



Federal Register

**Tuesday,
August 15, 2006**

Part IV

Securities and Exchange Commission

**17 CFR Parts 210, 228, 229, 240 and 249
Internal Control Over Financial Reporting
in Exchange Act Reports; Final Rule and
Proposed Rule**

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 228, 229, 240 and 249

[Release Nos. 33-8730; 34-54294; File No. S7-06-03]

RIN 3235-A179

Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Foreign Private Issuers That Are Accelerated Filers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of compliance dates.

SUMMARY: We are extending the compliance date that was published on March 8, 2005, in Release No. 33-8545 [70 FR 11528], for foreign private issuers that are accelerated filers, but not large accelerated filers, for amendments to Forms 20-F and 40-F that require a foreign private issuer to include in its annual reports an attestation report by the issuer's registered public accounting firm on management's assessment on internal control over financial reporting.

DATES: *Effective Date:* September 14, 2006; except Temporary § 210.2-02T, Temporary Item 15T of Form 20-F, and Temporary Instruction 2T of General Instruction B(6) of Form 40-F are effective from September 14, 2006 to December 31, 2007.

Compliance Dates: The compliance dates are extended as follows: A foreign private issuer that is an accelerated filer, but not a large accelerated filer, under the definition in Rule 12b-2 of the Securities Exchange Act of 1934, and that files its annual report on Form 20-F or Form 40-F, must begin to comply with the requirement to provide the auditor's attestation report on internal control over financial reporting in the annual report filed for its first fiscal year ending on or after July 15, 2007.

Furthermore, until this type of foreign private issuer becomes subject to the auditor attestation report requirement, the registered public accounting firm retained by the issuer need not comply with the obligation in Rule 2-02(f) of Regulation S-X. Rule 2-02(f) requires every registered public accounting firm that issues or prepares an accountant's report that is included in an annual report filed by an Exchange Act reporting company (other than a registered investment company) containing an assessment by management of the effectiveness of the company's internal control over financial reporting to attest to, and report on, such assessment.

FOR FURTHER INFORMATION CONTACT: Michael Coco, Special Counsel, Office of International Corporate Finance, Division of Corporation Finance, at (202) 551-3450, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: On June 5, 2003,¹ the Commission adopted several amendments to its rules and forms implementing section 404 of the Sarbanes-Oxley Act of 2002.² Among other things, these amendments require companies, other than registered investment companies, to include in their annual reports a report of management on the effectiveness of the company's internal control over financial reporting, and an accompanying auditor's attestation report, and 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.

In February 2004, we approved an extension of the original compliance dates for the amendments related to internal control over financial reporting.³ Specifically, we extended the compliance dates for companies that are accelerated filers, as defined in Exchange Act Rule 12b-2,⁴ to fiscal years ending on or after November 15, 2004, and for non-accelerated filers⁵ and all foreign private issuers filing annual reports on Form 20-F or 40-F,⁶ to fiscal years ending on or after July 15, 2005. In March 2005, we approved a further one-year extension of the compliance dates for non-accelerated filers and for all foreign private issuers filing annual reports on Form 20-F or 40-F⁷ and acknowledged the significant efforts that were being expended by many foreign private issuers to comply with International Financial Reporting Standards.

Most recently, in September 2005, we again extended for another one year period the compliance dates for the internal control over financial reporting

requirements applicable to non-accelerated filers, including foreign private issuers that are non-accelerated filers.⁸ Based on the September 2005 extension, a foreign private issuer that is a non-accelerated filer currently is scheduled to become subject to compliance with the internal control over financial reporting requirements beginning with the annual report filed for its first fiscal year ending on or after July 15, 2007.

In a companion release also being issued today,⁹ we propose both to further extend the management assessment compliance date for non-accelerated filers with a fiscal year ending on or after July 15, 2007, but before December 15, 2007, and to also extend the compliance date relating to the auditor's attestation report on internal control over financial reporting for all non-accelerated filers until fiscal years ending on or after December 15, 2008.

Pursuant to the compliance dates established in the March 2005 release, a foreign private issuer that is either an accelerated filer¹⁰ or a large accelerated filer,¹¹ and that files its annual reports on Form 20-F or 40-F, currently is

⁸ Release No. 33-8618 (September 22, 2005) [70 FR 56825]. Prior to December 1, 2005, "accelerated filer" status did not directly affect a foreign private issuer filing its annual reports on Form 20-F or 40-F because we had not accelerated the filing deadlines for those forms, even though the Rule 12b-2 definition of "accelerated filer" did not expressly exclude foreign private issuers by its terms. After December 1, 2005, however, as a result of a change made as part of the Commission's Securities Offering Reform final rules, a foreign private issuer meeting the accelerated filer definition, and filing its annual report on Form 20-F, became subject to a new requirement in Item 4A of Form 20-F to disclose unresolved staff comments.

⁹ Release No. 34-54295 (Aug. 9, 2006). In the companion proposing release, we request comment on the potential implications of separating management's report on internal control over financial reporting from the auditor's attestation report on internal control over financial reporting on the efficiency and effectiveness of implementation of the Section 404 requirements. We also request comment on a variety of other questions, including whether there is any relief or guidance that we should consider providing specifically with respect to foreign private issuers apart from the actions described in the release affecting foreign private issuers that are non-accelerated filers.

¹⁰ Exchange Act Rule 12b-2(1) [17 CFR 240.12b-2(1)] defines an accelerated filer as an issuer that, among other criteria, has an aggregate market value of voting and non-voting common equity held by non-affiliates of the issuer of \$75 million or more as of the last day of the issuer's most recently completed second fiscal quarter.

¹¹ Exchange Act Rule 12b-2(2) [17 CFR 240.12b-2(2)] defines a large accelerated filer as an issuer that, among other criteria, has an aggregate market value of voting and non-voting common equity held by non-affiliates of the issuer of \$700 million or more as of the last day of the issuer's most recently completed second fiscal quarter.

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

² 15 U.S.C. 7262.

³ See Release No. 33-8392 (February 24, 2004) [69 FR 9722].

⁴ 17 CFR 240.12b-2.

⁵ The term "non-accelerated filer" is not defined in our rules, but we use it throughout this release to refer to an Exchange Act reporting company that does not meet the Exchange Act Rule 12b-2 definition of either an "accelerated filer" or a "large accelerated filer."

⁶ 17 CFR 249.20f and 249.40f.

⁷ Release No. 33-8545 (March 2, 2005) [70 FR 11528].

scheduled to comply with the internal control over financial reporting requirements beginning with the annual report filed for its first fiscal year ending on or after July 15, 2006.

In this release, we are extending for one year the date by which a foreign private issuer that is an accelerated filer (but not a large accelerated filer),¹² and that files its annual reports on Form 20-F or 40-F, must begin to comply with the requirement to provide the auditor's attestation report on internal control over financial reporting.¹³ Pursuant to this extension, this type of issuer must begin to comply with the requirement to provide the auditor's attestation report in the Form 20-F or 40-F annual report filed for its first fiscal year ending on or after July 15, 2007. The extension will become effective 30 days after this release is published in the **Federal Register**.

The extension that we are providing in this release does not alter any other requirements regarding internal control that already are in effect, including without limitation, section 13(b)(2) of the Exchange Act¹⁴ and the related rules, nor does it affect any other previously established compliance date. Therefore, a foreign private issuer that is an accelerated filer must begin to comply with the requirement to include management's report on internal control over financial reporting in the Form 20-F or 40-F annual report filed for its first fiscal year ending on or after July 15, 2006.

In the companion release referenced above that we also are issuing today, we are proposing that all non-accelerated filers, like the foreign private issuers that are the subject of this release, would include only management's report on internal control over financial reporting during their first year of compliance with the section 404 requirements. In that release, we propose that during the first compliance year, the non-accelerated filer would "furnish" rather than file management's report. The release states that if we adopt that proposal, we intend to afford similar relief to the accelerated foreign private issuer filers that likewise will file only management's report during their first year of compliance with the section 404 requirements.¹⁵ We invite foreign private issuers and all interested

parties to comment on the questions raised in the companion release as to whether this type of proposed relief is appropriate.

The chief executive officer and chief financial officer of a foreign private issuer that is an accelerated filer must begin to provide the complete certification required by Exchange Act Rule 13a-14(a) or 15d-14(a),¹⁶ including the references to the officers' responsibility for establishing and maintaining internal control over financial reporting in paragraph 4 of the certification, in the Form 20-F or 40-F annual report filed for the foreign private issuer's first fiscal year ending on or after July 15, 2006.

This extension also does not affect the date by which a foreign private issuer that is a large accelerated filer must comply with all of the internal control over financial reporting requirements.¹⁷ These filers must include both a report by management and an attestation report by the issuer's registered public accounting firm on internal control over financial reporting, as well as complete certifications, in their Form 20-F or 40-F reports filed for a fiscal year ending on or after July 15, 2006. Our data indicates that out of the approximately 1,240 foreign private issuers that are subject to the Exchange Act reporting requirements, about 39% of these are large accelerated filers, 23% are accelerated filers, and the remaining 38% are non-accelerated filers.¹⁸

The Commission, for good cause, finds that notice and solicitation of comment regarding extension of the audit attestation report compliance date for foreign private issuers that are accelerated filers (but not large accelerated filers) is impractical, unnecessary and contrary to the public

¹⁶ 17 CFR 240.13a-14(a) or 15d-14(a).

¹⁷ We are not extending the compliance dates for large accelerated foreign private issuers given their more extensive reporting resources and the greater market interest they generate than smaller issuers. Industry sources indicate that these issuers are further along in their compliance efforts than the accelerated foreign private issuers and generally appear to be better prepared to comply with the current filing deadline. Furthermore, the distinction between large accelerated and accelerated foreign private issuers that we are making for purposes of the extension is consistent with a similar size-based distinction that we made in 2004 when we provided certain accelerated filers up to an additional 45 days to file their Section 404 reports. Although the order pre-dated our creation of the "large accelerated filer" category of issuers, companies with public equity float thresholds exceeding \$700 million, representing approximately 96% of the U.S. equity market capitalization, were not eligible for the 45-day extension. See Release No. 34-50754 (November 30, 2004).

¹⁸ The estimated percentages of foreign private issuers within each accelerated filer category are based on market capitalization data from Datastream as of December 31, 2005.

interest for a variety of reasons.¹⁹ One reason is that a number of events related to internal control assessments by companies and their auditors have occurred since we granted the last extension of compliance dates.

First, the extension will provide these foreign private issuers and their registered accounting firms an additional year to consider, and adapt to, any actions that the Commission and the Public Company Accounting Oversight Board decide to take as part of their plans announced on May 17, 2006 to improve the implementation of the section 404 requirements.²⁰

These actions include:

- Revisions to Auditing Standard No. 2;
- Issuance of a Concept Release soliciting comment on a variety of issues that might be included in future Commission guidance for management to assist in its performance of a top-down, risk-based assessment of internal control over financial reporting;
- Reinforcement of auditor efficiency through PCAOB inspections;
- Development, or facilitation of development, of implementation guidance for auditors of smaller public companies; and
- Continuation of PCAOB forums on auditing in the small business environment.

Although the first three initiatives will affect all Exchange Act reporting companies subject to the section 404 internal control requirements, including accelerated and large accelerated domestic filers and their registered public accounting firms that already have been complying with these requirements for two years, as well as large accelerated foreign private issuers and their auditors, we expect that smaller foreign private issuers likely will face greater challenges than these larger filers as they prepare to comply with the internal control reporting requirements.

¹⁹ 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."). Also, because the Regulatory Flexibility Act [5 U.S.C. 601-612] only requires agencies to prepare analyses when the Administrative Procedures Act requires general notice of rulemaking, that Act does not apply to the actions that we are taking in this release.

²⁰ See SEC Press Release 2006-75 (May 17, 2006), "SEC Announces Next Steps for Sarbanes-Oxley Implementation" at <http://www.sec.gov/news/press/2006/2006-75.htm> and PCAOB News Release entitled "Board Announces Four-Point Plan to Improve Implementation of Internal Control Reporting Requirements" at http://www.pcaobus.org/News_and_Events/News/2006/05-17.aspx.

¹² As defined in Rule 12b-2, the term "accelerated filer" does not include a filer that is a "large accelerated filer." The two categories of filers therefore are mutually exclusive.

¹³ See Item 15(c) of 20-F and General Instruction B(6)(d) of Form 40-F.

¹⁴ 15 U.S.C. 78m(b)(2).

¹⁵ See Section II of Release No. 34-54295 (August 9, 2006).

Second, on April 23, 2006, the SEC's Advisory Committee on Smaller Public Companies submitted its final report to the Commission.²¹ The final report includes recommendations designed to address the potential impact of the internal control reporting requirements on smaller public companies. Specifically, the Advisory Committee recommends that certain smaller public companies be exempted from the management report requirement and from external auditor involvement in the section 404 process under certain circumstances unless and until a framework for assessing internal control over financial reporting is developed that recognizes the characteristics and needs of these companies.

Third, on May 10, 2006, the Commission and PCAOB sponsored a roundtable to elicit feedback from companies, their auditors, board members, investors, and others regarding their experiences during the accelerated filers' second year of compliance with the internal control over financial reporting requirements. Several of the comments provided at, and in connection with, the roundtable expressed support for revisions to the PCAOB's Auditing Standard No. 2.²²

Apart from these developments, solicitation of public comment regarding extension of the compliance date is impractical given that the current compliance date requires management of foreign private issuers that are accelerated filers to assess internal control over financial reporting at the end of the first fiscal year ending on or after July 15, 2006. We anticipate that these issuers and their investors would be unlikely to derive any meaningful benefit from an extension that is granted several months from now as the issuers' registered public accounting firms likely would have completed substantial work on their internal control audits by then, and the issuers would have incurred fees for the work already completed by the auditor. We recognize that some of the foreign private issuers qualifying for this extension may already be at such an advanced stage of preparation for compliance with the internal control reporting requirements, including the audit report requirement, that they may choose to include both the management

and audit report in the annual report they file for their first fiscal year ending on or after July 15, 2006.

Another reason for the extension is that it will enable management of these foreign private issuers to begin the process of reviewing and evaluating the effectiveness of internal control over financial reporting a year before the initial audit of such effectiveness but will still permit investors to begin to see and evaluate the results of these initial efforts. Management will not have to devote time and resources to assisting the auditor with its audit of internal control over financial reporting and can use the first year of compliance as an opportunity to more gradually prepare for compliance with the audit portion of the requirements in the second year. We believe that this will reduce the first year cost of compliance. The extension also should enable foreign private issuers that are accelerated filers to benefit from the learning and efficiencies gained by the auditing firms as a result of their previous experience auditing the large accelerated foreign private issuers' compliance with the section 404 requirements.

While acknowledging the potential risks that could stem from a lack of required auditor involvement in the first year of the internal control assessment process, a more gradual transition to full compliance ultimately should make implementation of the internal control over financial reporting requirements more effective. Consequently, this will benefit investors and improve confidence in the reliability of the disclosure made by these companies about their internal control over financial reporting.

As a result of the extension, these foreign private issuers will not have to incur the cost of the internal control audit during the first compliance year. Furthermore, we have learned from public comments, including our roundtables on implementation of the internal control reporting provisions,²³ that while many companies incur increased internal costs in the first year of compliance due to "deferred maintenance" items (e.g., documentation, remediation, etc.), these costs may decrease in the second year. Therefore, postponing the audit costs until the second year would help smooth the significant cost spike that

has been experienced by many accelerated filers in their first year of compliance. A competitive or cost impact could result from the differing treatment of accelerated foreign private issuers that are the subject of the actions that we are taking today and large accelerated foreign private issuers that are not affected by these actions.

Finally, four commenters on the Commission's pending proposals regarding termination of a foreign private issuer's registration of a class of securities under Exchange Act section 12(g) and duty to file periodic reports²⁴ requested that the Commission extend the compliance dates for the section 404 requirements. The extension of compliance dates announced in this release will provide foreign private issuers (other than large accelerated filers) with the opportunity to determine whether they meet any revised deregistration criteria that the Commission determines to adopt before having to implement steps toward providing an auditor attestation report on internal control over financial reporting.²⁵ We have been considering all of the public comments on the deregistration proposals and expect to take further action on them by early fall of this year.

Statutory Authority and Text of the Rule Amendments

We are adopting the amendments described in this release pursuant to sections 12, 13, 15 and 23 of the Exchange Act.

List of Subjects

17 CFR Part 210

Accountants, Accounting, Reporting and recordkeeping requirements, Securities.

17 CFR Part 249

Reporting and recordkeeping requirements, Securities.

Text of Amendments

■ For the reasons set forth above, we are amending title 17, chapter II, of the Code of Federal Regulations as follows:

²⁴ Rel. No. 34-53020 (December 23, 2005) [70 FR 77688].

²⁵ See Letters from the American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities at pp. 6-7, Cleary Gottlieb Steen & Hamilton LLP at p. 19, the European Association for Listed Companies and 16 other European industry association signatories at p. 6 and the European Commission at p. 10, at <http://www.sec.gov/rules/proposal/s71205.shtml>.

²¹ See *Final Report of the Advisory Committee on Smaller Public Companies to the United States Securities and Exchange Commission* (April 23, 2006), available at <http://www.sec.gov/info/smallbus/acspc.shtml>.

²² See, for example, letters from the Biotech Industry Association, American Electronics Association, Emerson Electric Institute, U.S. Chamber of Commerce and Joseph A. Grundfest. These letters are available in File No. 4-511, at <http://www.sec.gov/news/press/4-511.shtml>.

²³ Materials related to the Commission's 2005 Roundtable Discussion on Implementation of Internal Control Reporting Provisions and 2006 Roundtable on Second-year Experiences with Internal Control Reporting and Auditing Provisions, including the archived roundtable broadcasts, are available at <http://www.sec.gov/spotlight/soxcomp.htm>.

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, in part, 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, 79e(b), 79k(a), 79n, 79t(a), 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202 and 7262, unless otherwise noted.

■ 2. Section 210.2-02T is added after § 210.2-02 to read as follows:

§ 210.2-02T Accountants' reports and attestation reports on management's assessment of internal control over financial reporting.

(a) The requirements of section 210.2-02(f) shall not apply to a registered public accounting firm that issues or prepares an accountant's report that is included in an annual report on Form 20-F or 40-F (§ 249.220f or 249.240f of this chapter) filed by a foreign private issuer that is an accelerated filer, as that term is defined in § 240.12b-2 of this chapter, for a fiscal year ending on or after July 15, 2006 but before July 15, 2007.

(b) This temporary section will expire on December 31, 2007.

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 3. The authority citation for part 249 continues to read, in part, as follows:

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

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■ 4. Form 20-F (referenced in § 249.220f), Part II, is amended by adding Item 15T after Item 15 to read as follows.

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

FORM 20-F

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PART II

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Item 15T. Controls and Procedures

Note to Item 15T: This is a special temporary section that applies instead of Item 15 only to an issuer that is an "accelerated filer," but not a "large accelerated filer," as those terms are defined in § 240.12b-2 of this chapter, and only with respect to an annual report that the issuer is required to file for a fiscal year ending on or after July 15, 2006 but before July 15, 2007.

(a) *Disclosure Controls and Procedures.* Where the Form is being used as an annual report filed under section 13(a) or 15(d) of the Exchange Act, disclose the conclusions of the issuer's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the issuer's disclosure controls and procedures (as defined in 17 CFR 240.13a-15(e) or 240.15d-15(e)) as of the end of the period covered by the report, based on the evaluation of these controls and procedures required by paragraph (b) of 17 CFR 240.13a-15 or 240.15d-15.

(b) *Management's annual report on internal control over financial reporting.* Where the Form is being used as an annual report filed under section 13(a) or 15(d) of the Exchange Act, provide a report of management on the issuer's internal control over financial reporting (as defined in § 240.13a-15(f) or 240.15d-15(f) of this chapter). The report must contain:

- (1) A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the issuer;
- (2) A statement identifying the framework used by management to evaluate the effectiveness of the issuer's internal control over financial reporting as required by paragraph (c) of § 240.13a-15 or 240.15d-15 of this chapter; and
- (3) Management's assessment of the effectiveness of the issuer's internal control over financial reporting as of the end of the issuer's most recent fiscal year, including a statement as to whether or not internal control over financial reporting is effective. This discussion must include disclosure of any material weakness in the issuer's internal control over financial reporting identified by management. Management is not permitted to conclude that the issuer's internal control over financial reporting is effective if there are one or more material weaknesses in the issuer's internal control over financial reporting.

(c) *Changes in internal control over financial reporting.* Disclose any change in the issuer's internal control over

financial reporting identified in connection with the evaluation required by paragraph (d) of § 240.13a-15 or 240.15d-15 of this chapter that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

Instruction to Item 15T

The registrant must maintain evidential matter, including documentation to provide reasonable support for management's assessment of the effectiveness of the issuer's internal control over financial reporting.

(d) This temporary Item 15T, and accompanying note and instructions, will expire on December 31, 2007.

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■ 5. Form 40-F (referenced in § 249.240f) is amended by revising "Instruction to paragraphs (b), (c), (d) and (e) of General Instruction B.(6)" as follows:

- a. adding an "s" to the word "Instruction" in the descriptive heading of the Instructions to paragraphs (b), (c), (d) and (e) of General Instruction B(6).
- b. adding Instruction 2T.

The addition reads as follows:

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

FORM 40-F

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GENERAL INSTRUCTIONS

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B. Information To Be Filed on This Form

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(6) * * *

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2T. Paragraph (d) of this General Instruction B.6 does not apply to an issuer that is an "accelerated filer," but not a "large accelerated filer," as those terms are defined in Rule 12b-2 of this chapter, with respect to an annual report that the issuer is required to file for a fiscal year ending on or after July 15, 2006 but before July 15, 2007.

This temporary Instruction 2T will expire on December 31, 2007.

* * * * *

Dated: August 9, 2006.

By the Commission.

Nancy M. Morris,
Secretary.

[FR Doc. E6-13289 Filed 8-14-06; 8:45 am]

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