

**SEC EXTENDS SECTION 404 COMPLIANCE  
DEADLINES FOR CERTAIN ISSUERS**

On August 9, 2006, the Securities and Exchange Commission issued two releases designed to grant smaller companies, newly public companies and many foreign private issuers further relief from compliance with Section 404 of the Sarbanes-Oxley Act. Most significantly, the releases bifurcate the timing of the two major elements of Section 404: management's assessment of a company's internal control over financial reporting and the related auditors' attestation report regarding such management assessment. These releases follow a series of steps taken by the SEC to address concerns raised regarding Section 404, including previous deadline extensions, the establishment of an advisory committee and a task force, roundtable discussions and the solicitation of public comments.

In addition to proposing, for non-accelerated filers, a six-month extension of the initial compliance date for the management assessment of internal controls, the SEC has proposed to delay until fiscal years ending on or after December 15, 2008 the related auditors' attestation report. Similarly, final regulations issued by the SEC will permit foreign private issuers that are not large accelerated filers to delay their auditors' attestation report until their annual report filed for a fiscal year ending on or after July 15, 2007. Finally, the SEC has proposed a transition period that would permit newly public companies to delay the filing of their management assessment and auditors' attestation until their second annual report filed with the SEC.

**Background**

Section 404(a) of the Sarbanes-Oxley Act and related SEC regulations mandate that companies subject to the reporting requirements of the Securities Exchange Act of 1934 include in their annual reports:

- a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year; and
- a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting.

Under Section 404(b), the company must also include a report from the registered public accounting firm that audited the company's financial statements attesting to management's assessment of the company's internal control over financial reporting.

Accelerated filers<sup>1</sup> (other than foreign private issuers) have been required to include the Section 404 reports in their annual reports commencing with their fiscal years ended on or after November 15, 2004. Following a series of extensions, accelerated foreign private issuers were required to include the Section 404 reports commencing with their fiscal years ended on or after July 15, 2006, with non-accelerated filers, including foreign private issuers, required to include the reports commencing with their fiscal years ending on or after July 15, 2007.

The extensions in these recent releases are the SEC's latest response to the outcry by smaller public companies and others regarding the significant costs and efforts required to comply with Section 404. In December 2004, the SEC established an Advisory Committee on Smaller Public Companies to evaluate the impact of the new regulatory system on smaller companies, particularly in regards to internal control reporting. The SEC convened a task force of the Committee of Sponsoring Organizations (COSO) to elaborate on the application of the existing COSO framework to smaller companies. In addition, the U.S. Government Accountability Office also issued a report discussing the challenges of applying Section 404. Following these reports, the SEC sponsored a roundtable to elicit comments on this question. In July 2006, it issued a "concept release" outlining the further steps the SEC expects to take regarding internal controls.

This extension of the Section 404 compliance deadlines, the SEC believes, and particularly the bifurcation of the Section 404(a) management report and Section 404(b) auditors' attestation deadlines, will provide the SEC and the Public Company Accounting Oversight Board (PCAOB) with additional time to develop further guidance that will permit smaller companies to implement Section 404 in a more efficient manner, will save companies the additional cost of the auditors' attestation as changes to the guidelines contained in PCAOB Auditing Standard No. 2 are being considered and will permit the SEC to consider additional comments regarding the auditors' role.

## **I. *Proposed Extensions for Non-Accelerated Filers***

The SEC has proposed extending the deadline for all non-accelerated filers (whether a domestic or a foreign private issuer) to file the management report on the company's internal control over financial reporting pursuant to Section 404(a) from the current deadline of fiscal years ending on or after July 15, 2007 to fiscal years ending on or after December 15, 2007. More significantly, non-accelerated filers would not be required to file an auditor's attestation report pursuant to Section 404(b) until a year later – until their first annual report filed for a fiscal year ending on or after December 15, 2008. During the first year of compliance (*i.e.*, before a company has filed its auditors' attestation report), the SEC has proposed to permit the management report to be "furnished" rather than "filed." Until it files the management report, the issuer would be able to

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<sup>1</sup> Public companies with an equity market capitalization (held by non-affiliates), as of the end of the issuer's most recently completed second fiscal quarter, of at least \$75 million (but less than \$700 million) that have been subject to reporting requirements under the Exchange Act for 12 calendar months.

omit certain language regarding management's responsibility for designing, establishing and maintaining the company's internal control over financial reporting contained in the Section 302 management certification filed as an exhibit to the annual report.

## **II. Extensions for Foreign Private Issuers that are Accelerated Filers**

The SEC has adopted final regulations<sup>2</sup> extending the deadline for auditors' attestations under Section 404(b) for foreign private issuers that are accelerated filers (but not large accelerated filers<sup>3</sup>) until their annual reports on Form 20-F or 40-F for fiscal years ending on or after July 15, 2007. Although the auditor attestation report deadline has been postponed, these companies must still include the Section 404(a) management report on the effectiveness of the internal controls in their annual reports for fiscal years ended on or after July 15, 2006. As with non-accelerated filers, the SEC has proposed that, during the first year of compliance (*i.e.*, before a company has filed its auditors' attestation report), these foreign private issuers may "furnish" (rather than "file") the management reports.

However, for foreign private issuers that qualify as large accelerated filers, the deadline for compliance with both Sections 404(a) and (b) remains at annual reports for fiscal years ended on or after July 15, 2006.

## **III. Proposed Grace Period for Newly Public Companies**

The SEC has proposed<sup>4</sup> a transition period for companies (whether non-accelerated, accelerated or large accelerated filers) that have recently become public. Neither the management report nor the auditors' attestation report would be required to be filed with the first annual report that a company is required to file with the SEC. However, both reports would be required in a company's second annual report, in accordance with the various compliance deadlines in effect based on the size of the company. This transition period would also apply to foreign private issuers listing on a U.S. stock exchange for the first time.

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<sup>2</sup> See SEC Release No. 33-8730; 34-54294 (August 9, 2006).

<sup>3</sup> Accelerated filers that meet an equity market capitalization test of at least \$700 million, as of the end of the issuer's most recently completed second fiscal quarter.

<sup>4</sup> See SEC Release No. 33-8731; 34-54295 (August 9, 2006).

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If you wish to obtain additional information regarding these regulations, please contact Jeffrey S. Hochman (212-728-8592, [jhochman@willkie.com](mailto:jhochman@willkie.com)), Serge Benchetrit (212-728-8798, [sbenchetrit@willkie.com](mailto:sbenchetrit@willkie.com)) or the attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at [www.willkie.com](http://www.willkie.com).

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