

## Section 404 Compliance Deadlines Postponed for Certain Issuers

*August 15, 2006*

On August 9, 2006, the Securities and Exchange Commission took additional steps to make it easier for foreign private issuers and smaller and newly public companies to meet their compliance obligations under Section 404 of the Sarbanes-Oxley Act. The SEC's latest action with respect to Section 404 compliance is contained in two separate releases, the first reflecting the adoption of new provisions extending Section 404 compliance deadlines for foreign private issuers that are not large accelerated filers<sup>1</sup> and the second proposing of a further postponement of Section 404 compliance deadlines for smaller and newly public companies.<sup>2</sup>

This latest action by the SEC with regard to Section 404 is part of the SEC's continuing efforts to lessen the much publicized burdens associated with Section 404 compliance. The SEC believes that postponing the Section 404 compliance deadlines for certain filers will allow such filers to benefit from guidance the SEC plans to issue following the receipt of public comments in response to its Concept Release Concerning Management's Reports on Internal Control Over Financial Reporting<sup>3</sup>, from recently issued guidance from the Committee of Sponsoring Organizations (COSO) as to the application of its internal control framework and from likely revisions to Auditing Standard No. 2 and particular guidance applicable to auditors of smaller public companies from the Public Company Accounting Oversight Board (PCAOB). The SEC also indicated that the postponement is intended to enable foreign private issuers (other than large accelerated filers) to defer compliance until after the issuance of its final revamped rules regarding deregistration by foreign private issuers, which rules the SEC now expects to issue in early fall of this year.

### **BACKGROUND**

Section 404(a) requires that a filer's annual report include a report by management regarding the effectiveness of the filer's internal control over financial reporting, and Section 404(b) requires that the annual report include a corresponding auditor's attestation to management's assessment of the effectiveness of the filer's internal control over financial reporting. Accelerated filers and large

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<sup>1</sup> See Rule Release No. 33-8730A (August 9, 2006) at <http://www.sec.gov/rules/final/2006/33-8730a.pdf>.

<sup>2</sup> See Rule Release No. 33-8731 (August 9, 2006) at <http://www.sec.gov/rules/proposed/2006/33-8731.pdf>.

<sup>3</sup> See Rule Release No. 34-54122 (July 11, 2006) at <http://www.sec.gov/rules/concept/2006/34-54122.pdf>.

accelerated filers<sup>4</sup> (other than foreign private issuers) have been required to comply with Section 404 in their annual reports for fiscal years ending on or after November 15, 2004. Prior to the SEC's rule changes, foreign private issuers with a public float of \$75 million or more would have been required to comply with Section 404 in their annual reports for fiscal years ending on or after July 15, 2006. Under current rules, companies (including foreign private issuers) with a public float of less than \$75 million, referred to as non-accelerated filers, would have been required to comply with Section 404 in their annual reports for fiscal years ending on or after July 15, 2007.

#### COMPLIANCE DEADLINE EXTENSION FOR CERTAIN FOREIGN PRIVATE ISSUERS

Pursuant to the new rule adopted by the SEC, the deadline applicable to foreign private issuers that are not large accelerated filers for compliance with the Section 404(b) auditor attestation requirement has been extended for an additional year. Accordingly, a foreign private issuer with a public float of at least \$75 million but less than \$700 million will now be required to provide an auditor attestation report in its annual report on Form 20-F or Form 40-F for its first fiscal year ending on or after July 15, 2007 (rather than the first fiscal year ending on or after July 15, 2006). Because the SEC's new rule only extends the Section 404(b) compliance deadline for foreign private issuers that are accelerated filers, such filers must include the Section 404(a) report containing management's assessment of the effectiveness of internal controls over financial reporting, but not the Section 404(b) auditor's attestation report, in their first annual reports for fiscal years ending on or after July 15, 2006. In the companion release proposing Section 404 compliance deadline extensions for non-accelerated filers, the SEC proposed that, during the first year of compliance, a filer including a management's assessment report in any annual report that does not include an auditor's attestation report be permitted to "furnish" rather than "file" such management's assessment report. If this proposal is adopted with respect to non-accelerated filers, the SEC will afford similar relief to accelerated filer foreign private issuers during their first year of compliance. There is no change to the Section 404 compliance obligations of foreign private issuers that are large accelerated filers. Such filers must still comply with both Section 404(a) and Section 404(b) in their first annual reports for fiscal years ending on or after July 15, 2006.

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<sup>4</sup> An accelerated filer is an issuer that meets the following conditions at the end of its fiscal year: (i) the aggregate market value of the voting and non-voting and non-voting common equity held by non-affiliates of the issuer is \$75 million or more, but less than \$700 million, as of the last day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to reporting requirements under the Securities Exchange Act of 1934 for at least 12 calendar months; (iii) the issuer has filed at least one annual report under the Exchange Act; and (iv) the issuer is not eligible to use Forms 10-KSB and 10-QSB for its annual and quarterly reports. A large accelerated filer is an issuer that meets the foregoing conditions (ii)-(iv) and has a public float of \$700 million or more as of the last day of the issuer's most recently completed second fiscal quarter.

#### **PROPOSED COMPLIANCE DEADLINE EXTENSIONS FOR NON-ACCELERATED FILERS**

The SEC proposed a new rule that would extend by five months the Section 404(a) compliance deadline for all non-accelerated filers, including foreign private issuers that are non-accelerated filers. If this proposal is adopted, a non-accelerated filer will be required to include a report by management assessing the effectiveness of the filer's internal control over financial reporting in the filer's annual report for its first fiscal year ending on or after December 15, 2007 (rather than the first fiscal year ending on or after July 15, 2007). This extension would have no impact on the timing of 404(a) compliance obligations for non-accelerated filers with fiscal years ending on December 31. The SEC further proposed extending by seventeen months the deadline for non-accelerated filers to comply with the Section 404(b) requirement to provide an auditor's attestation report. If this proposed extension is adopted, a non-accelerated filer will not be required to comply with the Section 404(b) auditor attestation requirement until the filer's annual report for its first fiscal year ending on or after December 15, 2008. The SEC has proposed that any non-accelerated filer that, during the first year of compliance, files an annual report including a management's assessment report but not an auditor's attestation report may "furnish" rather than "file" the management's assessment report. In addition, the SEC proposed that, until it files an annual report including a management's assessment report, a non-accelerated filer be permitted to continue to file modified versions of the certifications required by Section 302 of the Sarbanes-Oxley Act omitting the language referring to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting. The SEC left open the possibility of a further extension of the December 15, 2007 Section 404(a) compliance deadline if there are delays in the SEC's issuance of additional internal control guidance and of a further extension of the December 15, 2008 Section 404(b) compliance deadline if there are delays in the PCAOB's revisions to Auditing Standard No. 2.

#### **PROPOSED TRANSITIONAL RELIEF FOR NEWLY PUBLIC COMPANIES**

In recognition of the significant time and resources a filer must expend to produce its first annual report as a public company, the SEC proposed that newly public companies be granted a one-year transition period before they would be required to comply with Section 404. If this proposal is adopted, a newly public filer would not need to include either the Section 404(a) management's assessment report or the Section 404(b) auditor's attestation report until its second annual report following the filer's initial public offering or initial listing on a U.S. securities exchange.

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