

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-63108; File No. S7-29-10]

Study Required by Section 989G(b) of the Dodd-Frank Act Regarding Compliance with Section 404(b) of the Sarbanes-Oxley Act

AGENCY: Securities and Exchange Commission.

ACTION: Request for comment.

SUMMARY: The Securities and Exchange Commission is requesting public comment related to a study of how the Commission could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 for companies whose public float is between \$75 million and \$250 million, while maintaining investor protections for such companies, and whether any methods of reducing the compliance burden or a complete exemption for such companies from the auditor attestation requirement in Section 404(b) would encourage companies to list on exchanges in the United States in their initial public offerings. This study is required by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

DATES: Comments should be received on or before December 6, 2010.

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. Please include File Number S7-29-10 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number S7-29-10. 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>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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: John Offenbacher, Senior Associate Chief Accountant, or Jason Plourde, Professional Accounting Fellow, Office of the Chief Accountant, at (202) 551-5300, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

DISCUSSION:

Under Section 989G(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act),¹ the Commission is required to conduct a study to determine how the Commission could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act of 2002 (Section 404(b))² for companies whose market capitalization is between \$75 million and \$250 million, while maintaining investor protections for such companies. Section 989G(b)

¹ Pub. L. No. 111-203 (July 21, 2010).

² 15 U.S.C. 7201 et seq.

of the Dodd-Frank Act also provides that the study must 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.

The Dodd-Frank Act does not define “market capitalization” and it is not defined in Commission rules. For purposes of the study, we believe that public float is an appropriate measure of market capitalization. Public float, which is the aggregate worldwide market value of an issuer’s voting and non-voting common equity held by its non-affiliates, is the measure used in Commission rules for determining “accelerated filer” and “large accelerated filer” status.³ The Commission has used public float historically in its actions to phase issuers into Section 404 compliance,⁴ and Section 404(c) of the Sarbanes-Oxley Act of 2002, as amended by Section 989G(a) of the Dodd-Frank Act, provides that Section 404(b) shall not apply with respect to issuers that are neither an “accelerated filer” nor a “large accelerated filer” pursuant to Commission rules, which are generally issuers with a public float below \$75 million. We therefore believe it would be consistent to use public float between \$75 million and \$250 million to describe the group of issuers that are the subject of the study. For the remainder of the release, we generally will refer to issuers with a public float between \$75 million and \$250 million as the “subject issuers.”

In addition, Section 404(b) only addresses the auditor attestation requirement with respect to a company’s internal control over financial reporting. The required study will not evaluate the

³ See Exchange Act Rule 12b-2 [17 CFR 240.12b-2].

⁴ See, e.g., Release No. 33-9072 (Oct. 13, 2009) [74 FR 53628]; and Release 33-8934 (June 26, 2008) [73 FR 38094].

compliance burden of Section 404(a) of the Sarbanes-Oxley Act of 2002, which addresses management's responsibility for reporting on the effectiveness of internal control over financial reporting.

The Commission is required to submit a report of this study to Congress no later than nine months after the date of enactment of the Dodd-Frank Act. All interested parties are invited to submit their views, in writing, on any of the following topics in which they are interested:

- (1) quantitative and qualitative information about the trends of internal and external costs of having an external auditor attest to management's assessment under Section 404(b) for issuers with a public float between \$75 million and \$250 million from the first year of required compliance to the present;
- (2) current cost of auditor attestation under Section 404(b) in relation to overall cost of compliance with all of Section 404 (i.e. including management's assessment required by Section 404(a)) and changes to this relative cost over time;
- (3) characteristics of internal controls, management's evaluation process and corporate governance of subject issuers that distinguish them from other issuers;
- (4) unique audit planning and performance characteristics, if any, associated with subject issuers;
- (5) incremental effort for preparers and auditors to comply with the auditor attestation requirement of Section 404(b) for an integrated audit beyond the efforts that would already be incurred to comply with the requirements for a financial statement only audit, including the requirement to evaluate internal controls in connection with such an audit, for subject issuers;

- (6) whether and how initiatives of the Commission, such as the Commission Guidance Regarding Management’s Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934,⁵ have reduced the burden of complying with Section 404(b) for subject issuers;
- (7) whether and how any aspects of Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 5,⁶ such as its focus on risk and materiality, scalability, tailoring of testing to risk, and extent of permitted use of the work of others, have reduced costs of compliance with Section 404(b) versus PCAOB Auditing Standard No. 2 for subject issuers;
- (8) whether and how other initiatives of the PCAOB, such as its staff guidance for auditors of smaller public companies,⁷ have reduced the burden of complying with Section 404(b) for subject issuers;
- (9) whether and how initiatives of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), such as the June 2006 guidance for smaller public companies on internal control over financial reporting,⁸ and the January 2009 Guidance on Monitoring Internal Control Systems,⁹ have reduced the burden of complying with Section 404(b) for subject issuers;

⁵ See Release No. 33-8810 (June 20, 2007) [72 FR 35324].

⁶ See Order Approving Proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements, a Related Independence Rule, and Conforming Amendments, Release No. 34-56152 (July 27, 2007) [72 FR 42141].

⁷ See “Staff Views - An Audit of Internal Control that is Integrated with an Audit of the Financial Statements: Guidance for Auditors of Smaller Public Companies” (Jan. 23, 2009), available at www.pcaobus.org.

⁸ For further information, see www.coso.org/ICFR-GuidanceforSPCs.htm.

⁹ For further information, see www.coso.org/GuidanceonMonitoring.htm.

- (10) whether and how initiatives of any other organization have reduced the burden of complying with Section 404(b) for subject issuers;
- (11) the possibility that guidance or rules issued by the Commission, PCAOB or others could further reduce the burden of complying with the auditor attestation requirement of Section 404(b), while maintaining investor protection, for subject issuers, and any specific recommendations concerning any such guidance or rules;
- (12) the impact on investor protection, investor confidence, and the cost of capital arising from the establishment and ongoing compliance with Section 404(b) by subject issuers, including in the context of initial public offerings;
- (13) the degree to which investor protection, investor confidence, and the cost of capital would increase or decrease, if any, as a function of each specific recommendation by which the Commission, the PCAOB, or others might reduce the burden of complying with Section 404(b) for subject issuers, while maintaining investor protection;
- (14) the impact of costs of complying with the auditor attestation requirement of Section 404(b) on company decisions to list on exchanges in the United States versus foreign exchanges in initial public offerings for subject issuers after the offering;
- (15) the impact of costs of complying with Section 404(b) on company and investor decisions to engage in initial public offerings versus other financing alternatives for issuers whose public float is expected to be between \$75 million and \$250 million after the offering;

- (16) potential effect on the number of companies listing initial public offerings in the United States of a complete exemption from the internal control audit requirements for subject issuers, and the potential effect on listings for each specific recommendation for reducing the compliance burden of such requirements on subject issuers;
- (17) any qualitative differences between subject issuers that might list securities on a U.S. exchange in connection with their initial public offerings if the existing internal control audit requirement of Section 404(b) remains in effect and subject issuers that might list securities on a U.S. exchange in connection with their initial public offerings if subject issuers are completely exempt from the internal control audit requirements of Section 404(b), and any such qualitative differences that may arise from each specific recommendation for reducing the compliance burden of such requirements on subject issuers;
- (18) the potential effect of a complete exemption from Section 404(b) for subject issuers on matters such as: raising capital; engaging in mergers, acquisitions and similar corporate transactions; and attracting and retaining qualified independent directors;
- (19) whether and how the use of the auditor's attestation report on internal control over financial reporting for subject issuers differs from the use of the auditor's attestation report on internal control over financial reporting for issuers whose public float is greater than \$250 million and the reason(s) for those differences;

- (20) quantitative and qualitative information about whether and how compliance with Section 404(b) has benefited investors and other users of financial statements of subject issuers;
- (21) whether and to what extent auditor attestation reports on internal control over financial reporting enhances confidence in management's assessment of the effectiveness of its internal control over financial reporting, improves the reliability of financial reporting and improves the prevention and detection of fraud and other misconduct for subject issuers;
- (22) any additional information for the Commission to consider to describe the study population and how the Commission could reduce the burden of complying with Section 404(b) on that population; and
- (23) any other information commenters would like the Commission to consider in regards to the study.

By the Commission.

Elizabeth M. Murphy
Secretary

Dated: October 14, 2010