

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 210, 228, 229 and 249

[Release Nos. 33-8934; 34-58028; File No. S7-06-03]

RIN 3235-AJ64

### Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rules.

**SUMMARY:** We are adopting amendments to temporary rules that were published on December 21, 2006, in Release No. 33-8760 [71 FR 76580]. Those temporary rules require companies that are non-accelerated filers to include in their annual reports, pursuant to rules implementing section 404(b) of the Sarbanes-Oxley Act of 2002, an attestation report of their independent auditors on internal control over financial reporting for fiscal years ending on or after December 15, 2008. Under the amendments, a non-accelerated filer will be required to file the auditor's attestation report on internal control over financial reporting when it files an annual report for a fiscal year ending on or after December 15, 2009.

**DATES: Effective Dates:** The amendments are effective September 2, 2008, except Form 10-QSB will be effective from September 2, 2008 to October 31, 2008; § 228.308T and Form 10-KSB will be effective from September 2, 2008 to March 15, 2009; and §§ 210.2-02T and 229.308T, Form 20-F, Form 40-F, Form 10-Q, and Form 10-K will be effective from September 2, 2008 to June 30, 2010.

#### FOR FURTHER INFORMATION CONTACT:

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**SUPPLEMENTARY INFORMATION:** We are adopting amendments to the following forms and temporary rules: Rule 2-02T of Regulation S-X,<sup>1</sup> Item 308T of Regulations S-K<sup>2</sup> and S-B,<sup>3</sup> Item 4T of Form 10-Q,<sup>4</sup> Item 3A(T) of Form 10-QSB,<sup>5</sup> Item 9A(T) of Form 10-K,<sup>6</sup> Item

8A(T) of Form 10-KSB,<sup>7</sup> Item 15T of Form 20-F,<sup>8</sup> and Instruction 3T of General Instruction B.(6) of Form 40-F.<sup>9</sup>

#### I. Background

In February 2008,<sup>10</sup> we proposed an extension of the section 404(b) auditor attestation requirement for non-accelerated filers.<sup>11</sup> This proposal followed an action we took in December 2006<sup>12</sup> to extend the dates by which non-accelerated filers must begin to comply with the internal control over financial reporting ("ICFR") requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002.<sup>13</sup> Specifically, we postponed for five months, from fiscal years ending on or after July 15, 2007, to fiscal years ending on or after December 15, 2007, the date by which non-accelerated filers must begin to comply with the management report requirement in Item 308(a) of Regulation S-K.<sup>14</sup> We also postponed to fiscal years ending on or after December 15, 2008, the date by which non-accelerated filers must begin to comply with the auditor attestation report requirement in Item 308(b) of Regulation S-K.<sup>15</sup> We indicated that we would consider further postponing the auditor attestation report compliance date after considering the anticipated revisions to the Public Company Accounting Oversight Board's ("PCAOB") Auditing Standard No. 2 ("AS No. 2").

In the 2006 Release, we cited two primary reasons for deferring implementation of the auditor attestation report requirement for an additional year after implementation of the management report requirement. First, we stated that the deferred implementation would afford non-accelerated filers and their auditors the benefit of anticipated changes by the PCAOB to AS No. 2, subject to

Commission approval, as well as any implementation guidance that the PCAOB issued for auditors of smaller public companies.

Second, we expected a deferred implementation of the auditor attestation requirement to save non-accelerated filers the full potential costs associated with the auditor's initial attestation to, and report on, management's assessment of ICFR during the period that changes to AS No. 2 were being considered and implemented, and the PCAOB was formulating guidance specifically for auditors of smaller public companies. Public commenters previously have asserted that the ICFR compliance costs are likely to be disproportionately higher for smaller public companies than larger ones, and that the auditor's fee represents a large percentage of those costs.<sup>16</sup>

On June 20, 2007, we approved the issuance of interpretive guidance regarding management's report on ICFR<sup>17</sup> and adopted rule amendments<sup>18</sup> to help public companies strengthen their ICFR evaluations while reducing unnecessary costs. The interpretive release provided guidance for management on how to conduct an evaluation of the effectiveness of a company's ICFR. The guidance sets forth an approach by which management can conduct a top-down, risk-based evaluation of ICFR.

In addition, on July 25, 2007, we approved the PCAOB's Auditing Standard No. 5 ("AS No. 5"), which replaced AS No. 2. The new standard sets forth the professional standards and related performance guidance for independent auditors to attest to, and report on, management's assessment of the effectiveness of ICFR. Our management guidance, in combination with AS No. 5, is intended to make evaluations of ICFR and ICFR audits more effective and efficient by being risk-based and scalable to a company's size and complexity.

On February 1, 2008, we proposed a one-year extension of the Section 404(b)

<sup>7</sup> 17 CFR 249.310b.

<sup>8</sup> 17 CFR 249.220f.

<sup>9</sup> 17 CFR 249.240f.

<sup>10</sup> See Release No. 33-8889 (February 1, 2008) [73 FR 7450].

<sup>11</sup> Although the term "non-accelerated filer" is not defined in our rules, we use it throughout this release to refer to an Exchange Act reporting company that does not meet the Rule 12b-2 definition of either an "accelerated filer" or a "large accelerated filer."

<sup>12</sup> See Release No. 33-8760 (December 15, 2006) [71 FR 76580] (the "2006 Release").

<sup>13</sup> 15 U.S.C. 7262.

<sup>14</sup> 17 CFR 229.308(a). We effected the postponement, in part, by adding temporary Item 308T to Regulation S-K. We similarly added temporary Item 308T to Regulation S-B, but the Commission recently adopted amendments that will eliminate Regulation S-B effective March 15, 2009. See Release No. 33-8876 (December 19, 2007) [73 FR 934].

<sup>15</sup> 17 CFR 229.308(b).

<sup>16</sup> See, for example, letters of American Electronics Association, International Association of Small Broker-Dealers and Advisers, Small Business Entrepreneurship Council, and the Silicon Valley Leadership Group, Committee on Capital Markets Regulation on Release No. 33-8762 (December 20, 2006) [71 FR 77635], File No. S7-24-06.

<sup>17</sup> Release No. 33-8810 (Jun. 20, 2007) [72 FR 35324].

<sup>18</sup> Release No. 33-8809 (Jun. 20, 2007) [72 FR 35310]. The rule amendments, among other things, provided that an evaluation that complies with our interpretive guidance is one way to satisfy the annual ICFR evaluation requirement in Exchange Act Rules 13a-15(c) and 15d-15(c) [17 CFR 240.13a-15(c) and 240.15d-15(c)].

<sup>1</sup> 17 CFR 210-2.02T.

<sup>2</sup> 17 CFR 229.308T.

<sup>3</sup> 17 CFR 228.310T.

<sup>4</sup> 17 CFR 249.308a.

<sup>5</sup> 17 CFR 249.308b.

<sup>6</sup> 17 CFR 249.310.

auditor attestation requirement for non-accelerated filers in view of the fact that there were still some additional actions that the Commission and PCAOB intended to take with respect to implementation of the section 404 requirements, and of concerns expressed by some about the orderly and efficient implementation of the ICFR requirements.<sup>19</sup>

One of these actions is the PCAOB's issuance of final staff guidance on auditing ICFR of smaller public companies. On October 17, 2007, the PCAOB published preliminary staff guidance that demonstrates how auditors can apply the principles described in AS No. 5 and provides examples of approaches to particular issues that might arise in the audits of smaller, less complex public companies.<sup>20</sup> Topics discussed in the PCAOB's guidance include: entity-level controls, risk of management override, segregation of duties and alternative controls, information technology controls, financial reporting competencies, and testing controls with less formal documentation. The comment period on the PCAOB's guidance ended on December 17, 2007, and the PCAOB is working on the final guidance.

Another action involves a study that we are undertaking to help determine whether our new management guidance on evaluating ICFR and AS No. 5 are having the intended effect of facilitating more cost-effective ICFR evaluations and audits for smaller reporting companies. Our study plan includes gathering new data from a broad array of companies about the costs and benefits of compliance with the ICFR requirements. The study will pay special attention to those smaller companies that are complying with the ICFR requirements for the first time.

One part of the study will consist of a web-based survey of all companies to

which the section 404 requirements apply. Participation in this survey will be voluntary. Another part of the study will involve the Commission staff conducting in-depth interviews of a small number of interested parties. We are targeting the fall of 2008 for the initial release of findings.

We have received letters from a total of 67 commenters on the proposal to further extend the section 404(b) auditor attestation requirement for non-accelerated filers.<sup>21</sup> Approximately half of the commenters supported the proposed one-year extension,<sup>22</sup> and half opposed a further delay in compliance with the section 404(b) requirements by non-accelerated filers.<sup>23</sup> Many of the commenters that supported the proposed extension agreed that the one-year deferral was appropriate in light of our upcoming study. Absent the extension that we are granting in this release, many non-accelerated filers would have begun to incur independent auditor costs for fiscal years ending on or after December 15, 2008, before we had the opportunity to observe whether further action to improve the effectiveness and efficiency of section 404 implementation is warranted. In addition, several commenters that supported the proposed extension also believed the extension was necessary to provide additional time for companies and their auditors to consider the PCAOB's guidance on the ICFR audits of smaller public companies.<sup>24</sup> Another commenter,<sup>25</sup> while neither supporting nor opposing the proposed extension, suggested that the Commission should limit the extension to companies that qualify as a "smaller reporting

company" under Exchange Act Rule 12b-2.<sup>26</sup>

Many of the commenters opposed to the proposed extension thought that non-accelerated filers have had adequate time to prepare for full compliance with the Section 404 requirements.<sup>27</sup> Several commenters opposed to the proposed extension also claimed that it was unnecessary for the Commission to undertake a study because several studies on the topic already have been completed, including some studies that reported evidence from surveys.<sup>28</sup>

We believe that an additional one-year deferral of the auditor attestation requirement is appropriate so that non-accelerated filers do not incur unnecessary compliance costs. An additional one-year deferral will allow these companies additional time to consider the PCAOB's guidance on ICFR audits of smaller public companies when it is finalized, as well as additional time for the auditors of non-accelerated filers to incorporate such guidance in their planning and conduct of their ICFR audits for 2009. The planned study is designed to elicit information on the recent compliance experiences of companies that is not available in the various earlier studies, including those that use evidence from surveys.<sup>29</sup>

## II. Extension of Auditor Attestation Compliance Date for Non-Accelerated Filers

After consideration of the public comments that were received, we are adopting the one-year extension of the auditor attestation report requirement

<sup>26</sup> See 17 CFR 240.12b-2. Although there is considerable overlap between companies that meet the definition of a "smaller reporting company" in Exchange Act Rule 12b-2 and companies that are non-accelerated filers because they fall outside the definitions of "accelerated filer" and "large accelerated filer," the terms "smaller reporting company" and "non-accelerated filer" are not synonymous. For example, a company that has publicly issued a class of debt securities, but does not have a class of equity securities outstanding would be a non-accelerated filer even though it may not meet the definition of a "smaller reporting company." Many companies that are debt-only issuers, however, are subsidiaries of larger public companies that meet the definition of accelerated filer or large accelerated filer. Therefore, we do not believe it necessary for purposes of this extension to make a distinction between non-accelerated filers and smaller reporting companies.

<sup>27</sup> See, for example, the letters from CII, Jared Galassini, Joshua Pike, and Jennifer Welsh.

<sup>28</sup> See, for example, the letters from CII and Michael Tolvstad.

<sup>29</sup> A key objective of the planned survey is to enable the Commission staff to evaluate any response bias that might cause the responses to over-represent the experiences of a particular sub-sample of companies, as opposed to the companies that are affected by the Section 404 requirements more generally.

<sup>21</sup> The public comments we received are available for inspection in the Commission's Public Reference Room at 100 F Street, NE., Washington DC 20549 in File No. S7-06-03. They are also available on-line at <http://www.sec.gov/rules/proposed/s70603.shtml>. Of the 67 commenters, 49 were graduate and undergraduate students at the University of Wisconsin-La Crosse. More than half of the students opposed the proposed extension.

<sup>22</sup> See, for example, letters from the U.S. Chamber of Commerce, First National Bank of Groton (NY), Mark Hart, Independent Community Bankers of America ("ICBA"), International Association of Small Broker Dealers and Advisors ("IASBD"), Kyle Kaja, George Merkl, New York State Society of Certified Public Accountants ("NYSSCPA"), Melissa Palmer, Maria Romundstad, the Office of Advocacy of the Small Business Administration ("SBA"), Small Business and Entrepreneurship Council ("SBEC"), David Tews and Jordan Walt.

<sup>23</sup> See, for example, letters from Kevin Burgess, California Public Employees' Retirement System ("CalPERS"), Council of Institutional Investors ("CII"), Daniel DeGier, Christopher Fearn, Jared Galassini and Anna Wildenberg.

<sup>24</sup> See, for example, letters from the U.S. Chamber of Commerce, ICBA and Nicole Nederloe.

<sup>25</sup> See letter from Ernst & Young LLP ("EY").

<sup>19</sup> See, for example, the May 8, 2007, letter to Chairman Christopher Cox and Chairman Mark Olson from Senator John Kerry, Chairman, Senate Committee on Small Business and Entrepreneurship, and Senator Olympia Snowe, Ranking Member, Senate Committee on Small Business and Entrepreneurship, available at <http://sbc.senate.gov/lettersout/070508-SEC-PCAOB-HearingFollowUp.pdf>; hearing on "Sarbanes-Oxley Section 404: New Evidence on the Costs for Small Businesses," House Committee on Small Business (December 12, 2007); and the July 12, 2007, letter from Sharon Haeger, America's Community Bankers, on Release No. 34-55876 [72 FR 32340], File No. PCAOB 2007-02, available at <http://www.sec.gov/comments/pcaob-2007-02/pcaob200702.shtml>.

<sup>20</sup> See "An Audit of Internal Control that is Integrated with an Audit of the Financial Statements: Guidance for Auditors of Smaller Companies," (October 17, 2007), available at <http://www.pcaobus.org>.

substantially as proposed. We are amending Item 308T of Regulations S–K and S–B, Rule 2–02T of Regulation S–X, and Forms 10–Q, 10–K, 20–F and 40–F to require non-accelerated filers to provide their auditor’s attestation in their annual reports filed for fiscal years ending on or after December 15, 2009. A non-accelerated filer will continue to be required to state in its management report on ICFR that the company’s annual report does not include an auditor attestation report.<sup>30</sup>

In the Proposing Release, we also requested comment on whether management’s report on ICFR should be “filed” rather than “furnished” and not be subject to liability under Section 18 of the Exchange Act<sup>31</sup> during the second year of a non-accelerated filer’s compliance with the ICFR requirements under section 404(a) if we adopted the proposed extension. Two commenters argued that we should discontinue treating the management report on ICFR

as “furnished” rather than “filed” because the protection was not needed for the second year of the section 404(b) extension<sup>32</sup>. Three commenters believed that we should continue to allow the management report on ICFR of non-accelerated filers to be “furnished” rather than “filed” because non-accelerated filers should not be subject to liability under Section 18 until such time that they have had their ICFR attested to by their auditor.<sup>33</sup>

We recognize that a non-accelerated filer that files only a management report on ICFR may become subject to more second-guessing as a result of separating the management and auditor reports. Management may conclude that the company’s ICFR is effective when the management report is filed without the auditor’s attestation report, but the company’s auditor may come to a contrary conclusion in its report filed in a subsequent year, and as a result, the company’s previous assessment may be

called into question. To reduce the liability risk associated with such second-guessing, we believe that until such time as non-accelerated filers are required to comply with both the section 404(a) and 404(b) requirements, it is reasonable to continue the temporary liability distinction and treat the management report as “furnished” rather than “filed.” Therefore, we also have decided to extend the amendments that cause a non-accelerated filer’s management report on ICFR to be “furnished” rather than “filed.” Of course, material misstatements or omissions in management’s report on ICFR, regardless of whether the report is “furnished” or “filed,” are subject to liability under section 10(b) and Rule 10b-5 under the Exchange Act.<sup>34</sup>

The revised compliance dates for the Section 404 internal control requirements are presented in the table below:

Filer status	Compliance dates for the internal control over financial reporting requirements	
	Management report on ICFR	Auditor attestation on management’s report on ICFR
U.S. Issuer:		
Non-accelerated filer (public float under \$75 million).	Annual reports for fiscal years ending on or after December 15, 2007.	Annual reports for fiscal years ending on or after December 15, 2009.
Large accelerated filer and accelerated filer (public float above \$75 million).	Annual reports for fiscal years ending on or after November 15, 2004.	Annual reports for fiscal years ending on or after November 15, 2004.
Foreign private issuer:		
Non-accelerated filer (public float under \$75 million).	Annual reports for fiscal years ending on or after December 15, 2007.	Annual reports for fiscal years ending on or after December 15, 2009.
Accelerated filer (public float above \$75 million and below \$700 million).	Annual reports for fiscal years ending on or after July 15, 2006.	Annual reports for fiscal years ending on or after July 15, 2007.
Large accelerated filer (public float above \$700 million).	Annual reports for fiscal years ending on or after July 15, 2006.	Annual reports for fiscal years ending on or after July 15, 2006.
U.S. or foreign private issuer:		
Newly public company .....	Second annual report .....	Second annual report.

**III. Paperwork Reduction Act**

In connection with our original proposal and adoption of the rules and amendments implementing the section 404 requirements,<sup>35</sup> we submitted cost and burden estimates of the collection of information requirements of the amendments to the Office of Management and Budget (“OMB”). We published a notice requesting comment on the collection of information requirements in the proposing release for the rule amendments. We submitted these requirements to the OMB for

review in accordance with the Paperwork Reduction Act of 1995 (“PRA”)<sup>36</sup> and received approval of these estimates. We do not believe that the amendments will result in any change in the collection of information requirements of the amendments implementing section 404 and we received no comments suggesting the amendments would result in any change. Therefore, we are not revising our PRA burden and cost estimates submitted to the OMB.

**IV. Cost-Benefit Analysis**

*A. Benefits*

The amendments will postpone for one year the date by which a non-accelerated filer must begin to include in its annual report an auditor attestation report on management’s assessment of internal control over financial reporting. As a result, non-accelerated filers will be required to complete only management’s assessment in the first and second year

<sup>30</sup> See Items 308T(a)(4) of Regulations S–K and S–B.

<sup>31</sup> Section 18 of the Exchange Act [15 U.S.C. 78r] imposes liability on any person who makes or causes to be made in any application or report or document filed under the Act, or any rule thereunder, any statement that “was at the time and in the light of the circumstances under which it was made false or misleading with respect to any

material fact.” As a result of the temporary Item 308T of Regulation S–K and S–B and the temporary amendments to Forms 20–F and 40–F, however, during the applicable periods, management’s report would be subject to liability under this section only in the event that a non-accelerated filer specifically states that the report is to be considered “filed” under the Exchange Act or incorporates it by reference into a filing under the Securities Act or the Exchange Act.

<sup>32</sup> See letters from CalPERS and E&Y.

<sup>33</sup> See letters from the U.S. Chamber of Commerce, CommBancorp, Inc. and George Merkl.

<sup>34</sup> See 15 U.S.C. 78j(b) and 17 CFR 240.10b–5.

<sup>35</sup> See Release No. 33–8138 (October 22, 2002) [67 FR 66208] and Release No. 33–8238 (June 5, 2003) [68 FR 36636].

<sup>36</sup> 44 U.S.C. 3501 *et seq.* and 5 CFR 1320.11.

of their compliance with the section 404 requirements.

We are undertaking a study to help assess whether the new management guidance and AS No. 5 are having the intended effect of facilitating more effective and efficient ICFR evaluations and audits for smaller reporting companies. Our interpretive guidance for management and AS No. 5 were designed to make management evaluations and ICFR audits more effective and efficient. We believe that an additional one-year deferral of the auditor attestation report requirement will benefit investors in non-accelerated filers by helping those smaller companies avoid incurring unnecessary compliance costs as we determine whether further action to improve the effectiveness and efficiency of section 404 implementation is warranted. In addition, we believe that investors in non-accelerated filers may experience benefits from the following economic effects of the extension:

- Auditors of non-accelerated filers will have significantly more time to conform their ICFR audit approach to meet the requirements of AS No. 5, and to consider the PCAOB's guidance for auditors of smaller public companies;<sup>37</sup> and

- Non-accelerated filers will have additional time to focus on their approach for evaluating and reporting on the effectiveness of ICFR. This may facilitate their efforts to develop best practices and efficiencies in preparing the management report prior to becoming subject to the auditor attestation report requirement.

#### B. Costs

Under the amendments, investors in non-accelerated filers will have to wait longer than they would in the absence of the deferral for the assurances provided by the attestation report by the companies' auditor on management's report on ICFR. For example, several commenters expressed concern that the amendments may reduce investor confidence in non-accelerated filers.<sup>38</sup> However, we believe that the risk that some investors may lose confidence in non-accelerated filers is small because the management reports on ICFR of these companies, while not subject to liability under section 18 of the Exchange, will continue to be subject to

other liability provisions of the Exchange Act.

The amendments may also increase the risk that, without the auditor's attestation, some non-accelerated filers may erroneously conclude that the company's ICFR is effective, when an ICFR audit might reveal that it is not effective. Two commenters argued the amendments could increase the risk that a weakness in a company's ICFR would not be detected or might be concealed from investors.<sup>39</sup> In addition, some companies may conduct an assessment that is not as thorough, careful and as appropriate to the company's circumstances as they would perform if the auditor were also conducting an audit of ICFR.

No commenter provided cost estimates for the proposed extension. Several commenters, however, referred to costs estimates prepared by a number of sources regarding the costs of section 404 compliance generally.<sup>40</sup> As mentioned above, we are undertaking our own study in part because these prior cost estimates do not reflect the recent efforts to make section 404 compliance more efficient.

#### V. Consideration of Impact on the Economy, Burden on Competition and Promotion of Efficiency, Competition and Capital Formation

Section 23(a)(2) of the Exchange Act<sup>41</sup> requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, section 2(b)<sup>42</sup> of the Securities Act and section 3(f)<sup>43</sup> of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

We believe that the additional one-year delay of the auditor attestation report requirement will promote efficiency and capital formation by helping reduce inefficiencies and transition costs for non-accelerated filers. Several commenters stated that the proposed extension would help smaller companies reduce the overall costs associated with the ICFR

requirements.<sup>44</sup> In addition, the delay will provide us with the opportunity to evaluate whether the new management guidance and AS No. 5 are having the intended effect of facilitating more effective and efficient ICFR evaluations and audits and to observe whether further action is needed to improve the effectiveness and efficiency of section 404 before non-accelerated filers begin to incur costs. We expect the additional one-year deferral of the auditor attestation requirement to increase efficiency by providing more time for non-accelerated filers to prepare for compliance with the section 404 requirements and by affording these companies and their auditors time to consider the PCAOB's small company ICFR audit guidance. Increased efficiency may promote capital formation and thereby benefit investors. However, we acknowledge that the deferral of the auditor attestation requirement may cause some investors to lose confidence in non-accelerated filers, which could make it more difficult for these companies to raise capital in the public markets.

It is possible that a competitive impact could result from the differing treatment of non-accelerated filers and larger companies that already have been complying with the section 404 requirements, but we did not receive any comments suggesting that this type of impact has occurred as a result of the prior extension or otherwise specifically addressing the effect of the extension on competition.

#### VI. Final Regulatory Flexibility Analysis

We have prepared this Final Regulatory Flexibility Analysis ("FRFA") in accordance with section 603 of the Regulatory Flexibility Act.<sup>45</sup> This FRFA relates to amendments to the following temporary provisions: Item 308T of Regulations S-K and S-B, Rule 2-02T of Regulation S-X, Item 4T of Form 10-Q, Item 3A(T) of Form 10-QSB, Item 9A(T) of Form 10-K, Item 8A(T) of Form 10-KSB, Item 15T of Form 20-F, and Instruction 3T of General Instruction B.(6) of Form 40-F. Prior to these amendments, a non-accelerated filer was scheduled to start providing its auditor's attestation report on ICFR in its annual report for a fiscal year ending on or after December 15, 2008. We are amending these forms and temporary rules to require a non-accelerated filer to start providing the auditor attestation report on ICFR in its

<sup>37</sup> Several commenters also noted this benefit. See, for example, letters from the Chamber of Commerce and ICBA.

<sup>38</sup> See letters from CalPERS, Hang Bui, John DeGoey, Jared Galassini, Stacy Lulloff, Anthony Morgan, Joshua Pike, Brandon Wagner and Jennifer Welsh.

<sup>39</sup> See letters from E&Y and Michael Tolvstad.

<sup>40</sup> See, for example, letters from CII and the SBA.

<sup>41</sup> 15 U.S.C. 78w(a).

<sup>42</sup> 15 U.S.C. 77b(b).

<sup>43</sup> 15 U.S.C. 78c(f).

<sup>44</sup> See, for example, letters from U.S. Chamber of Commerce and ICBA.

<sup>45</sup> 5 U.S.C. 603.

annual reports for fiscal years ending on or after December 15, 2009.

#### A. Reasons for, and Objectives of, the Amendments

The Commission is undertaking a study to assess whether the new management guidance and AS No. 5 are having the intended effect of facilitating more effective and efficient ICFR evaluations and audits for smaller reporting companies. We are amending our forms and temporary rules to defer implementation of the auditor attestation report requirement for non-accelerated filers for an additional year for the following primary reasons:

- To enable non-accelerated filers more time to gain efficiencies in management's evaluation of the effectiveness of internal control over financial reporting;
- To provide the Commission with time to review the findings of its study and to consider whether further action to improve the effectiveness and efficiency of Section 404 implementation is warranted;
- To provide the PCAOB time to promulgate its guidance for ICFR audits of smaller public companies in final form; and
- To provide the auditors of non-accelerated filers additional time to consider such guidance.

The amendments aim to further the goals of the Sarbanes-Oxley Act to enhance the quality of public company disclosure concerning the company's internal control over financial reporting and increase investor confidence in the financial markets.

#### B. Significant Issues Raised by Public Comment

In the Proposing Release, we requested comment on the number of small entity issuers that may be affected, the existence or nature of the potential impact and how to quantify the impact of the amendments. As mentioned above, several commenters believed that the extension would help smaller companies reduce the overall costs associated with the ICFR requirements,<sup>46</sup> but other commenters argued that a further delay may affect investor confidence in the ICFR of smaller companies.<sup>47</sup> We did receive data from the Office of Advocacy of the Small Business Administration on the general costs of compliance related to implementation of the section 404 requirements.<sup>48</sup> However, this data did not address the costs of delayed

implementation, and we are conducting our own study to assess the costs that reflect our recent efforts to make section 404 compliance more efficient.<sup>49</sup>

#### C. Small Entities Subject to the Amendments

The amendments will affect some issuers that are small entities. Exchange Act Rule 0-10(a)<sup>50</sup> defines an issuer, other than an investment company, to be a "small business" or "small organization" if it had total assets of \$5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 1,100 issuers, other than registered investment companies, that may be considered small entities. The amendments will apply to any small entity that is subject to reporting under either section 13(a) or 15(d) of the Exchange Act. One commenter recommended that we use the definition of "smaller reporting company"<sup>51</sup> in Securities Act Rule 405<sup>52</sup> and Exchange Act Rule 12b-2<sup>53</sup> to define "small entity" for purposes of the FRFA.<sup>54</sup> Although, we are not proposing any amendments to the definition of small entity in Exchange Act Rule 0-10(a) at

<sup>49</sup> The SBA also recommended that we use the results of our Section 404 study to update the Final Regulatory Flexibility Act analysis of the internal control reporting requirements included in the original 2003 release adopting the rules implementing section 404 (Release No. 33-8238 [68 FR 36636]). In evaluating the efficiency and effectiveness of the section 404 requirements, we will look to the results of our study, as well as other information. We will also consider the results of our study when we conduct a review under section 610 of the Regulatory Flexibility Act.

<sup>50</sup> 17 CFR 240.0-10(a).

<sup>51</sup> A "small reporting company" is defined as an issuer that is not an investment company, an asset-backed issuer (as defined in 17 CFR 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter, computed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity; or (2) In the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than \$75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of such shares held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares; or (3) In the case of an issuer whose public float as calculated under (1) or (2) was zero, had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available.

<sup>52</sup> 17 CFR 230.405.

<sup>53</sup> 17 CFR 240.12b-2.

<sup>54</sup> See letter from SBA.

this time, we will consider in the future whether any revisions to this definition are warranted.

#### D. Reporting, Recordkeeping, and Other Compliance Requirements

The amendments will alleviate reporting and compliance burdens by postponing by an additional year the date by which non-accelerated filers must begin to comply with the auditor attestation report on ICFR in their annual reports.

#### E. Agency Action To Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

In connection with the amendments, we considered several of these alternatives. One commenter recommended that we should consider a two-year extension for larger non-accelerated filers and a three-year extension for non-accelerated filers that had market capitalizations of \$25 million or less.<sup>55</sup> The amendments establish a different compliance and reporting timetable for non-accelerated filers and small entities from that of other companies.

As discussed above, the amendments are designed to allow non-accelerated filers to avoid incurring unnecessary compliance costs before we have the benefit of analyzing the results of our section 404 study, and to provide non-accelerated filers and their auditors with time to consider, and integrate the concepts in the forthcoming PCAOB smaller company ICFR audit guidance. We anticipate that one year should be adequate.

We believe that the amendments will promote the primary goal of enhancing the quality of reporting and increasing investor confidence in the fairness and integrity of the securities markets. Exempting small entities entirely from

<sup>55</sup> See letter from IASBD.

<sup>46</sup> See footnote 44 above.

<sup>47</sup> See footnote 38 above.

<sup>48</sup> See letter from SBA.

the requirements of section 404(b) may be contrary to this goal.

An exemption from the amendments delaying compliance with the auditor attestation requirement, on the other hand, would be inconsistent with one of the goals of our study to determine whether further action to improve the effectiveness and efficiency of section 404 implementation is warranted before smaller companies have begun to incur independent auditor costs to perform integrated audits of their financial statements and ICFR.

## VII. Statutory Authority and Text of the Amendments

The amendments described in this release are adopted under the authority set forth in section 19 of the Securities Act, Sections 3, 12, 13, 15, 23 and 36 of the Exchange Act, and sections 3(a) and 404 of the Sarbanes-Oxley Act.

### List of Subjects

#### 17 CFR Part 210

Accountants, Accounting, Reporting and recordkeeping requirements, Securities.

#### 17 CFR Part 228

Reporting and recordkeeping requirements, Securities, Small businesses.

#### 17 CFR Parts 229 and 249

Reporting and recordkeeping requirements, Securities.

### Text of Amendments

■ For the reasons set out in the preamble, the Commission is amending title 17, chapter II, of the Code of Federal Regulations as follows:

#### **PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975**

■ 1. The authority citation for part 210 continues to read as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 78c, 78j-1, 78l, 78m, 78n, 78o(d), 78q, 78u-5, 78w(a), 78ll, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202, 7218 and 7262, unless otherwise noted.

■ 2. Section 210.2-02T is amended by:

■ a. Removing paragraphs (a) and (b), and redesignating paragraphs (c) and (d) as paragraphs (a) and (b);

■ b. Revising the date “December 15, 2008” in newly redesignated paragraph (a) to read “December 15, 2009”; and

■ c. Revising newly redesignated paragraph (b).

The revision reads as follows:

#### **§ 210.2-02T Accountants' reports and attestation reports on internal control over financial reporting.**

\* \* \* \* \*

(b) This section expires on June 30, 2010.

#### **PART 228—INTEGRATED DISCLOSURE SYSTEM FOR SMALL BUSINESS ISSUERS**

■ 3. The authority citation for part 228 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 77nnn, 77sss, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-29, 80a-30, 80a-37, 80b-11, and 7201 *et seq.*, and 18 U.S.C. 1350.

\* \* \* \* \*

■ 4. Section 228.308T is amended by revising the “Note to Item 308T” and paragraph (c) to read as follows:

#### **§ 228.308T (Item 308T) Internal control over financial reporting.**

**Note to Item 308T:** This is a special temporary section that applies only to a fiscal period ending on or after December 15, 2007 but before March 15, 2009.

\* \* \* \* \*

(c) This temporary Item 308T, and accompanying note and instructions, will expire on March 15, 2009.

#### **PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S-K**

■ 5. The authority citation for part 229 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

■ 6. Section 229.308T is amended by revising the “Note to Item 308T” and paragraph (c) to read as follows:

#### **§ 229.308T (Item 308T) Internal control over financial reporting.**

**Note to Item 308T:** This is a special temporary section that applies only to a

registrant that is neither a “large accelerated filer” nor an “accelerated filer” as those terms are defined in § 240.12b-2 of this chapter and only with respect to a fiscal period ending on or after December 15, 2007, but before December 15, 2009.

\* \* \* \* \*

(c) This temporary Item 308T, and accompanying note and instructions, will expire on June 30, 2010.

#### **PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934**

■ 7. The general authority citation for Part 249 is revised to read as follows:

**Authority:** 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

■ 8. Form 20-F (referenced in § 249.220f), Part II, Item 15T is amended by:

■ a. Revising the date “December 15, 2008” in paragraph (2) to the “Note to Item 15T” to read “December 15, 2009”; and

■ b. Revising the date “June 30, 2009” in paragraph (d) to read “June 30, 2010”.

**Note:** The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.

■ 9. Form 40-F (referenced in § 249.240f) is amended by:

■ a. Revising the date “December 15, 2008” in “Instruction 3T(2)” to the “Instructions to paragraphs (b), (c), (d) and (e) of General Instruction B.(6)” to read “December 15, 2009”; and

■ b. Revising the date “June 30, 2009” in the paragraph following “Instruction 3T” to the “Instructions to paragraphs (b), (c), (d) and (e) of General Instruction B.(6)” to read “June 30, 2010”.

**Note:** The text of Form 40-F does not, and this amendment will not, appear in the Code of Federal Regulations.

■ 10. Form 10-Q (referenced in § 249.308a) is amended by revising Item 4T to Part I to read as follows:

**Note:** The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.

### Form 10-Q

\* \* \* \* \*

#### **PART I—FINANCIAL INFORMATION**

\* \* \* \* \*

#### **Item 4T. Controls and Procedures**

(a) If the registrant is neither a large accelerated filer nor an accelerated filer as those terms are defined in § 240.12b-2 of this chapter, furnish the

information required by Items 307 and 308T(b) of Regulation S-K (17 CFR 229.307 and 229.308T(b)) with respect to a quarterly report that the registrant is required to file for a fiscal year ending on or after December 15, 2007, but before December 15, 2009.

(b) This temporary Item 4T will expire on June 30, 2010.

\* \* \* \* \*

■ 11. Form 10-QSB (referenced in § 249.308b) is amended by revising Item 3A(T) to Part I to read as follows:

**Note:** The text of Form 10-QSB does not, and this amendment will not, appear in the Code of Federal Regulations.

**Form 10-QSB**

\* \* \* \* \*

**PART I—FINANCIAL INFORMATION**

\* \* \* \* \*

**Item 3A(T). Controls and Procedures**

(a) Furnish the information required by Items 307 and 308T(b) of Regulation S-B (17 CFR 228.307 and 228.308T(b)) with respect to a quarterly report that the small business issuer is required to file for a fiscal year ending on or after December 15, 2007, but before October 31, 2008.

(b) This temporary Item 3A(T) will expire on October 31, 2008.

\* \* \* \* \*

■ 12. Form 10-K (referenced in § 249.310) is amended by:

- a. Revising the date “December 15, 2008” in paragraph (a) to Item 9A(T) to Part II to read “December 15, 2009”; and
- b. Revising the date “June 30, 2009” in paragraph (b) to Item 9A(T) to Part II to read “June 30, 2010”.

**Note:** The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.

■ 13. Form 10-KSB (referenced in § 249.310b) is amended by revising the dates “December 15, 2008” in paragraph (a), and “June 30, 2009” in paragraph (b) to Item 8A(T) to Part II to read “March 15, 2009”.

**Note:** The text of Form 10-KSB does not, and this amendment will not, appear in the Code of Federal Regulations.

By the Commission.

Dated: June 26, 2008.

**Florence E. Harmon,**

*Acting Secretary.*

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