

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 210, 228, 229, 240 and 249**

**[RELEASE NOS. 33-8618; 34-52492; File Nos. S7-40-02; S7-06-03]**

**RIN 3235-AI66 and 3235-AI79**

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND CERTIFICATION OF DISCLOSURE IN EXCHANGE ACT PERIODIC REPORTS OF COMPANIES THAT ARE NOT ACCELERATED FILERS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule; extension of compliance dates; request for comment.

**SUMMARY:** We are extending the compliance dates that were published on March 8, 2005, in Release No. 33-8545 [70 FR 11528], for companies that are not accelerated filers, for certain amendments to Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, Items 308(a) and (b) of Regulations S-K and S-B, Item 15 of Form 20-F and General Instruction B of Form 40-F. These amendments require companies, other than registered investment companies, to include in their annual reports a report of management and accompanying auditor's report on the company's internal control over financial reporting. The amendments also require management to evaluate, as of the end of each fiscal period, any change in the company's internal control over financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting. We are also extending the compliance dates applicable to companies that are not accelerated filers for amendments to certain representations that must be included in the certifications required by Exchange Act Rules 13a-14 and 15d-14 regarding a company's internal

control over financial reporting. Finally, we are soliciting comment about the implementation of these rules.

**DATES:** Effective Date: The effective date published on June 18, 2003, in Release No. 33-8238 [68 FR 36636] remains August 14, 2003. The effective date of this document is [insert date of publication in the Federal Register].

Comment Date: Comments should be received on or before [insert date 30 days after publication in the Federal Register].

Compliance Dates: The compliance dates are extended as follows: A company that is not an accelerated filer must begin to comply with these requirements for its first fiscal year ending on or after July 15, 2007. Companies must begin to comply with the provisions of Exchange Act Rule 13a-15(d) or 15d-15(d), whichever applies, requiring an evaluation of changes to internal control over financial reporting requirements with respect to the company's first periodic report due after the first annual report that must include management's report on internal control over financial reporting.

In addition, during the extended compliance period, a company that is not an accelerated filer may continue to omit the amended portion of the introductory language in paragraph 4 of the certification required by Exchange Act Rules 13a-14(a) and 15d-14(a) that refers to the certifying officers' responsibility for establishing and maintaining internal control over financial reporting for the company, as well as paragraph 4(b). This language, however, must be provided in the first annual report required to contain management's internal control report and in all periodic reports filed thereafter. The extended compliance dates also apply to the amendments of Exchange Act Rules 13a-15(a) and 15d-15(a) relating to the maintenance of internal control over financial reporting. The compliance dates relating to accelerated filers and registered

investment companies published in Release No. 33-8392 [69 FR 9722] are not affected by this release.

While the definition of an accelerated filer in Exchange Act Rule 12b-2 previously has had applicability only for a foreign private issuer that files its Exchange Act periodic reports on Forms 10-K and 10-Q, the definition by its terms does not exclude foreign private issuers. As of December 1, 2005, a foreign private issuer that is an accelerated filer and files its annual report on Form 20-F will become subject to a requirement in new Item 4A of Form 20-F to disclose unresolved staff comments. This change was part of our recently adopted Securities Offering Reform final rules published in Release No. 33-8591 [70 FR 44722]. A foreign private issuer that is an accelerated filer under the Exchange Act Rule 12b-2 definition, and that files its annual reports on Form 20-F or Form 40-F, must begin to comply with the internal control over financial reporting and related requirements in the annual report for its first fiscal year ending on or after July 15, 2006. A foreign private issuer that is not an accelerated filer under the Exchange Act Rule 12b-2 definition must begin to comply in its annual report for its first fiscal year ending on or after July 15, 2007.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-06-03 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number S7-06-03. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Sean Harrison, Special Counsel, Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** On June 5, 2003,<sup>1</sup> the Commission adopted several amendments to its rules and forms implementing Section 404 of the Sarbanes-Oxley Act of 2002.<sup>2</sup> Among other things, these amendments require companies, other than registered investment companies, to include in their annual reports a report of management on the company's internal control over financial reporting and an accompanying auditor's report, and to evaluate, as of the end of each fiscal quarter, or year in the case of a foreign private issuer filing its annual report on Form 20-F or Form 40-F,<sup>3</sup> any change in the company's internal control over

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<sup>1</sup> See Release No. 33-8238 (June 5, 2003) [68 FR 36636].

<sup>2</sup> 15 U.S.C. 7262.

<sup>3</sup> 17 CFR 249.20f and 249.40f.

financial reporting that occurred during the period that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

On February 24, 2004, we approved an extension of the original compliance dates for the amendments related to internal control reporting.<sup>4</sup> Specifically, we extended the compliance dates for companies that are accelerated filers, as defined in Rule 12b-2<sup>5</sup> under the Securities Exchange Act of 1934,<sup>6</sup> to fiscal years ending on or after November 15, 2004, and for companies that are not accelerated filers and for foreign private issuers, to fiscal years ending on or after July 15, 2005. We believed that providing additional time for compliance was appropriate in light of both the substantial time and resources needed to properly implement the rules and to provide additional time for companies and their auditors to implement Auditing Standard No. 2, which set forth new standards for conducting an audit of internal control over financial reporting performed in conjunction with an audit of the financial statements.<sup>7</sup>

On March 2, 2005, we approved a further one-year extension of the compliance dates for companies that are not accelerated filers and for foreign private issuers filing annual reports on

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<sup>4</sup> See Release No. 33-8392 (February 24, 2004) [69 FR 9722].

<sup>5</sup> 17 CFR 240.12b-2. An "accelerated filer" means an issuer after it first meets the following conditions as of the end of its fiscal year: (i) the aggregate market value of the voting and non-voting common equity held by non-affiliates of the issuer is \$75 million or more; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use Forms 10-KSB and 10-QSB for its annual and quarterly reports. In a separate release that we are issuing today, we are proposing to add a definition of "large accelerated filer" to Exchange Act Rule 12b-2. If we adopt that proposal, the extension of compliance dates for internal control reports affected by this release would apply to companies, including foreign private issuers, that are neither accelerated filers nor large accelerated filers. See Release No. 33-8617 (September 22, 2005).

<sup>6</sup> 15 U.S.C. 78a *et. seq.*

<sup>7</sup> See Release No. 34-49884 File No. PCAOB 2004-03 (June 17, 2004) [69 FR 35083]. Auditing Standard No. 2 provides the professional standards and related performance guidance for independent auditors to attest to, and report on, the effectiveness of companies' internal control over financial reporting.

Form 20-F or 40-F.<sup>8</sup> In granting this relief, we noted that an extension was warranted, in part, in view of the significant effort being expended by many foreign private issuers to begin complying with new International Financial Reporting Standards.<sup>9</sup>

In addition, we thought it was appropriate to provide an additional extension for non-accelerated filers in recognition of other efforts in the market place that might affect the implementation of internal control reporting by smaller companies. For example, at the request of Commission staff, the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) established a task force to provide more guidance on how the COSO Internal Control-Integrated Framework (the “framework”)<sup>10</sup> can be applied to smaller public companies. Moreover, the Commission organized the Advisory Committee on Smaller Public Companies in March 2005 to examine the impact of the Sarbanes-Oxley Act and other federal securities laws on smaller companies.<sup>11</sup> These efforts were just commencing at the time we approved the extension.

Today we are again extending the dates for complying with our internal control over financial reporting requirements for companies, including foreign private issuers, that are not accelerated filers. The extended compliance period does not in any way alter requirements regarding internal control that are in effect, including, without limitation, Section 13(b)(2) of the

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<sup>8</sup> See Release No. 33-8545 (March 2, 2005) [70 FR 11528].

<sup>9</sup> In March 2004, we proposed amendments to Form 20-F under the Exchange Act to provide foreign private issuers a one-time accommodation relating to financial statements prepared under the International Financial Reporting Standards. These amendments were adopted in April 2005. See Release No. 34-49403 (March 11, 2004) [69 FR 12904] and Release No. 34-51535 (April 12, 2005) [70 FR 20674].

<sup>10</sup> Under Commission rules, a reporting company is required to use a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, such as the COSO Framework, to assess the effectiveness of the company’s internal control over financial reporting. See Exchange Act Rules 13a-15(c) and 15d-15(c) [17 CFR 240.13a-15(c) and 240.15d-15(c)].

<sup>11</sup> See SEC Press Release 2004-174 (December 16, 2004) and Release No. 33-8514 (December 16, 2004) [69 FR 76498]. The Advisory Committee held its first meeting on April 12, 2005.

Exchange Act<sup>12</sup> and the rules thereunder. In this regard, notwithstanding the deferral of the applicability of the specific requirements of our rules under Section 404 of the Sarbanes-Oxley Act (and also, as a result, the deferral of the applicability of Auditing Standard No. 2 of the Public Company Accounting Oversight Board), non-accelerated filers must continue to assess whether the company's internal accounting controls are sufficient to meet applicable requirements under federal securities laws, and we would expect that officers with responsibility for financial reporting and internal control and audit committees (or in the absence of audit committees, boards of directors) would continue to work together in this area. Moreover, independent auditors of non-accelerated filers must consider filers' internal accounting controls in connection with the conduct of audits of financial statements in accordance with the standards of the Public Company Accounting Oversight Board.<sup>13</sup>

The Commission, for good cause, finds that notice and solicitation of comment regarding extension of the compliance dates is impractical, unnecessary and contrary to the public interest.<sup>14</sup> First, comments regarding current requirements under Section 404, including comments provided at, and in connection with our Roundtable on Implementation of Internal Control Reporting Provisions held on April 13, 2005, raise issues as to whether a broadly accepted or demonstrably suitable framework is currently in place for evaluating internal control at smaller public companies, including non-accelerated filers. As stated above, the Commission

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<sup>12</sup> 15 U.S.C. 78m(b)(2).

<sup>13</sup> See Auditing Standards Board, AICPA, Statement on Auditing Standards No. 78, Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55 (1995), adopted by the PCAOB in Rule 3200T, Interim Auditing Standards, and as amended by the PCAOB on September 15, 2004 in Conforming Amendments to PCAOB Interim Standards Resulting From the Adoption of PCAOB Auditing Standard No. 2, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements."

<sup>14</sup> See Section 553(b)(3)(B) of the Administrative Procedure Act [5 U.S.C. 553(b)(3)(B)] (stating that an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impracticable, unnecessary, or contrary to the public interest.").

staff has sought an enhanced framework for smaller public companies, including by calling on COSO to evaluate its existing framework and possible adjustments, modifications or supplemental guidance for smaller public companies.

We believe that the COSO task force has devoted significant time and effort to this matter and appreciate their contribution in an important area. We also believe, however, that the task has proven challenging and more time-consuming than anticipated. The COSO task force has indicated to the Commission staff that it is approaching the point when an exposure draft will be made available for public comment. Any conclusions are a number of months away.

Second, by that time, significant work will have been done, and significant expenses incurred, by many non-accelerated filers to comply with the existing requirement for their first fiscal year ending on or after July 15, 2006, unless the current compliance date is extended. We believe that only an immediate deferral of the current compliance date can forestall that result. Due to the significant costs that smaller companies are likely to incur to prepare for initial compliance with the internal control requirements, we think that it is critical to make the extension effective as soon as possible so that they have the certainty of knowing that they can rely on it. We believe that many smaller companies already have begun to prepare for compliance with the internal reporting control requirements.<sup>15</sup>

In addition, the Advisory Committee on Smaller Public Companies continues to study the internal control over financial reporting requirements for smaller public companies and is

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<sup>15</sup> See, for example, the statement of William A. Loving, Jr., Executive Vice President and Chief Executive Officer of Pendleton County Bank that he submitted on behalf of the Independent Community Bankers of America. In his statement, Mr. Loving indicated that his bank already has spent approximately \$40,000 in consultancy and outside vendor costs, \$10,000 in training and education, and 160 staff hours to comply with Sarbanes-Oxley Act requirements. It anticipated incurring an additional 1,600 staff hours to prepare for compliance with the internal control requirements. Mr. Loving estimated the costs of the testing alone to be \$50,000, not including internal staffing costs and additional external audit costs. Mr. Loving's statement is available at: <http://www.sec.gov/rules/other/265-23/icba060805.pdf>.

scheduled to complete its work by April 2006. In the interim, the Advisory Committee recently has recommended that the Commission further extend the compliance date for companies that are not accelerated filers.<sup>16</sup>

The Commission further notes that many accelerated filers who became subject to the internal control over financial reporting requirements for the first time this year had difficulty filing their Form 10-K annual reports on time.<sup>17</sup> Moreover, several of the responses that we received from accelerated filers in connection with our internal control roundtable indicated that many of the costs that they incurred in the initial year of compliance would not be recurring costs; they expected the internal control reporting process to become more efficient and less costly in subsequent years. Companies that are not accelerated filers may be able to benefit from the experiences of accelerated filers in the second year of compliance with the internal control reporting requirements as best practices emerge and increased efficiencies are realized. Finally, the Commission notes that the overwhelming majority of market capitalization of U.S. public companies is subject to our requirements under Section 404 notwithstanding this deferral. On the basis of the foregoing, for good cause and because the extension will relieve a restriction, the extension will be effective on [insert date of publication in the Federal Register].

To assist us in our ongoing consideration of Section 404 of the Sarbanes-Oxley Act in the context of smaller public companies, we are including a list of questions below to solicit public comment on some substantive issues regarding the application of our internal control over

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<sup>16</sup> On August 10, 2005, the Advisory Committee adopted a resolution recommending that the Commission extend the compliance dates of the internal control reporting requirements for companies that are not accelerated filers. The Advisory Committee is of the opinion that there is overall consensus and widely-held support for its recommendation and suggested that we implement it as soon as possible. See The Advisory Committee's Letter to Securities and Exchange Commission Chairman Christopher Cox, dated August 18, 2005.

<sup>17</sup> During the first 11 months of the Commission's current fiscal year which ends on September 30, 2005, we received 2,320 notifications of late Form 10-K filings on Form 12b-25. This represented a 13% increase over the total number of similar notifications that we received during all of our 2004 fiscal year.

financial reporting requirements to these companies. We also are soliciting public comment on the amount of time and expense that companies that are not accelerated filers have incurred to date to prepare for compliance with the internal control reporting requirements. These comments will assist us in any future proposals regarding our rules under Section 404. We would expect to provide formal notice and an additional opportunity for public comment on any such proposals.

In this regard, we note that the Advisory Committee recently also has solicited public input on a range of issues related to the current securities regulatory system for smaller companies, including the impact on smaller public companies of the internal control reporting requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002. In formulating any possible proposed revisions to the internal control reporting requirements that would affect smaller reporting companies, we intend to consider relevant recommendations made to the Commission by the Advisory Committee.

**Request for Comment:**

- Should there be a different set of internal control over financial reporting requirements that applies to smaller companies than applies to larger companies? Would it be appropriate to apply a different set of substantive requirements to non-accelerated filers, or for management of non-accelerated filers to make a different kind of assessment? Why or why not? If you think that there should be a different set of requirements for companies that are not accelerated filers, what should those requirements be? What would be the impact of any such differences in the requirements on investors?
- Would a public float threshold that is higher or lower than the \$75 million threshold that we use to distinguish accelerated filers from non-accelerated filers be more appropriate for this purpose? If so, what should the threshold be and why? Would it be better to use

a test other than public float for this purpose, such as annual revenues, number of segments or number of locations or operations? If so, why?

- Should the independent auditor attestation requirement be different for smaller public companies? If so, how should the requirements differ?
- Should the same standard for auditing internal control over financial reporting apply to auditors of all public companies, or should there be different standards based on the size of the public company whose internal control is being audited? If the latter, how should the standards differ?
- How can we best assure that the costs of the internal control over financial reporting requirements imposed on smaller public companies are commensurate with the benefits?
- We solicit comment describing the actions that non-accelerated filers already have taken to prepare for compliance with the internal control over financial reporting requirements. Specific time and cost estimates would be particularly helpful. We also would be interested in receiving additional information about the compliance burdens incurred this year by smaller accelerated filers that included internal control reports in their Form 10-K annual reports.

By the Commission.

Jonathan G. Katz  
Secretary

September 22, 2005