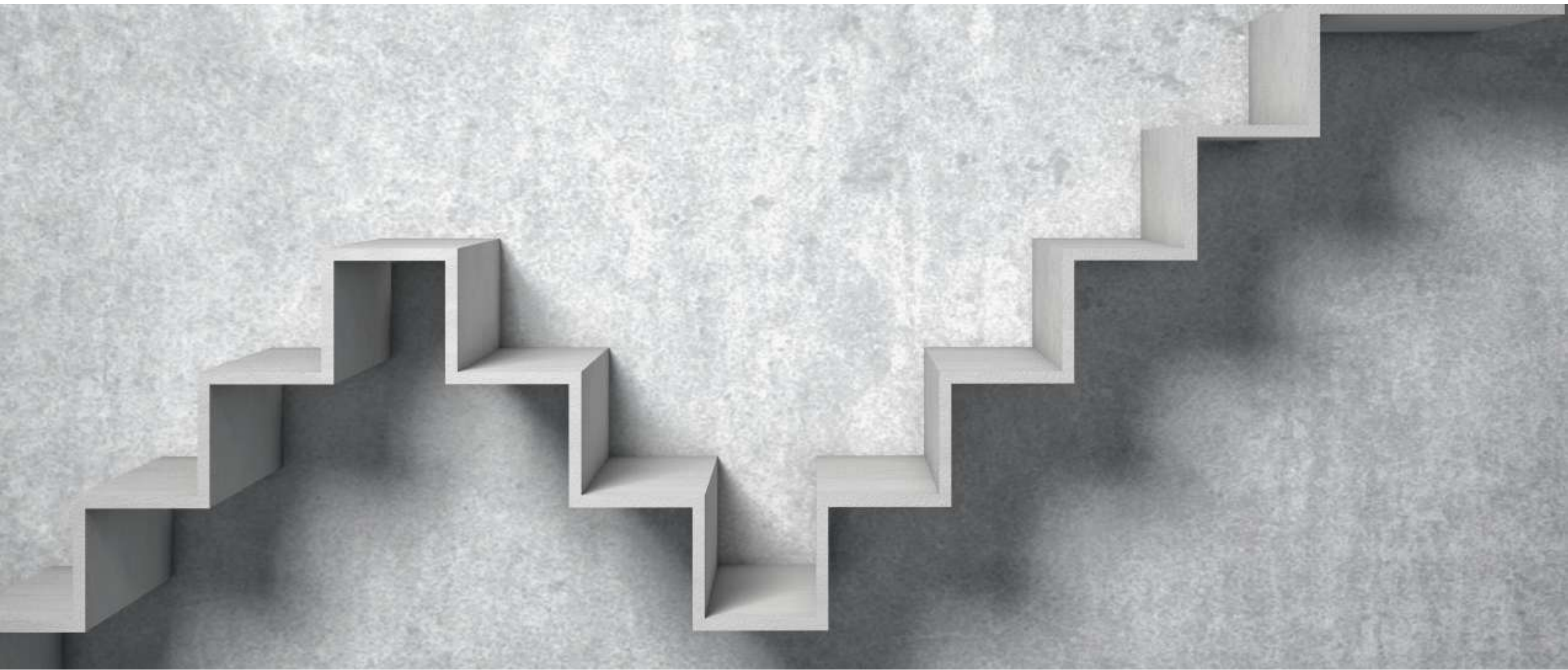
Accounting Issues Cited in Adverse Auditor Attestations



5. The percentage of adverse ICFR management reports and auditor attestations decreased in 2020, despite the impact of the COVID-19 pandemic throughout 2020 that necessitated changes to internal controls. The COVID-19 pandemic occurring throughout 2020 had particular effects on public companies and their internal control structure and environment.

Some companies with existing control deficiencies disclosed difficulty remediating those weaknesses due to pandemic circumstances. Furthermore, rapid changes to the control environment were required in order for many companies to continue operating, including the need to reduce personnel to comply with pandemic restrictions or conserve cash. A reduced workforce can result in issues in the control environment related to segregation of duties and maintaining appropriate accounting personnel. Additionally, many companies increased reliance on information technology to accommodate a remote workforce, an area of controls ripe for deficiencies.

Despite the unprecedented nature of the pandemic, little effect was noted in terms of the most common issues disclosed in adverse SOX 404 assessments. For example, the top two internal control issues cited in adverse ICFR management reports in 2020 – issues related to accounting personnel and segregation of duties – have been the top two issues for the previous five years. This illustrates that issues related to personnel are always common for smaller companies, regardless of circumstances arising from an event, such as the pandemic, that could significantly exacerbate existing deficiencies.



TRENDS IN ISSUES CITED IN ADVERSE SOX 404(A) AND SOX 404(B) ASSESSMENTS

Internal Control Issues

Adverse internal control assessments include disclosures of the issues that caused, at least in part, the conclusion that a company's ICFR was ineffective. Audit Analytics classifies 'internal control issues' as internal control weaknesses arising from deficiencies in the company's control structure.

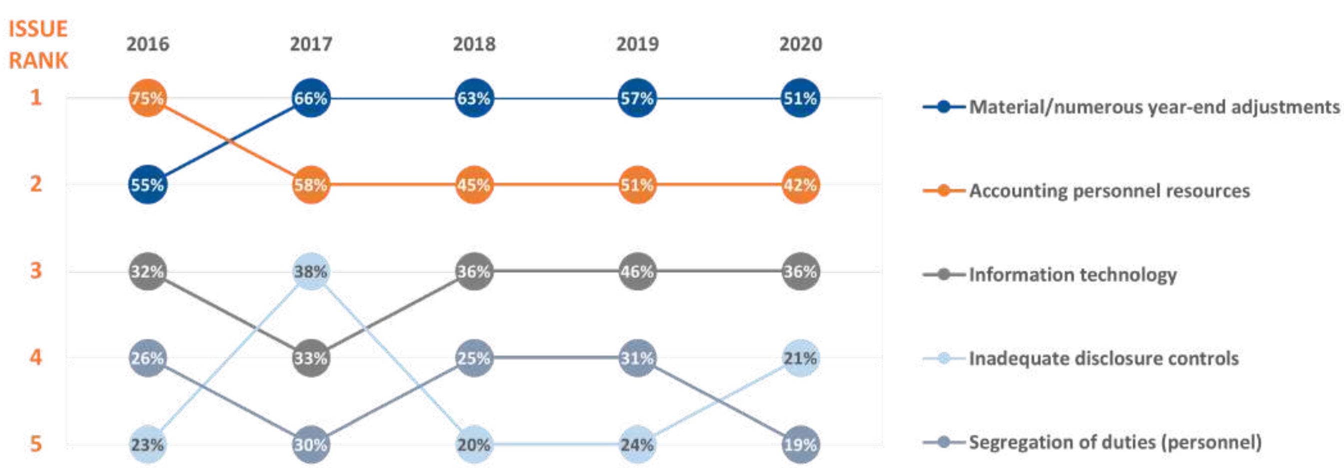
2020: Top 5 Internal Control Issues Cited in Adverse ICFR Assessments

	Issue	% of disclosures	# of disclosures
Auditor Attestations	**1.** Material/numerous year-end adjustments	50.7%	74
	2. Accounting personnel resources	42.5%	62
	3. Information technology	36.3%	53
	4. Inadequate disclosure controls	21.2%	31
	5. Segregation of duties (personnel)	19.2%	28

In adverse ICFR auditor attestations for the fiscal year 2020, the most common internal control issue that led to the conclusion that ICFR was ineffective was the need to make year-end adjustments. The second most common reason expressed by auditors was a need for more highly trained accounting personnel. These internal control issues are common, appearing as the top two issues in each of the last five years.

Top 5 Internal Control Issues Cited in Adverse ICFR Auditor Assessments

Rank based on percent of total disclosures referencing issue



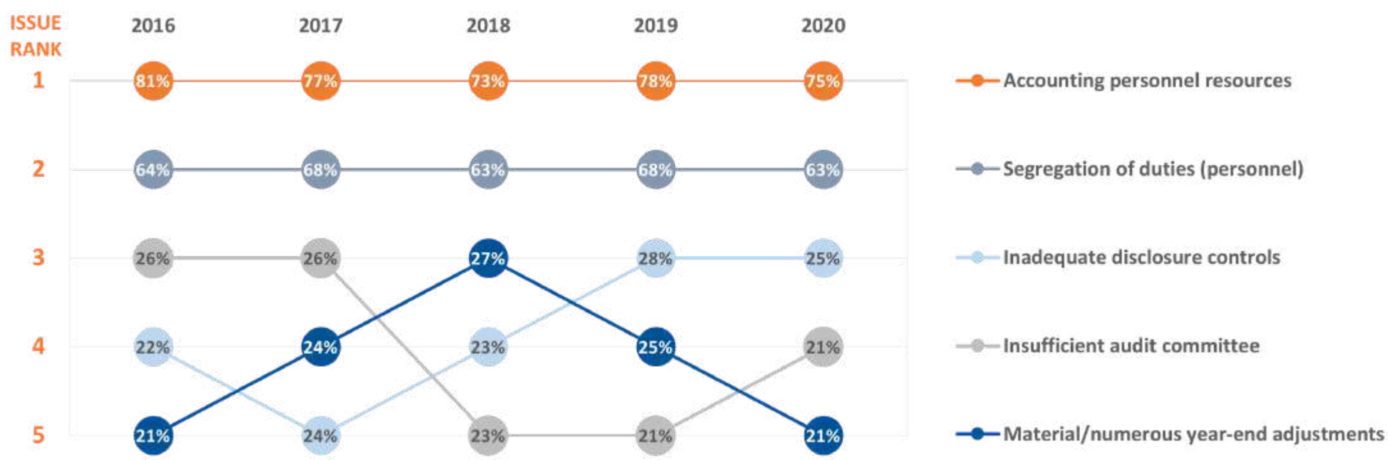
2020: Top 5 Internal Control Issues Cited in Adverse ICFR Assessments

	Issue	% of disclosures	# of disclosures
Management Reports	1. Accounting personnel resources	74.6%	991
	2. Segregation of duties (personnel)	63.2%	840
	3. Inadequate disclosure controls	25.4%	337
	4. Insufficient audit committee	20.9%	278
	5. Material/numerous year-end adjustments	20.7%	275

In adverse ICFR management reports for the fiscal year 2020, the most common internal control issue that led to the conclusion that ICFR was ineffective was a need for more highly trained accounting personnel. The second most common reason was related to segregation of duty issues associated with the design and use of personnel within an organization. These internal control issues are commonly cited in management reports, appearing as the top two issues in each of the last five years.

Top 5 Internal Control Issues Cited in Adverse ICFR Management Reports

Rank based on percent of total disclosures referencing issue



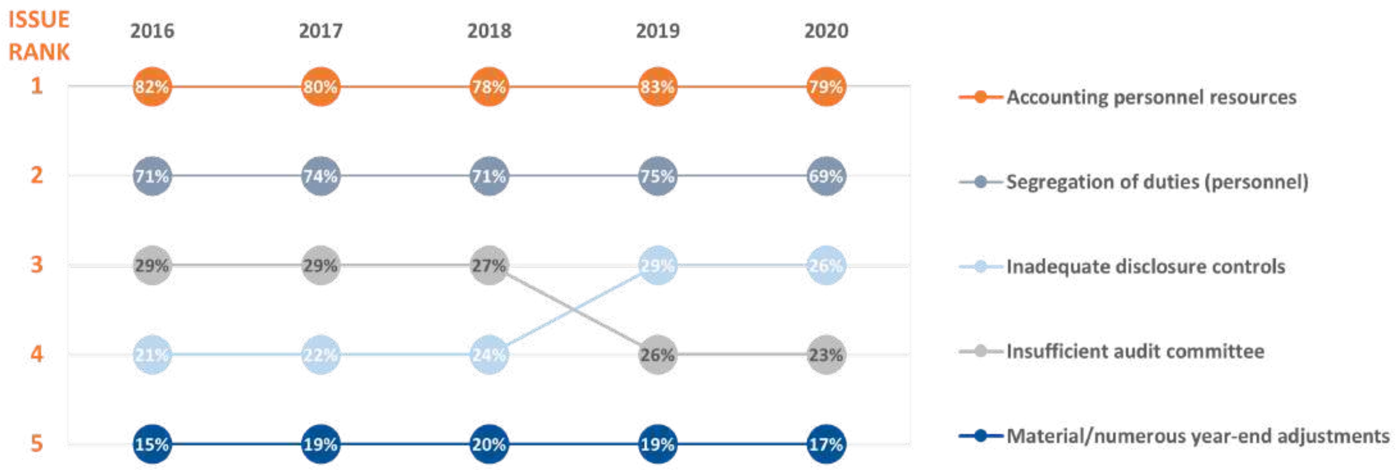
2020: Top 5 Internal Control Issues Cited in Adverse ICFR Assessments

	Issue	% of disclosures	# of disclosures
Management-Only Reports	**1.** Accounting personnel resources	78.5%	929
	2. Segregation of duties (personnel)	68.6%	812
	3. Inadequate disclosure controls	25.9%	306
	4. Insufficient audit committee	23.5%	278
	5. Material/numerous year-end adjustments	17.0%	201

In adverse ICFR management-only reports for fiscal year 2020, the two most common internal control issues that led to the conclusion that ICFR were ineffective was a need for more highly trained accounting personnel and segregation of duty issues. Management-only reports are primarily issued by smaller companies, potentially with less personnel overall and fewer resources to devote to accounting functions.

Top 5 Internal Control Issues Cited in Adverse ICFR Management-Only Reports

Rank based on percent of total disclosures referencing issue



Accounting Issues

Adverse internal control assessments include disclosures of the issues that caused, at least in part, the conclusion that a company's ICFR was ineffective. Audit Analytics classifies accounting issues as internal control weaknesses arising from GAAP/accounting failures.

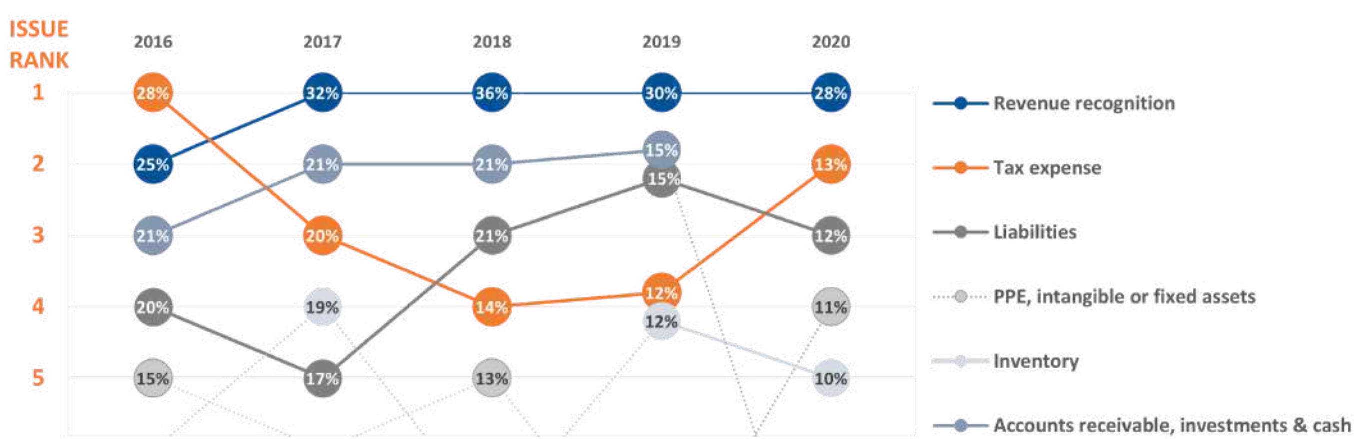
In adverse ICFR auditor attestations for the fiscal year 2020, the most common accounting issue that led to the conclusion that ICFR was not effective concerned revenue recognition. The second most common reason expressed by auditors was related to taxes. Taxes were the number one issue in 2016 but were less common between 2017-2019. Accounting issues related to PPE, intangible or fixed assets jumped in rank from eighth in 2019 to fourth in 2020. In a bigger jump, accounting issues related to the recording of debt and warrants identified in adverse ICFR auditor attestations went from being far outside the top five issues in the last five years to being the sixth most common issue in 2020.

2020: Top 5 Accounting Issues Cited in Adverse ICFR Assessments

	Issue	% of disclosures	# of disclosures
Auditor Attestations	**1.** Revenue recognition	28.1%	41
	2. Tax expense	13.0%	19
	3. Liabilities	11.6%	17
	4. PPE, intangible or fixed assets	11.0%	16
	5. Inventory	10.3%	15

Top 5 Accounting Issues Cited in Adverse ICFR Auditor Attestation

Rank based on percent of total disclosures referencing issue



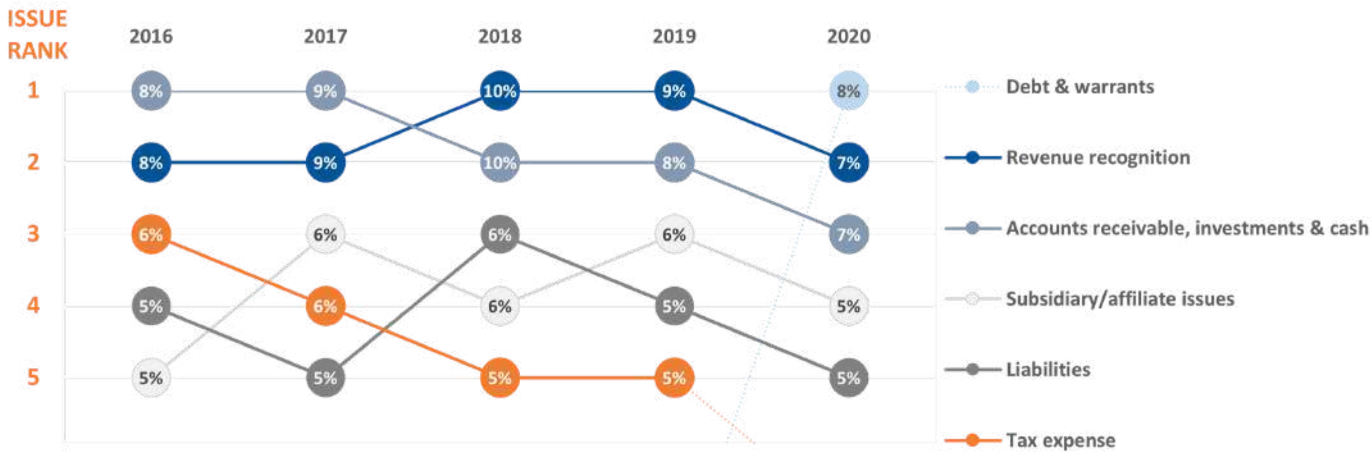
In adverse ICFR management reports for the fiscal year 2020, the most common accounting issue that led to the conclusion that ICFR was ineffective concerned the recording of debt/warrants/securities. This issue ranked fourth in 2015, but historically, the recording of debt and warrants was not a prevalent accounting issue cited in management reports with adverse ICFR.

2020: Top 5 Accounting Issues Cited in Adverse ICFR Assessments

	Issue	% of disclosures	# of disclosures
Management Reports	**1.** Debt & warrants	8.1%	108
	2. Revenue recognition	7.2%	96
	3. Accounts receivable, investments & cash	6.6%	88
	4. Subsidiary/affiliate issues	5.3%	71
	5. Liabilities	5.3%	70

Top 5 Accounting Issues Cited in Adverse ICFR Management Reports

Rank based on percent of total disclosures referencing issue



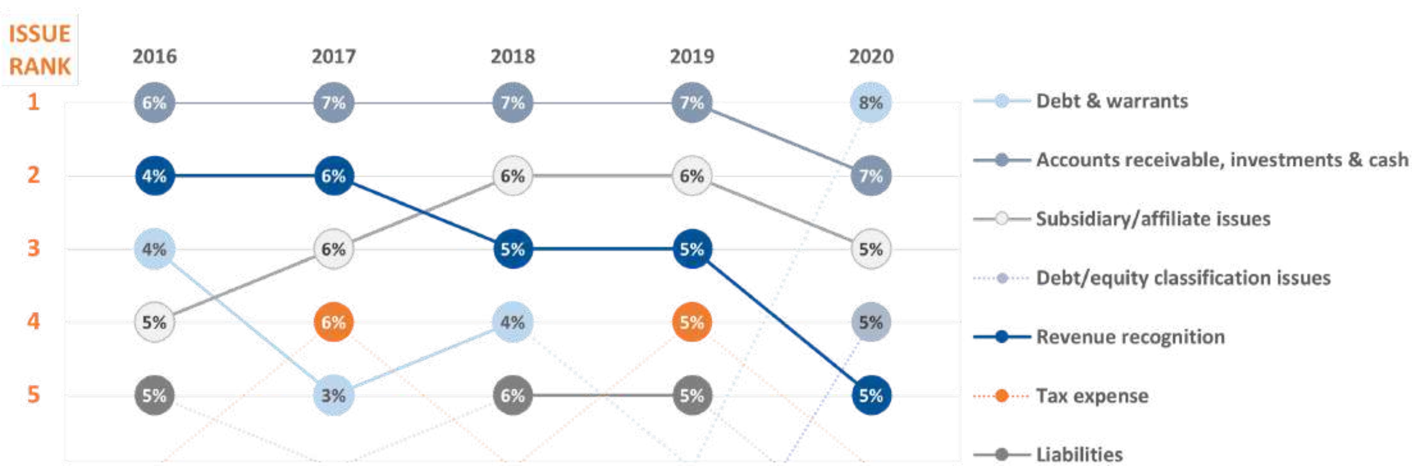
In adverse ICFR management-only reports for the fiscal year 2020, the most common accounting issue that led to the conclusion that ICFR was not effective concerned the recording of debt/warrants/securities. Accounting issues related to the recording of debt and warrants have been common in management-only reports over the last five years. Notably jumping in rank in 2020: accounting issues related to the proper classification of debt instruments.

2020: Top 5 Accounting Issues Cited in Adverse ICFR Assessments

	Issue	% of disclosures	# of disclosures
Management-Only Reports	**1.** Debt & warrants	7.9%	94
	2. Accounts receivable, investments & cash	6.6%	78
	3. Subsidiary/affiliate issues	5.2%	62
	4. Debt/equity classification issues	4.8%	57
	5. Revenue recognition	4.6%	55

Top 5 Accounting Issues Cited in Adverse ICFR Management-Only Reports

Rank based on percent of total disclosures referencing issue



TRENDS IN FIRST SOX 404 AUDITOR ATTESTATIONS AND MANAGEMENT REPORTS

Adverse ICFR in First Time Auditor Attestations

Fiscal Year	Total # of Auditor Attestations	# of Adverse ICFR in First Auditor Attestations	% of Adverse ICFR in First Auditor Attestations
2004	2,717	382	14.1%
2005	1,235	195	15.8%
2006	664	65	9.8%
2007	659	80	12.1%
2008	410	54	13.2%
2009	175	14	8.0%
2010	169	18	10.7%
2011	247	34	13.8%
2012	194	11	5.7%
2013	147	18	12.2%
2014	221	31	14.0%
2015	205	27	13.2%
2016	133	20	15.0%
2017	181	19	10.5%
2018	246	42	17.1%
2019	230	55	23.9%
2020	139	21	15.1%

As a company grows and begins to approach the accelerated filer threshold or exits a period of exemption, the auditor attestation provision in SOX 404(b) is triggered, bringing increased scrutiny from their independent auditor regarding the company's ICFR.

In every year since 2004, except for 2012, at least 10% of the companies filing their first auditor attestation disclosed a need to improve their ICFR. The percentage reached a high point of 23.9% in 2019 before dropping to 15.1% in 2020.

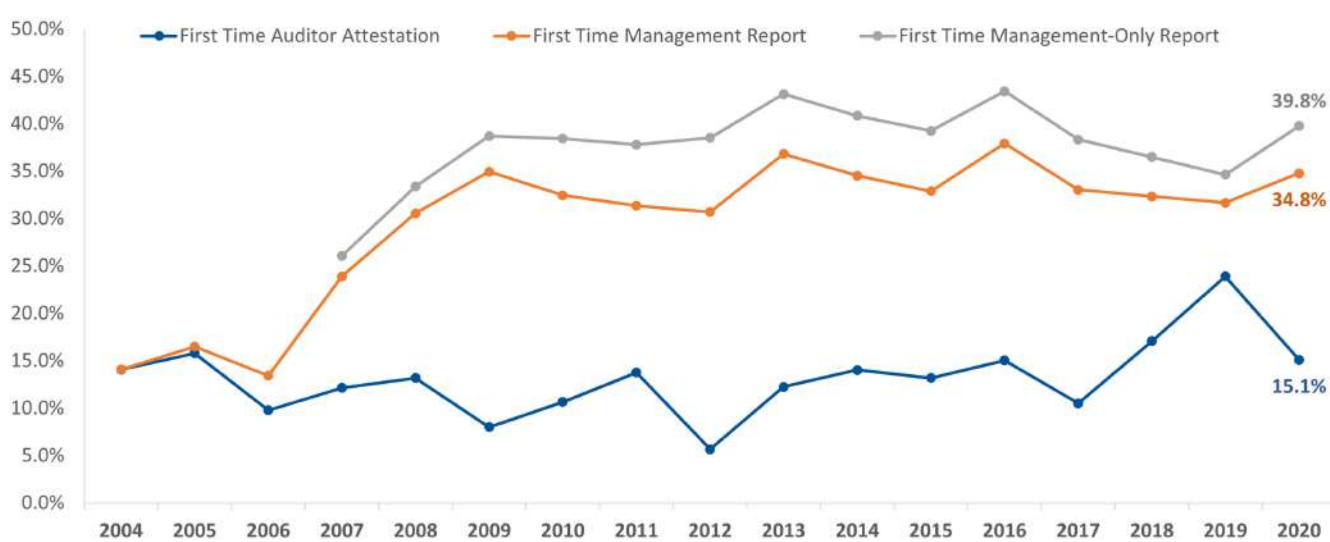
Companies that begin compliance with SOX 404(a) are required to file a first management report on ICFR. These companies are often small with fewer resources to devote to internal controls, contributing to overall higher percentages of ineffective ICFR in the first management assessment.

In contrast to the decrease noted in adverse first-time ICFR auditor attestations disclosed in 2020, there was an increase in adverse first-time ICFR management reports:

- In 2020, 34.8% of companies filing first-time management reports disclosed ineffective controls, up from 31.7% in 2019.
- Comparatively, 39.8% of first-time management-only reports cited ineffective controls in 2020, up from 34.6% in 2019.

Adverse First Time ICFR Assessments

Adverse ICFR assessments as a percentage of total first time disclosures



HISTORICAL TREND ANALYSES OF ADVERSE SOX 404(A) AND SOX 404(B) ASSESSMENTS

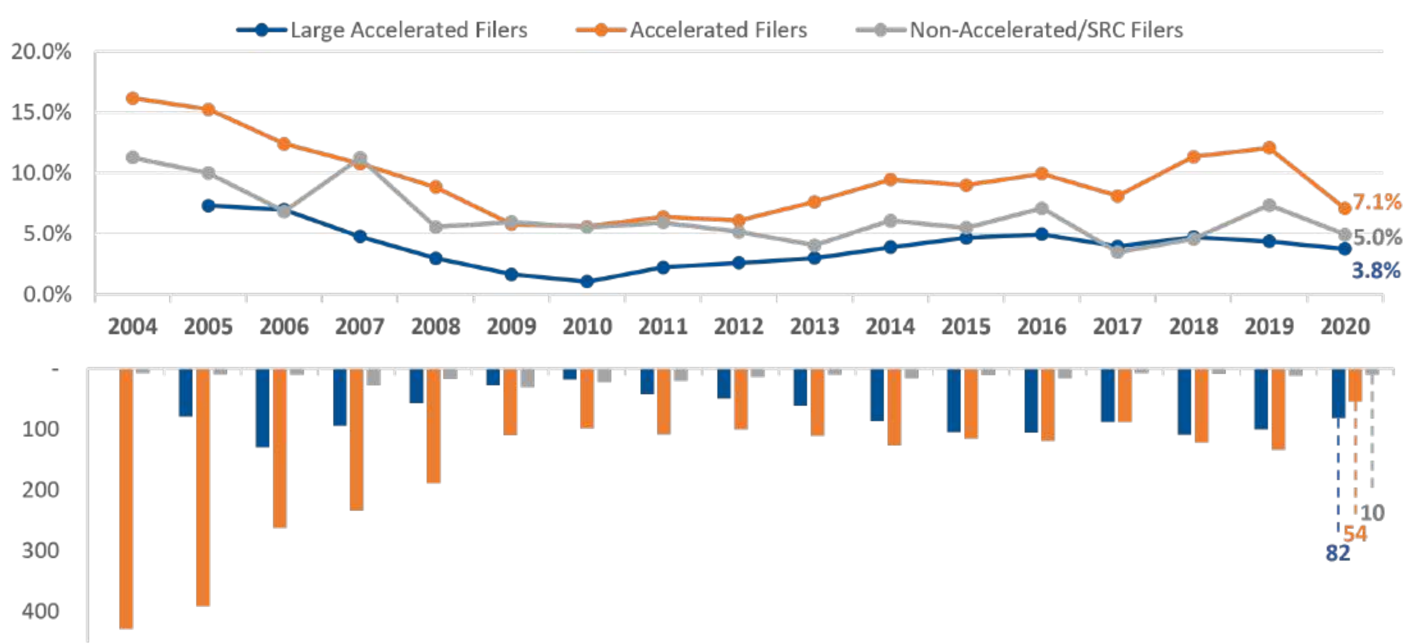
By Company Size

There are differences in SOX 404 requirements based on company filer status. Small companies identifying as a non-accelerated filer or smaller reporting company, or those identifying as an emerging growth company, are not required to file an auditor attestation under SOX 404(b) requirements and are therefore voluntarily filing an auditor attestation. Large accelerated and accelerated filers are required to provide an auditor attestation under SOX 404(b); therefore, larger companies issuing a management-only report are doing so under specific circumstances (i.e. as an emerging growth company exempt from SOX 404(b)).

**The designation of non-accelerated/smaller reporting company includes those companies that identify with the following statuses: non-accelerated filer and/or a smaller reporting company or did not disclose filer status.*

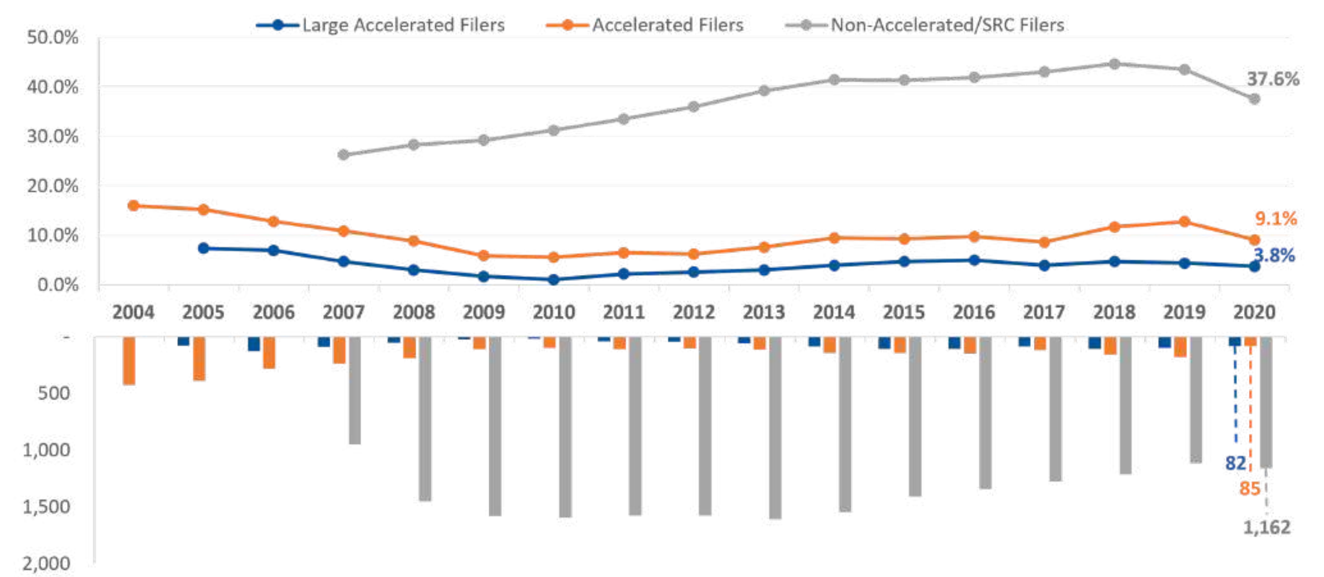
In a review of adverse ICFR auditor attestations, large accelerated filers historically have the lowest percentages of ineffective internal controls. This is unsurprising, as larger companies have more resources to devote to developing robust control systems. In 2020, 3.8% of auditor attestations for large accelerated filers identified ineffective controls, a slight decrease from the 4.4% observed in 2019. Accelerated filers have slightly higher percentages of adverse ICFR auditor attestations than large accelerated filers but generally have followed the same trends observed with large accelerated filers. In 2020, 7.1% of auditor attestations for accelerated filers identified ineffective controls, a decrease from the 12.1% observed in 2019.

Adverse ICFR Auditor Attestations, by Company Size



The percentage of adverse management ICFR reports decreased across all filer sizes in 2020. Ineffective controls identified in management ICFR reports are more common amongst non-accelerated filers and smaller companies due to small companies having fewer resources to devote to control systems. Up until 2019, the percentage of ineffective controls identified in SOX 404(a) ICFR management reports for non-accelerated and smaller reporting companies had been increasing. After a high point of 44.7% in 2018, the percentage of ineffective control assessments for smaller companies decreased to 37.6% in 2020.

Adverse ICFR Management Reports, by Company Size



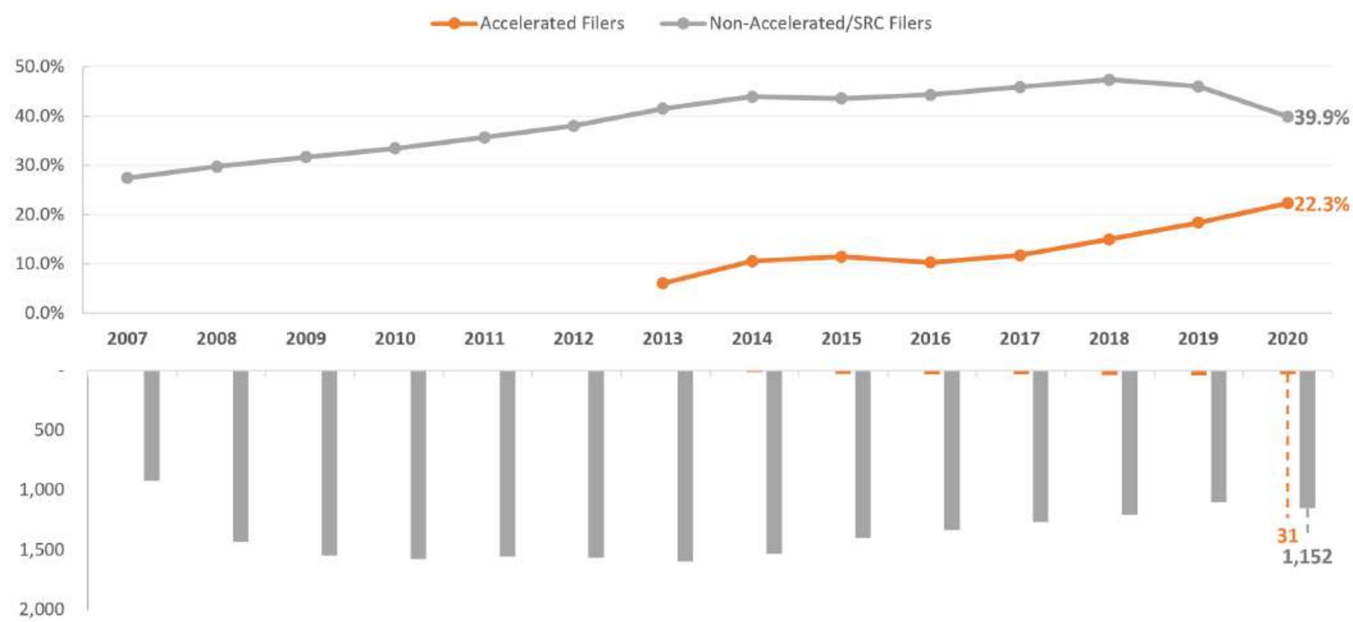
In 2020, the percentage of adverse SOX 404(a) ICFR management-only reports for non-accelerated and smaller reporting companies decreased to 39.9% in 2020, down from 43.6% in 2019. This partially relates to the filer status shifts that occurred in 2020. As previously mentioned, the SEC amended the accelerated filer definition, expanding the number of companies eligible to file disclosures as a non-accelerated filer.

As a company shifts from an accelerated filer requiring an auditor attestation to a non-accelerated filer only requiring a management report, they retain their controls that were previously reviewed and attested to by their independent auditor. This makes it more likely for those companies to disclose effective controls compared to other small companies.

Beginning in 2013, the 'emerging growth company' classification allowed certain accelerated filers an exemption from the auditor attestation requirement under SOX 404(b). This resulted in larger companies, that were qualified as accelerated filers with an emerging growth company classification, filing management-only reports on ICFR.

However, as previously mentioned, accelerated and large accelerated filers do not routinely provide management-only reports; fluctuations in the percent of adverse management-only reports for accelerated filers, therefore, must be viewed through the lens of a company's specific circumstances.

Adverse ICFR Management-Only Reports, by Company Size



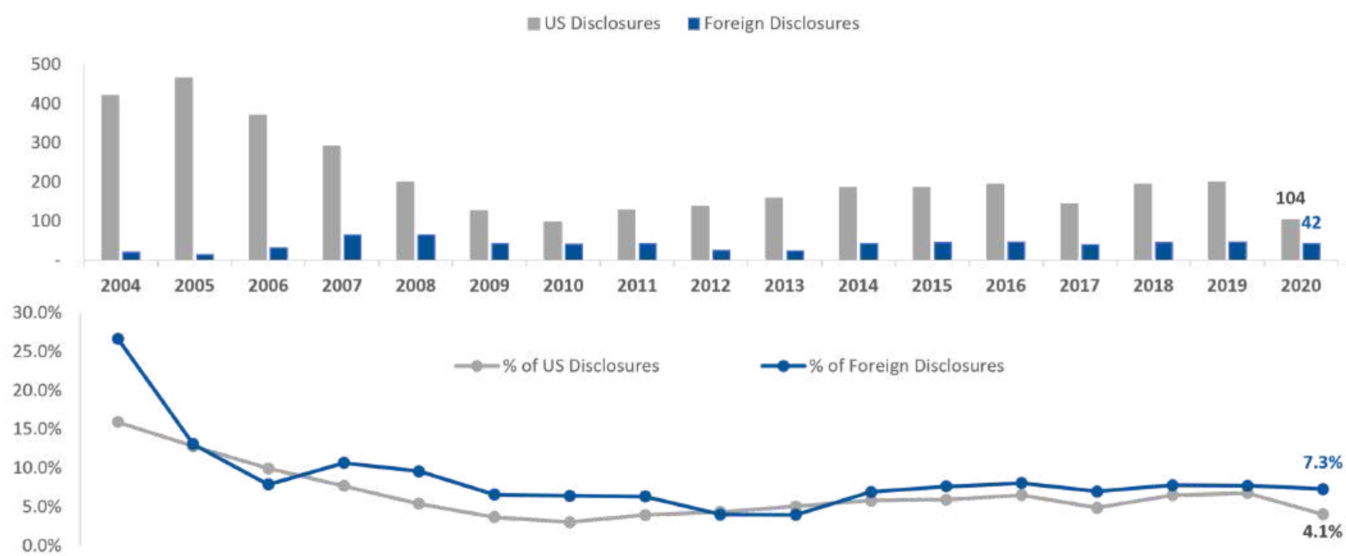
By Company Location

SOX 404 requirements were implemented on a staggered timeline based on company location. Large accelerated foreign filers came under SOX 404 (a) and (b) compliance as of July 15, 2006; accelerated foreign filers came under the SOX 404(a) ICFR management report requirement as of July 15, 2006, and the SOX 404(b) auditor attestation provision as of July 15, 2007.

Comparing ICFR auditor attestations across company location, 2020 saw a decrease in both the number and percent of ineffective internal control disclosures for both US and foreign companies. For US companies in 2020, 4.1% of auditor attestations (104 disclosures) disclosed an adverse assessment, a decrease from the 6.8% (200 disclosures) in 2019. For foreign companies in 2020, 7.3% of auditor attestations (42 disclosures) disclosed an adverse assessment, a decrease from the 7.7% (46 disclosures) in 2019.

Historically, foreign companies have a higher percentage of ineffective controls compared to US companies on an annual basis.

Adverse ICFR Auditor Attestations Reports, by Company Location

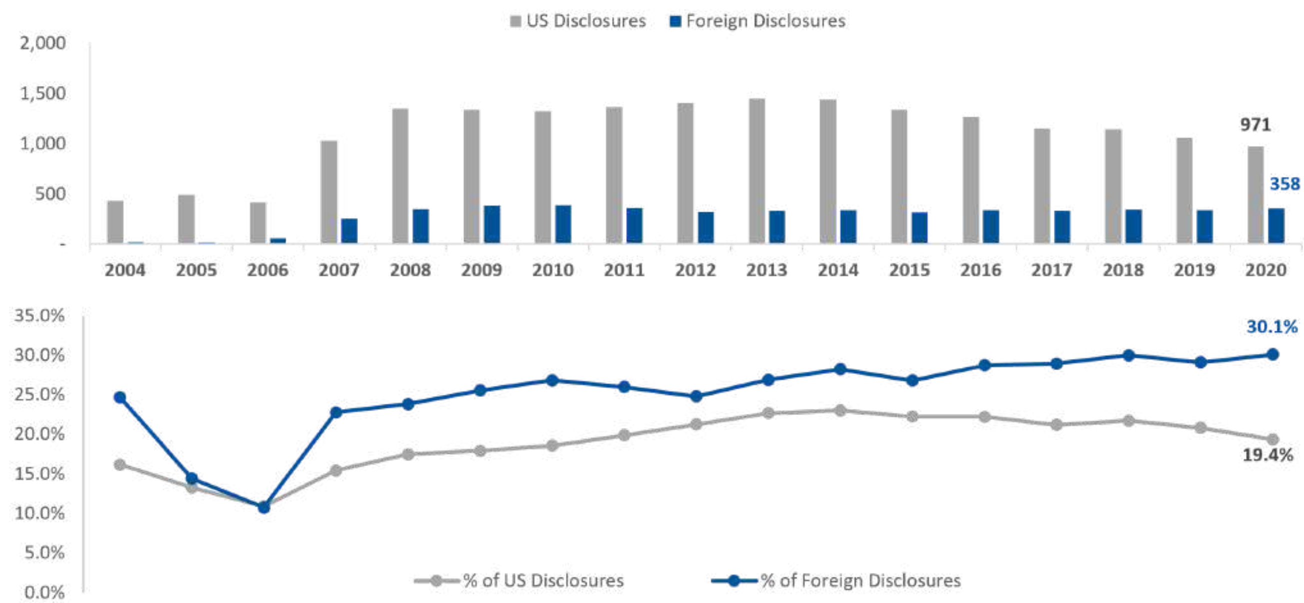


Comparing ICFR management reports across company location, 2020 saw a decrease in both the number and percent of ineffective internal control disclosures for US companies. In contrast, there was an increase in the number and percent of adverse attestations disclosed by foreign companies in 2020.

For US companies in 2020, 19.4% of management reports (971 disclosures) disclosed ineffective internal controls, a decrease from the 20.8% (1,057 disclosures) observed in 2019. For foreign companies in 2020, 30.1% (358 disclosures) disclosed an adverse assessment, a slight increase from the 29.1% (338 disclosures) observed in 2019.

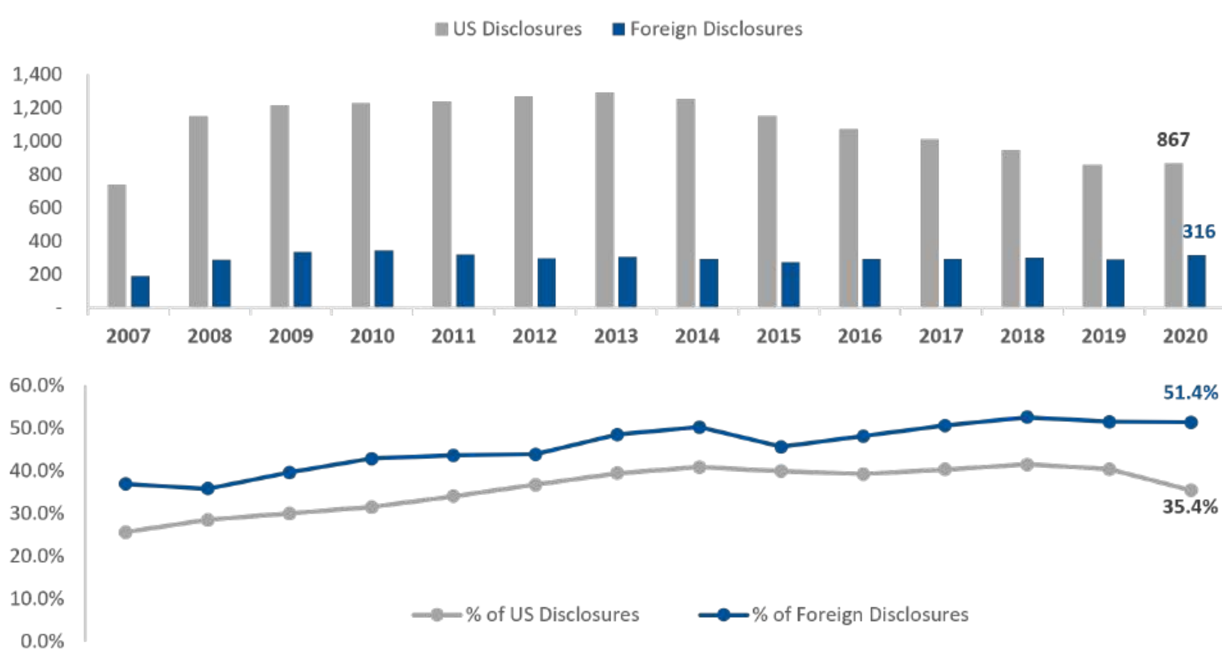
As with the historical trend observed in auditor attestations, the percentage of adverse internal control assessments is higher for foreign companies but follows the same trend as US companies.

Adverse ICFR Management Reports, by Company Location



Comparing ICFR management-only reports across company location, 2020 saw a decrease in both the number and percent of ineffective internal control disclosures for US companies. In contrast, there was an increase in the number of adverse ICFR disclosed in management-only reports by foreign companies in 2020, but a decrease in adverse reports as a percent of the total. For US companies in 2020, 35.4% of management-only reports (867 disclosures) disclosed ineffective internal controls, a decrease from the 40.2% (853 disclosures) observed in 2019. For foreign companies in 2020, 51.4% (316 disclosures) disclosed an adverse assessment, a slight decrease from the 51.5% (293 disclosures) observed in 2019.

Adverse ICFR Management-Only Reports, by Company Location

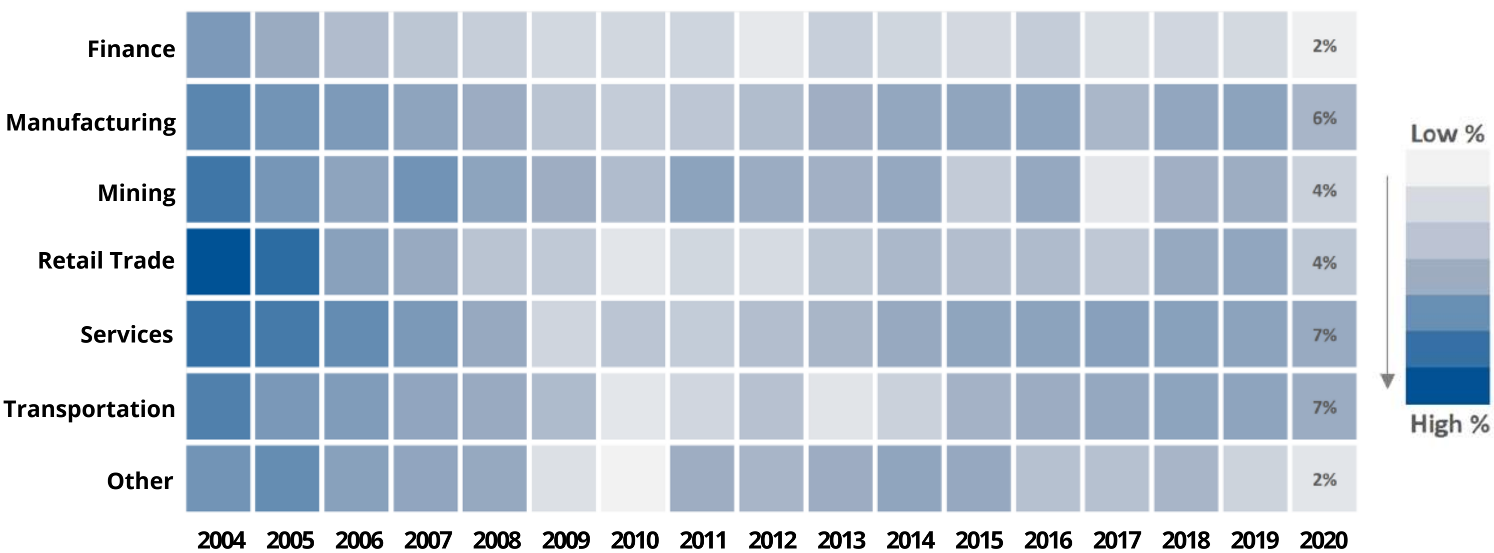


By Company Industry

Company industries are determined by SIC codes. The 'Other' category includes the following industries: Agriculture, Forestry, Fishing; Construction; and Wholesale Trade.

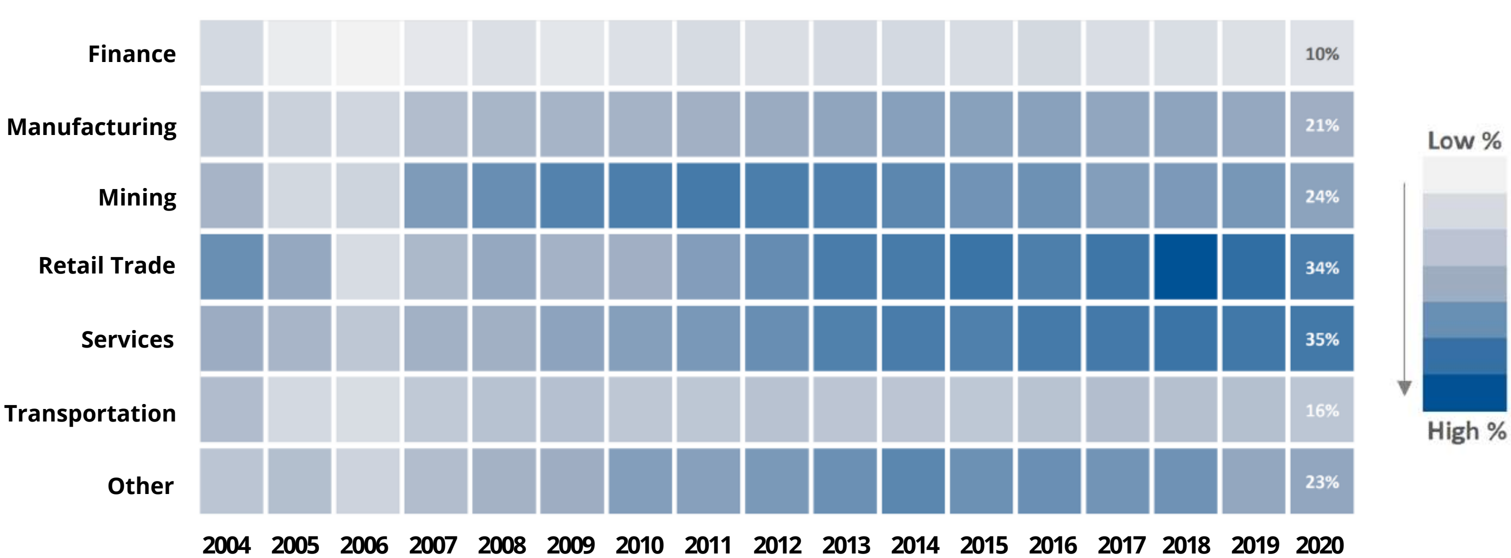
Comparing ICFR auditor attestations across industries, 2020 saw a decrease in the percent of ineffective internal control disclosures for all industries. The biggest decrease occurred in Retail Trade, with 4% of retail companies receiving an adverse ICFR auditor attestation in 2020, compared to 8% in 2019.

Adverse ICFR Auditor Attestations, by Industry

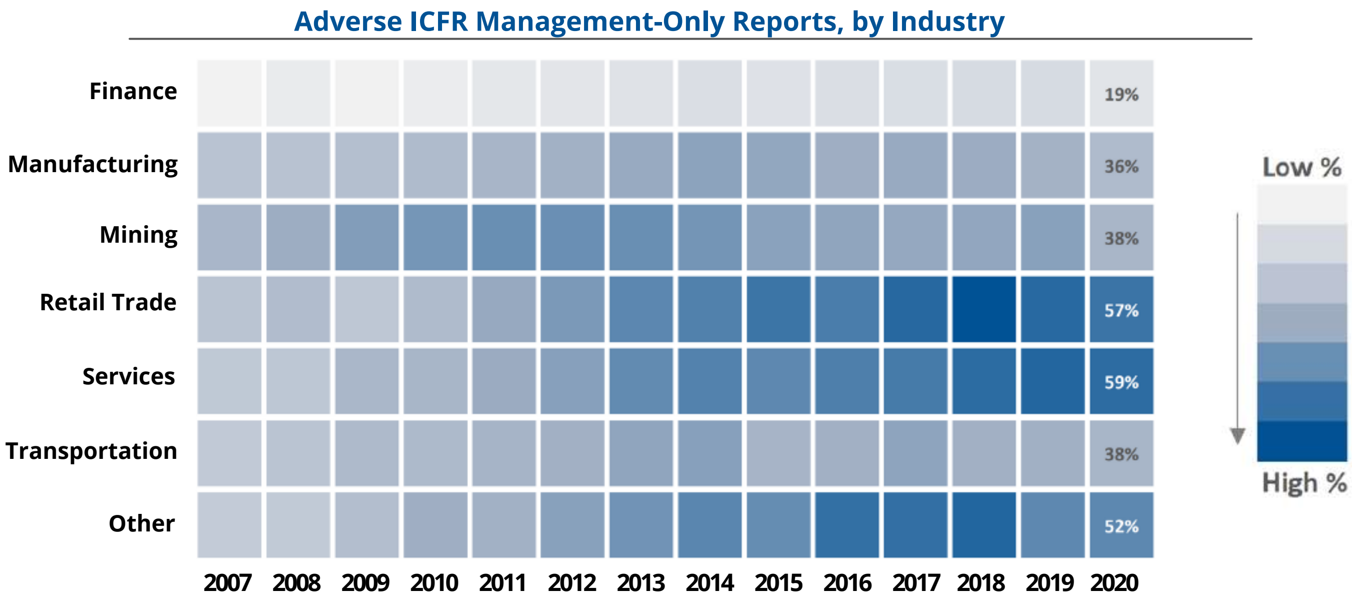


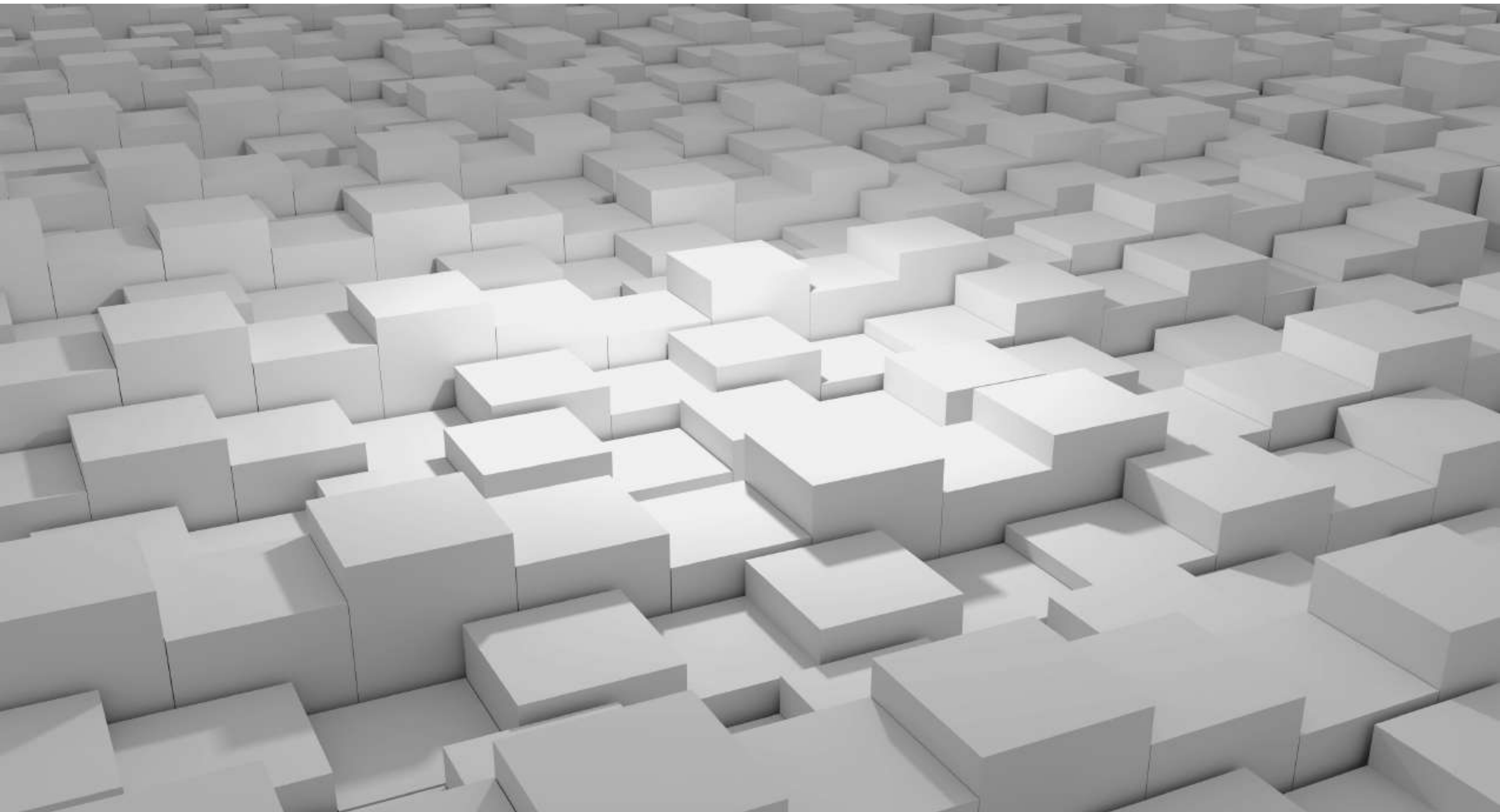
Comparing ICFR management reports across industries, there was a decrease in adverse reports in 2020 for the Manufacturing, Mining, Retail Trade, Services, and Transportation industries, while no change was observed in the Financial industry or the industries included in the Other category. Services and Retail Trade had the highest percentage of adverse reports, with 35% and 34%, respectively, and have historically struggled, more than other industries over the past decade, to maintain an effective system of controls.

Adverse ICFR Management Reports, by Industry



In a comparison of ICFR management-only reports across industries, one can see that there was a decrease in adverse reports in 2020 for all industries, except for industries included in the Other category, where no change is observed. Over half of management-only reports filed in the Retail Trade, Services, and Other industries have contained an adverse assessment in each year since 2014.





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