

## SECURITIES AND EXCHANGE COMMISSION

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

[Release Nos. 33-8731; 34-54295; File No. S7-06-03]

RIN 3235-AJ64

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

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed extension of compliance dates.

**SUMMARY:** We are proposing to further extend for smaller public companies the dates that were published in the **Federal Register** on September 29, 2005, in Release No. 33-8618 [70 FR 56825] for their compliance with the internal control requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002. Pursuant to the proposal, a non-accelerated filer would not be required to provide management's report on internal control over financial reporting until it files an annual report for a fiscal year ending on or after December 15, 2007. If we have not issued additional guidance for management on how to complete its assessment of internal control over financial reporting in time to be of assistance in connection with annual reports filed for fiscal years ending on or after December 15, 2007, this deadline could be further postponed. Under the proposal, the auditor's attestation report on internal control over financial reporting would not be required until a non-accelerated filer files an annual report for a fiscal year ending on or after December 15, 2008. If revisions to Auditing Standard No. 2 have not been finalized in time to be of assistance in connection with annual reports filed for fiscal years ending on or after December 15, 2008, this deadline could also be further postponed.

We also are proposing to provide a transition period for newly public companies before they become subject to compliance with the internal control over financial reporting requirements. Under the proposal, a company would not become subject to these requirements until it previously has been required to file one annual report with the Commission.

**DATES:** Comments should be received on or before September 14, 2006.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-06-03 on the subject line; or
- Use the Federal Rulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-06-03. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Sean Harrison, Special Counsel, Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are proposing to amend certain internal control over financial reporting requirements in Rules 13a-14,<sup>1</sup> 15d-14,<sup>2</sup> 13a-15<sup>3</sup> and 15d-15<sup>4</sup> under the Securities Exchange Act of 1934,<sup>5</sup> Items 308(a) and (b) of Regulations S-K<sup>6</sup> and S-B,<sup>7</sup> Item 15 of Form 20-F,<sup>8</sup> General Instruction B(6) of Form 40-F,<sup>9</sup> and Rule 2-02(f) of Regulation S-X.<sup>10</sup> We also propose to add the following

temporary provisions: Item 308T of Regulations S-K and S-B, Item 8A(T) of Form 10-KSB, Item 9A(T) of Form 10-K, and Item 15T of Form 20-F.

## I. Background

On June 5, 2003,<sup>11</sup> the Commission adopted several amendments to its rules and forms implementing Section 404 of the Sarbanes-Oxley Act of 2002.<sup>12</sup> Among other things, these amendments require companies, other than registered investment companies, to include in their annual reports a report of management, and an accompanying auditor's attestation report, on the effectiveness of the company's internal control over financial reporting, and to evaluate, as of the end of each fiscal quarter, or year in the case of a foreign private issuer filing its annual report on Form 20-F or Form 40-F, 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.

Under the compliance dates that we originally established, companies meeting the definition of an "accelerated filer" in Exchange Act Rule 12b-2<sup>13</sup> would have become subject to the internal control reporting requirements with respect to the first annual report that they filed for a fiscal year ending on or after June 15, 2004. Non-accelerated filers<sup>14</sup> would not have become subject to the requirements until they filed an annual report for a fiscal year ending on or after April 15, 2005. The Commission provided a lengthy compliance period for these amendments in light of both the substantial time and resources needed by companies to properly implement the rules.<sup>15</sup> In addition, we believed that a corresponding benefit to investors would result from an extended transition period that allowed companies to carefully implement the new requirements, and noted that an extended period would provide additional time for the Public Company Accounting Oversight Board (the "PCAOB") to consider relevant factors in determining and implementing new

<sup>11</sup> See Release No. 33-8238 (June 5, 2003) [68 FR 36636].

<sup>12</sup> 15 U.S.C. 7262.

<sup>13</sup> 17 CFR 240.12b-2.

<sup>14</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>15</sup> See Release No. 33-8238.

<sup>1</sup> 17 CFR 240.13a-14.

<sup>2</sup> 17 CFR 240.15d-14.

<sup>3</sup> 17 CFR 240.13a-15.

<sup>4</sup> 17 CFR 240.15d-15.

<sup>5</sup> 15 U.S.C. 78a et seq.

<sup>6</sup> 17 CFR 229.10 et seq.

<sup>7</sup> 17 CFR 228.10 et seq.

<sup>8</sup> 17 CFR 249.20f.

<sup>9</sup> 17 CFR 249.40f.

<sup>10</sup> 17 CFR 210.2-02(f).

attestation standards for registered public accounting firms.<sup>16</sup>

In February 2004, we extended the compliance dates for accelerated filers to fiscal years ending on or after November 15, 2004, and for non-accelerated filers and for foreign private issuers to fiscal years ending on or after July 15, 2005.<sup>17</sup> The primary purpose of this extension was to provide additional time for companies' auditors to implement Auditing Standard No. 2, which the PCAOB had issued in final form in June 2004.<sup>18</sup>

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-F in view of the efforts by the Committee of Sponsoring Organizations ("COSO") to provide more guidance on how the COSO framework can be applied to smaller public companies.<sup>19</sup> We also acknowledged the significant efforts being expended by many foreign private issuers to comply with International Financial Reporting Standards.

Most recently, in September 2005, we again extended the compliance dates for the internal control over financial reporting requirements applicable to companies that are non-accelerated filers. Based on the September 2005 extension, domestic and foreign non-accelerated filers currently are scheduled to comply with the internal control over financial reporting requirements beginning with annual reports filed for their first fiscal year ending on or after July 15, 2007. This extension was based primarily on our desire to have the additional guidance in place that COSO had begun to develop to assist smaller companies in applying the COSO framework. In addition, the extension was consistent with a recommendation made by the SEC Advisory Committee on Smaller Public Companies.

Since we granted that extension last year, a number of events related to internal control assessments have occurred. Most recently, on July 11,

2006, COSO and its Advisory Task Force issued *Guidance for Smaller Public Companies Reporting on Internal Control over Financial Reporting*.<sup>20</sup> The guidance is intended to assist the management of smaller companies in understanding and applying the COSO framework. It outlines 20 fundamental principles associated with the five key components of internal control described in the COSO framework, defines each principle, describes a variety of approaches that smaller companies can use to apply the principles, and includes examples of how smaller companies have applied the principles.

In addition, on April 23, 2006, the SEC Advisory Committee on Smaller Public Companies submitted its final report to the Commission.<sup>21</sup> 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.

In April 2006, the U.S. Government Accountability Office issued a report entitled *Sarbanes-Oxley Act, Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies*.<sup>22</sup> This report recommended that the Commission consider whether the currently available guidance, particularly the guidance on management's assessment, is sufficient or whether additional action is needed to help companies comply with the internal control over financial reporting requirements. The report indicates that management's implementation and assessment efforts were largely driven by Auditing Standard No. 2 because guidance at a similar level of detail was

not available for management's implementation and assessment process. Furthermore, the report recommended that the Commission coordinate its efforts with the PCAOB so that the Section 404-related audit standards and guidance are consistent with any additional guidance applicable to management's assessment of internal control.<sup>23</sup>

Finally, 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 suggested that additional management guidance would be useful, particularly for smaller public companies, and also expressed support for revisions to the PCAOB's Auditing Standard No. 2.<sup>24</sup>

## II. Proposed Extension of Internal Control Reporting Compliance Dates for Non-Accelerated Filers

On May 17, 2006, the Commission and the PCAOB each announced a series of actions that they intend to take to improve the implementation of the Section 404 internal control over financial reporting requirements of the Sarbanes-Oxley Act of 2002.<sup>25</sup> These actions include:

- 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;
- Consideration of additional guidance from COSO;
- Revisions to Auditing Standard No. 2;
- Reinforcement of auditor efficiency through PCAOB inspections and Commission oversight of the PCAOB's audit firm inspection program;
- Development, or facilitation of development, of implementation guidance for auditors of smaller public companies;

<sup>16</sup> Under the Sarbanes-Oxley Act, the PCAOB was granted authority to set auditing and attestation standards for registered public accounting firms.

<sup>17</sup> See Release No. 33-8392 (February 24, 2004) [69 FR 9722].

<sup>18</sup> See Release No. 34-49884 File No. PCAOB 2004-03 (June 17, 2004) [69 FR 35083]. Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Connection with an Audit of Financial Statements*, provides the professional standards and related performance guidance for independent auditors to attest to, and report on, the effectiveness of companies' internal control over financial reporting.

<sup>19</sup> Release No. 33-8545 (March 2, 2005) [70 FR 11528].

<sup>20</sup> See SEC Press Release No. 2006-114 (July 11, 2006) at <http://www.sec.gov/news/press/2006/2006-114.htm>.

<sup>21</sup> 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>.

<sup>22</sup> United States Government Accountability Office Report to the Committee on Small Business and Entrepreneurship, U.S. Senate: *Sarbanes-Oxley Act: Consideration of Key Principles Needed in Addressing Implementation for Smaller Public Companies* (April 2006).

<sup>23</sup> See GAO Report at 52-53 and 58.

<sup>24</sup> 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>.

<sup>25</sup> See SEC Press Release 2006-75 (May 17, 2006), "SEC Announces Next Steps for Sarbanes-Oxley Implementation" and PCAOB Press Release (May 17, 2006), "Board Announces Four-Point Plan to Improve Implementation of Internal Control Reporting Requirements."

- Continuation of PCAOB forums on auditing in the small business environment; and

- Provision of an additional extension of the compliance dates of the internal control reporting requirements for non-accelerated filers.

On July 11, 2006, we issued a Concept Release to seek public comment on issues that we should address in our guidance for management on how to assess internal control over financial reporting.<sup>26</sup> In accordance with the last point in the above list, we are issuing this release to propose an additional extension of the dates for complying with our internal control over financial reporting requirements for domestic and foreign non-accelerated filers. As a companion to this release, we are separately issuing a release that extends for a one-year period the date by which foreign private issuers that are accelerated filers (but not large accelerated filers), and that file their annual reports on Form 20-F or 40-F, must begin to comply with the auditor attestation report portion of the internal control over financial reporting requirements.<sup>27</sup>

As we proceed in our efforts to make the internal control reporting process more efficient and effective, we believe that a further postponement of the compliance dates for non-accelerated filers is appropriate. The postponement is intended to provide these filers, none of which is yet required to comply with the Section 404 requirements, with the benefit of the management guidance that the Commission plans to issue and the recently issued COSO guidance on understanding and applying the COSO framework, before planning and conducting their internal control assessments. Specifically, we propose to postpone for five months (from fiscal years ending on or after July 15, 2007 until fiscal years ending on or after December 15, 2007) the date by which non-accelerated filers must begin to include a report by management assessing the effectiveness of the companies' internal control over financial reporting. Approximately 44% of the domestic companies filing periodic reports are non-accelerated filers, and an estimated 38% of the foreign private issuers subject to Exchange Act reporting are non-accelerated filers.<sup>28</sup>

<sup>26</sup> Release No. 34-54122 (July 11, 2006).

<sup>27</sup> Release No. 34-54294 (Aug. 9, 2006).

<sup>28</sup> The percentage of domestic companies, excluding 1940 Act filers, that is categorized as non-accelerated filers is based on public float where available (or market capitalization, otherwise) from Datastream as of December 31, 2005. The estimated percentage of foreign private issuers that are non-

Pursuant to this proposed extension, a non-accelerated filer would begin to provide the management report required by Item 308(a) of Regulations S-K and S-B in the first annual report it files for a fiscal year ending on or after December 15, 2007.<sup>29</sup> We estimate that fewer than 15% of all non-accelerated filers will have a fiscal year ending between July 15, 2007 and December 15, 2007.<sup>30</sup> Therefore, the majority of non-accelerated filers, including those with a calendar year-end, would begin to include management's report in their annual reports for 2007.

We also propose to extend the compliance date for all non-accelerated filers regarding the auditor attestation report requirement in Item 308(b) of Regulations S-K and S-B for a longer period of time.<sup>31</sup> Under the proposed extension, a non-accelerated filer would not have to file the auditor's attestation report on management's assessment of internal control over financial reporting until it files an annual report for a fiscal year ending on or after December 15, 2008. Under current requirements, a non-accelerated filer would have to begin including the auditor's attestation report in the annual report filed for its first fiscal year ending on or after July 15, 2007, so we would be extending this deadline for 17 months. This proposed extension would result in all non-accelerated filers having to complete only management's portion of the internal control requirements in their first year of compliance with the requirements. The main purposes of the proposed extension of the auditor attestation report requirement are:

- To afford non-accelerated filers and their auditors the benefit of anticipated changes that the PCAOB makes to Auditing Standard No. 2, as approved by the Commission, as well as any implementation guidance that the

accelerated filers is based on market capitalization data from Datastream as of December 31, 2005.

<sup>29</sup> Similarly, a foreign private issuer that is a non-accelerated filer would have to begin to provide the management report required by Item 15(b) of Form 20-F or General Instruction B of Form 40-F in the annual report filed for its first fiscal year ending on or after December 15, 2007. See proposed Item 308T of Regulations S-K and S-B, Item 15T of Form 20-F and proposed Instruction 3T to paragraphs (b), (c), (d) and (e) of General Instruction B.6 in Form 40-F.

<sup>30</sup> The percent of all non-accelerated filers is categorized using float where available (or market capitalization, otherwise) using Datastream as of December 31, 2005 and excludes 1940 Act filers. Fiscal year ends are also from Datastream.

<sup>31</sup> We also propose to extend the compliance dates regarding the auditor attestation report requirement appearing in Item 15(c) of Form 20-F and General Instruction B of Form 40-F with respect to foreign private issuers that are non-accelerated filers.

PCAOB issues for auditors of smaller public companies;

- To save non-accelerated filers potential costs associated with the initial auditor's attestation to, and report on, management's assessment of internal control over financial reporting during the period that changes to Auditing Standard No. 2 are being considered and implemented, and the PCAOB is formulating guidance that will be specifically directed to auditors of smaller companies;

- To enable management of non-accelerated filers to more gradually prepare for full compliance with the Section 404 requirements and to gain some efficiencies in the process of reviewing and evaluating the effectiveness of internal control over financial reporting before becoming subject to the requirement that the auditor attest to, and report on, management's assessment of internal control over financial reporting (and to permit investors to see and evaluate the results of management's first compliance efforts); and

- To provide the Commission with the flexibility to consider any comments it receives on the Concept Release and its subsequent proposed guidance for management in response to the questions related to the appropriate role of the auditor in evaluating management's internal control assessment process.

We expect that the proposed extension of the management assessment requirement will provide sufficient time for the Commission to issue final guidance to assist in management's performance of a top-down, risk-based and scalable assessment of controls over financial reporting. If such guidance is not finalized in time to be of assistance to management of non-accelerated filers in connection with their annual reports filed for fiscal years ending on or after December 15, 2007, we will consider further postponing non-accelerated filers' deadline for the management assessment requirement. In addition, we expect that the proposed extension of the auditor attestation report requirement will provide sufficient time for revisions to Auditing Standard No. 2 to be proposed and finalized (including clarification of the auditor's role in evaluating a company's process for assessing the effectiveness of its internal control over financial reporting). If Auditing Standard No. 2 has not been revised in time to be of assistance in connection with the auditor attestation reports on management assessments for years ending on or after December 15, 2008,

we will consider further postponing the auditor attestation report compliance dates.

Many public commenters have asserted that the internal control reporting 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. Furthermore, we have learned from public comments, including our roundtables on implementation of the internal control reporting provisions,<sup>32</sup> that while companies incur increased internal costs in the first year of compliance as well due to "deferred maintenance" items (e.g., documentation, remediation, etc.), these costs may decrease in the second year. Therefore, postponing the costs that result from the auditor's attestation report until the second year would help non-accelerated filers smooth the significant cost spike that has been experienced by many accelerated filers in their first year of compliance with the Section 404 requirements.

Although the proposed extensions would permit non-accelerated filers to omit the auditor's attestation report from their annual reports in their initial year of compliance with the Section 404 requirements, we encourage frequent and frank dialogue among management, auditors and audit committees to improve internal controls and the financial reports upon which investors rely. In this regard, we repeat our assurance that management should not fear that a discussion of internal controls with, or a request for assistance or clarification from, the auditor will itself be deemed a deficiency in internal control or constitute a violation of our independence rules as long as management determines the accounting to be used and does not rely on the auditor to design or implement its controls.<sup>33</sup>

We are concerned that a company that files only a management report during its first year of compliance with the Section 404 requirements may become subject to more second-guessing as a result of the proposed separation of the reports than under the current requirements (e.g., management

concludes that the company's internal control over financial reporting is effective when only management's report is filed in the first year of compliance, but the auditor comes to a contrary conclusion in its report filed in the subsequent year, and as a result, the company's previous assessment is called into question). In an effort to address these concerns, we propose to deem the management report included in the non-accelerated filer's annual report during the first year of compliance to be "furnished" rather than "filed."<sup>34</sup> If we adopt this proposal, we intend to afford similar relief to the foreign private issuers that are accelerated filers (but not large accelerated filers), and that file their annual reports on Form 20-F or 40-F that similarly will file only management's report during their first year of compliance with the Section 404 requirements.<sup>35</sup>

We also propose that, until it files an annual report that includes a report by management on the effectiveness of the company's internal control over financial reporting, a non-accelerated filer could continue to omit the portion of the introductory language in paragraph 4 as well as language in paragraph 4(b) of the certification required by Exchange Act Rules 13a-14(a) and 15d-14(a)<sup>36</sup> that refers to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting for the company. This language, however, would have to be provided in the first annual report required to contain management's internal control report and in all periodic reports filed thereafter. The extended compliance dates also would apply to the provisions in Exchange Act Rules 13a-15(a) and (d) and 15d-15(a) and (d)<sup>37</sup> relating to the maintenance of internal control over financial reporting.

Finally, we propose to clarify that, until a non-accelerated filer becomes subject to the auditor attestation report requirement, the registered public accounting firm retained by the non-accelerated filer 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.

The extended compliance periods that are proposed in this release would not in any way alter requirements regarding internal control that already are in effect with respect to non-accelerated filers, including without limitation, Section 13(b)(2) of the Exchange Act<sup>38</sup> and the rules thereunder.

#### *Request for Comment*

We request and encourage any interested person to submit comments regarding the proposed extension of the compliance dates described above. In particular, we solicit comment on the following questions:

- Is it appropriate to provide a further extension of the compliance dates of the internal control over financial reporting requirements for non-accelerated filers? If so, are the proposed extensions for compliance with management and auditor attestation report requirements appropriate in length or should they be shorter or longer than proposed? Should the Commission consider a further extension if the revisions to Auditing Standard No. 2 and the release of guidance for management are not completed in sufficient time to permit issuers and auditors to rely on them?
- Is it appropriate to implement sequentially the requirements of Section 404(a) and (b) of the Sarbanes-Oxley Act, as proposed, so that a non-accelerated filer would only have to include management's internal control assessment in the annual report that it files for its first fiscal year ending on or after December 15, 2007 and would not have to begin providing an accompanying auditor's attestation report until it files an annual report for a fiscal year ending on or after December 15, 2008?
- Would the phasing-in of the management assessment requirement and auditor attestation report requirement make the ultimate application of Auditing Standard No. 2 more or less efficient and effective?
- Is it appropriate to deem the management report on internal control over financial reporting to be "furnished" rather than "filed" during the first year of a non-accelerated filer's compliance with the Section 404

<sup>32</sup> 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>.

<sup>33</sup> See *Commission Statement on Implementation of Internal Control Requirements*, Press Release No. 2005-74 (May 16, 2005) at <http://www.sec.gov/news/press/2005-74.htm>.

<sup>34</sup> As proposed, management's report would not be deemed to be filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the issuer 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>35</sup> See Release No. 34-54294 (Aug. 9, 2006).

<sup>36</sup> 17 CFR 13a-14(a) and 15d-14(a).

<sup>37</sup> 17 CFR 13a-15(a) and (d) and 15d-15(a) and (d).

<sup>38</sup> 15 U.S.C. 78m(b)(2).

requirements? If so, is it also appropriate to take the same action during the first year of compliance with the Section 404 requirements by a foreign private issuer that is an accelerated filer, but not a large accelerated filer, and that files its annual reports on Form 20-F or 40-F?

- Would management's assessment of internal control over financial reporting provide meaningful disclosure to investors, independent of the auditor attestation report? Is there an increased risk that management will fail to identify a material weakness in the company's internal control over financial reporting, and if so, do the potential benefits of the proposal outweigh this risk?

- Are the proposed extensions in the best interests of investors?

- Should we require a non-accelerated filer to disclose in its annual report that management's assessment has not been attested to by the auditor during the year that the audit attestation report is not required?

- Simultaneously with the publication of this release, we are issuing a separate release to extend the date by which a foreign private issuer that is an accelerated filer (but not a large accelerated filer), and that files its annual reports on Form 20-F or 40-F, must begin to comply with the auditor attestation report portion of the Section 404 requirements. Is there any additional relief or guidance that we should consider specifically with respect to foreign private issuers?

### III. Proposed Transition Period for Compliance with the Internal Control Over Financial Reporting Requirements by Newly Public Companies

In the future, after all types of Exchange Act reporting companies (*i.e.* large accelerated filers, accelerated filers and non-accelerated filers) are required to comply fully with the internal control reporting provisions, any company undertaking an initial public offering or registering a class of securities under the Exchange Act for the first time will be required to comply fully with our internal control reporting requirements as of the end of the fiscal year in which it becomes a public company. If the initial public offering or Exchange Act registration occurs in close proximity to the company's fiscal year end, the need to prepare for compliance with the internal control over financial reporting requirements therefore will arise very rapidly after the company becomes public. For a foreign private issuer, this requirement also might quickly follow

its having had to prepare, for the first time, a reconciliation to U.S. GAAP.<sup>39</sup>

For many companies, preparation of the first annual report on Form 10-K, 10-KSB, 20-F or 40-F is a comprehensive process involving the audit of financial statements, compilation of information that is responsive to many new public disclosure requirements and review of the report by the company's executive officers, board of directors and legal counsel. Requiring a newly public company and its auditor to also complete the management report and auditor attestation report on the effectiveness of the company's internal control over financial reporting within the same timeframe might impose undue burdens on this process. In addition, we are concerned that this requirement could affect a company's decision to undertake an initial public offering or to list a class of its securities on a U.S. exchange or a company's timing decisions with regard to such an offering or listing. During our roundtable on May 10, 2006, we received comments indicating that some private companies are more likely to consider alternative capital markets in view of the regulatory hurdles that newly public companies face in the U.S.<sup>40</sup> We believe that the current due date for filing the first Section 404 reports may exacerbate that disincentive.

A transition period also would alleviate reporting burdens imposed on some foreign companies that become subject to the Exchange Act reporting requirements solely by virtue of their registration of securities under the Securities Act in connection with an exchange offer for the securities of, or business combination with, another foreign company that does not have securities registered with the Commission.<sup>41</sup> Under Section 15(d) of the Exchange Act and related rules, the foreign private issuer that files a Securities Act registration statement in connection with the acquisition must

<sup>39</sup> See Item 17 or 18 of Form 20-F.

<sup>40</sup> Noreen Culhane, Peter Lyons, Robert Pozen and David Warren were among those making this observation at the roundtable. The roundtable webcast is archived at <http://www.connectlive.com/events/secicr2006>. See also the letter from Stephan Stephanov available in File No. 4-511 at <http://www.sec.gov/news/press/4-511.shtml>.

<sup>41</sup> Although Rule 802 [17 CFR 230.802] under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] provides an exemption from Securities Act registration for certain securities offerings by foreign private issuers in connection with an exchange offer or business combination, a transaction that does not meet all of the conditions for reliance on the exemption must be registered under the Securities Act, typically on Form F-4 [17 CFR 239.34].

file at least one annual report after the effective date of the registration statement before becoming eligible to terminate its periodic filing obligations. Under existing rules, the foreign private issuer would have to include the management and auditor reports on internal control over financial reporting in the only annual report that the foreign private issuer ever files with the Commission.<sup>42</sup> The proposed transition period similarly would alleviate reporting burdens imposed on domestic companies that become subject to Section 15(d) after filing a Securities Act registration statement but are eligible to terminate their periodic filing obligations after filing just one annual report.

In light of these concerns, we think that it may be appropriate to provide a transition period for newly public companies. Under the proposed amendments, a newly public company would not need to comply with our internal control over financial reporting requirements in the first annual report that it is required to file with the Commission.<sup>43</sup> Rather, the company would begin to comply with these requirements in the second annual report that it files with the Commission.

We believe that providing additional time for newly public companies to conduct their first assessment of internal control should benefit investors by making implementation of the internal control reporting requirements more effective and efficient and reducing some of the costs that these companies face in their first year as a public company. We also believe that the proposed transition period would remove a possibility that our rules may unnecessarily interfere with companies' business decisions regarding the timing and use of resources relating to their initial U.S. listings or public offerings. Like the proposed extension for non-accelerated filers, the proposed transition period for newly public companies would not in any way alter requirements regarding internal control that already are in effect with respect to all Exchange Act reporting companies, including without limitation, Section 13(b)(2) of the Exchange Act<sup>44</sup> and the rules thereunder.

<sup>42</sup> As a result, the current rules may serve as a disincentive to extend offers of securities in connection with a business acquisition transaction on a registered basis.

<sup>43</sup> Proposed Instruction 1 to Item 308 of Regulation S-B and S-K, Item 15 of Form 20-F, and General Instruction B(6) of Form 40-F, and Rules 13a-15(c) and (d) and 15d-15(c) and (d), as we proposed to revise them.

<sup>44</sup> 15 U.S.C. 78m(b)(2).

### Request for Comment

We request and encourage any interested person to submit comments regarding the proposed transition period for compliance with the internal control over financial reporting requirements.

- Do the timing requirements for initial compliance with the internal control reporting requirements make it overly burdensome or costly to undertake an initial public offering or public listing in the U.S.? Do they otherwise discourage companies from undertaking initial public offerings or seeking public listings in the U.S.? Is the proposed relief appropriate and in the interest of investors? Is some other type of relief appropriate?

- Should newly public companies, or a subgroup of newly public companies, be given additional time after going public before they are required to include management and auditor attestation reports on internal control over financial reporting in their annual reports filed with the Commission? If so, how much time? Should we propose a transition period only for companies that become public in the third or fourth quarter of their fiscal year?

- As an alternative to the proposed transition period, should we require a newly public company to include management's assessment, but not the auditor's attestation report on management's assessment in the first annual report that the company is required to file?

- Would the proposed transition period allow newly public companies to complete their internal control reporting processes more efficiently and effectively? Would it improve the quality of internal control reporting by newly public companies?

### IV. Paperwork Reduction Act

In connection with our original proposal and adoption of the rule and from amendments implementing the Section 404 requirements, we submitted a request for approval of the "collection of information" requirements contained in the amendments to the Office of Management and Budget ("OMB") in accordance with the Paperwork Reduction Act of 1995 ("PRA").<sup>45</sup> OMB approved these requirements.

### V. Cost-Benefit Analysis

#### A. Benefits

The proposed extension of the compliance dates is intended to make implementation of the internal control reporting requirements more efficient and cost-effective for non-accelerated

filers. The proposed extension would postpone for five months (from fiscal years ending on or after July 15, 2007 until fiscal years ending on or after December 15, 2007) the date by which non-accelerated filers must begin to include a report by management assessing the effectiveness of the companies' internal control over financial reporting. Based on our estimates, we believe that fewer than 15% of all non-accelerated filers have a fiscal year ending between July 15, 2007, and December 15, 2007. In addition, under the proposed extension, a non-accelerated filer would not have to include an auditor attestation report on management's assessment of internal control over financial reporting until it files an annual report for its first fiscal year ending on or after December 15, 2008. This would result in all non-accelerated filers having to complete only management's assessment in their first year of compliance with the Section 404 requirements. We believe that the following benefits would flow from an additional postponement of the dates by which non-accelerated filers must comply with the internal control reporting requirements:

- auditors of non-accelerated filers would have more time to conform their initial attestation reports on management's assessment of internal control over financial reporting to the changes that the PCAOB anticipates making to Auditing Standard No. 2 (as approved by the Commission) and other actions that the PCAOB intends to take as described above;

- non-accelerated filers would save costs associated with their initial audit of internal control over financial reporting while changes to the auditing standard are being considered and implemented and the PCAOB is developing, or facilitating the development of, additional guidance that will be specifically directed to auditors of smaller public companies;

- management of non-accelerated filers could begin the process of assessing the effectiveness of internal control over financial reporting before their auditors attest to such assessment (and investors could begin to see and evaluate the results of these initial efforts); and

- non-accelerated filers with a fiscal year ending between July 15, 2007 and December 15, 2007 would have additional time to consider the management guidance to be issued by the Commission and recently issued COSO guidance on understanding and applying the COSO framework, before planning and conducting their first internal control assessment.

Many public commenters have asserted that the internal control reporting compliance costs are likely to be disproportionately higher for smaller public companies than larger ones, and that the audit fee represents a large percentage of those costs. We believe that the potential cost savings that would result from the fact that the non-accelerated filers would not have to include an auditor's attestation report on management's assessment of the effectiveness of their internal control over financial reporting during the filers' first year of compliance with the Section 404 requirements would be substantial. Estimates of the average fee for an auditor's attestation report on management's assessment of internal control over financial reporting from various surveys suggest that, on average, a non-accelerated filer could save between \$475,000 and \$300,000 in auditor costs for one year.<sup>46</sup>

Additionally, we have learned from public comments, including our roundtables on implementation of the internal control reporting provisions,<sup>47</sup> that while companies incur increased internal costs in the first year of compliance as well due to "deferred maintenance" items (e.g., documentation, remediation, etc.), these costs may decrease in the second year. Therefore, postponing the auditor costs until the second year would help non-accelerated filers smooth the significant cost spike that many accelerated filers have experienced in the first year of compliance.

We think that benefits of the proposed transition for newly public companies include the following:

- Companies that are going public would be able to concentrate on their

<sup>46</sup> Estimates of costs savings are from highest: (1) Foley and Lardner Survey ([http://www.foley.com/files/tbl\\_s31Publications/FileUpload137/2777/2005%20Cost%20of%20Being%20Public%20Final.pdf](http://www.foley.com/files/tbl_s31Publications/FileUpload137/2777/2005%20Cost%20of%20Being%20Public%20Final.pdf)) which estimates that the increase in audit fees from 2003 to 2004 for the S&P Small cap was \$475,000; (2) FEI Survey ([http://www.fei.org/404\\_survey\\_3\\_21\\_05.cfm](http://www.fei.org/404_survey_3_21_05.cfm)) which estimates 2005 auditor attestation fees for non-accelerated filers of \$393,333 (a decline of -12.8% from 2004); and (3) CRA Survey ([http://www.s-oxinternalcontrolinfo.com/pdfs/CRA\\_III.pdf](http://www.s-oxinternalcontrolinfo.com/pdfs/CRA_III.pdf)) total audit costs are estimated for companies with market capitalization below \$125 million to be between \$312,800 in year 1 and \$206,700 in year two (based on the percent of total audit costs as a percent of total Section 404 fees from Table 1 in the study and multiplied by the total Section 404 fees estimated for this category of companies.) The Commission has not independently verified the reliability or accuracy of these survey data.

<sup>47</sup> 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>.

<sup>45</sup> 44 U.S.C. 3501 *et seq.* and 5 CFR 1320.11.

initial securities offering without the additional burden of becoming subject to the Section 404 requirements soon after the offering;

- Newly public companies would be able to prepare their first annual report without the additional burden of having to comply with the Section 404 requirements at the same time;
- The quality of newly public companies' first compliance efforts may improve due to the additional time that the companies would have to prepare to satisfy the Section 404 requirements; and
- The proposed transition period would eliminate any incentive that the current rules may create for a company that plans to go public to time its initial public offering to defer compliance with the Section 404 requirements for as long as possible after the offering.

#### B. Costs

Under the proposals, investors in companies that are non-accelerated filers will have to wait longer to review an attestation report by the companies' auditor on management's assessment of internal control over financial reporting. The proposals may create a risk that, without the auditor's attestation to management's assessment process, some issuers may conclude that the company's internal control over financial reporting is effective without conducting an assessment that is as thorough, careful and as appropriate to the issuers' circumstances as they would conduct if the auditor were involved.

Another potential cost in the form of increased litigation risk may be created by the proposed phasing-in of the auditor's attestation report on management's assessment if, in year one, management concludes that the company's internal control over financial reporting is effective, but the auditor comes to a contrary conclusion the following year, thereby calling into question management's earlier conclusion. We have tried to mitigate that risk by proposing that the management report be furnished to, rather than filed with, the Commission in the first year of compliance.

A potential cost of the proposed transition for newly public companies is that investors may be subject to uncertainty as to the effectiveness of a newly public company's internal control over financial reporting for a longer period of time than under current requirements.

We request comment on the costs and benefits of the proposed extension and amendments to the internal control over financial reporting requirements,

including any costs and benefits that we have not identified but that we should consider.

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

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or SBREFA,"<sup>48</sup> we solicit data to determine whether the proposals constitute a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposals on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views if possible. Section 23(a)(2) of the Exchange Act<sup>49</sup> also requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, 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.

We expect the proposed extension of compliance dates, if adopted, to increase efficiency and enhance capital formation, and thereby benefit investors, by providing more time for non-accelerated filers to prepare for compliance with the Section 404 requirements and affording these filers the opportunity to consider implementation guidance that is specifically tailored to smaller public companies. We further expect a more gradual phase-in of the management assessment and auditor attestation report requirements over a two-year period, rather than requiring non-accelerated filers to fully comply with both requirements in their first compliance year, to make the implementation process more efficient and less costly for non-accelerated filers. 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 do not expect that

the proposals will have any measurable effect on competition.

The proposed transition period for newly public companies should increase efficiency and enhance capital formation by enabling these companies to concentrate on the initial securities offering process, if they are becoming subject to the Exchange Act reporting requirements by virtue of a public securities offering, and to prepare their first annual reports without the additional burden of complying with the Section 404 requirements. The provision of additional time for newly public companies to prepare for compliance with the internal control over financial reporting requirements may lead to increased quality of the companies' initial compliance efforts.

In addition, the current requirements might provide an incentive for private companies to time their public offerings so as to maximize the length of time that they will have after going public before having to comply with the Section 404 requirements. The proposal to allow newly public companies to defer compliance with these requirements until they file their second annual report with the Commission would eliminate this incentive. This would enhance capital formation by allowing companies to time their offerings to raise the most capital rather than to avoid a compliance requirement. In reducing regulatory burdens for newly public companies, we may also increase the attractiveness of the U.S. markets to foreign companies.

We solicit public comment that will assist us in assessing the impact that the proposals could have on competition, efficiency and capital formation.

#### VII. Initial Regulatory Flexibility Analysis

This Initial Regulatory Flexibility Analysis ("IRFA") has been prepared in accordance with the Regulatory Flexibility Act.<sup>50</sup> This IRFA relates to proposed amendments to extend the compliance dates applicable to non-accelerated filers for certain internal control over financial reporting requirements in Rules 13a-14, 15d-14, 13a-15 and 15d-15 under the Securities Exchange Act of 1934, Items 308(a) and (b) of Regulations S-K and S-B, Rule 2-02(f) of Regulation S-X, Item 15 of Form 20-F and General Instruction B of Form 40-F. These amendments require Exchange Act reporting companies, other than registered investment companies, to include in their annual reports a report of management on the company's internal control over

<sup>48</sup> 5 U.S.C. 801 *et seq.*

<sup>49</sup> 15 U.S.C. 78w(a).

<sup>50</sup> 5 U.S.C. 603.

financial reporting. These amendments also require the registered public accounting firm that issues an audit report on the company's financial statements to attest to, and report on, management's assessment.

Non-accelerated filers currently are scheduled to begin to comply with the management's assessment and auditor attestation report requirements for their first fiscal year ending on or after July 15, 2007. We propose to extend this compliance date with respect to the management's assessment portion of these requirements for five months, so that a non-accelerated filer would begin including a report by management on the company's internal control over financial reporting in the annual report that it files for its first fiscal year ending on or after December 15, 2007. Furthermore, we propose to extend the compliance date with respect to the auditor attestation report portion of these requirements so that a non-accelerated filer would need to begin including an auditor's attestation report on management's assessment of the company's internal control over financial reporting in the annual report that it files for its first fiscal year ending on or after December 15, 2008.

This IRFA also relates to a proposed transition period for compliance with the internal control over financial reporting requirements by newly public companies. Under the proposed amendments, a newly public company would not need to comply with our internal control over financial reporting requirements until after it has been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for at least 12 months, and has filed at least one annual report with the Commission.

#### A. Reasons for the Proposed Action

The Commission and the PCAOB plan a series of actions that will result in the issuance of new guidance to aid companies and auditors in performing their evaluations of internal control over financial reporting. The proposed extension is designed to afford non-accelerated filers additional time to consider this planned guidance and the new guidance for smaller companies regarding application of the COSO Framework. The proposed transition period for newly public companies would eliminate the need for a public company with the Section 404 requirements in the first annual report that it files with the Commission.

#### B. Objectives

The proposed 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.

#### C. Legal Basis

We are issuing the proposals under the authority set forth in Sections 12, 13, 15 and 23 of the Exchange Act.

#### D. Small Entities Subject to the Proposed Revisions

The proposed changes would affect some issuers that are small entities. Exchange Act Rule 0-10(a)<sup>51</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 2,500 issuers, other than registered investment companies, that may be considered small entities. The proposed extensions would apply to any small entity that is subject to Exchange Act reporting requirements.

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

The proposed compliance date extensions would alleviate reporting and compliance burdens by postponing the date by which non-accelerated filers with a fiscal year end between July 15, 2007 and December 15, 2007 must begin to comply with the internal control over financial reporting requirements, and by eliminating the requirement for all non-accelerated filers that they must include an auditor's report on internal control over financial reporting in their annual report during their initial year of compliance with the internal control over financial reporting requirements.

The proposed transition for newly public companies also would alleviate reporting and compliance burdens. We are concerned that requiring a newly public company and its auditor to complete the management report and auditor attestation report on the effectiveness of the company's internal control over financial reporting within the same timeframe that it is preparing its first annual report might impose undue burdens on this process. In addition, we are concerned that the requirement that a newly public company must begin to comply with the Section 404 requirements in the first annual report that it files could affect a company's decision to undertake an initial public offering or to list a class of its securities on a U.S. exchange or

a company's timing decisions with regard to such an offering or listing.

#### F. Duplicative, Overlapping, or Conflicting Federal Rules

The internal control over financial reporting requirements, as they apply to any small entities, do not duplicate, overlap, or conflict with other federal rules.

#### G. Significant Alternatives

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 proposed extension, 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.

We are not proposing a complete and permanent exemption for small entities from coverage of the Section 404 requirements. However, the proposed amendments would establish a different compliance and reporting timetable for small entities and provide additional time for newly public companies to prepare to comply with the internal control over financial reporting requirements. We believe that the proposed amendments would promote the primary goal of enhancing the quality of reporting and increasing investor confidence in the fairness and integrity of the securities markets. The proposed extensions are designed to provide companies that are non-accelerated filers with sufficient time to consider any guidance issued by us and other entities, such as COSO, before planning and conducting their internal control assessments, and to consider the revisions to Auditing Standard No. 2 that we expect to be issued by the PCAOB and approved by the Commission. The proposed amendments, our forthcoming management guidance, and the revisions to Auditing Standard No. 2 should make implementation of the internal control reporting requirements more effective and efficient for non-accelerated filers and newly public companies.

<sup>51</sup> 17 CFR 240.0-10(a).



H. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comments regarding:

- the number of small entity issuers that may be affected by the proposed extension;
• the existence or nature of the potential impact of the proposed extension on small entity issuers discussed in the analysis; and
• how to quantify the impact of the proposed extension.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed revisions are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VIII. Statutory Authority and Text of the Amendments

The amendments described in this release are being proposed under the authority set forth in 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 228

Reporting and recordkeeping requirements, Securities, Small businesses.

17 CFR Parts 229, 240 and 249

Reporting and recordkeeping requirements, Securities.

Text of Amendments

For the reasons set out in the preamble, the Commission proposes to amend 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, 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 et seq., unless otherwise noted.

- 2. Section 210.2-02T is amended by:
a. Redesignating existing paragraph (b) as paragraph (c).
b. Revising newly redesignated paragraph (c).
b. Adding new paragraph (b).
The addition and revision read as follows:

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

\* \* \* \* \*

(b) 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 filed by 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, for a fiscal year ending on or after December 15, 2007 but before December 15, 2008.

(c) This temporary section will expire on June 30, 2009.

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, 7201 et seq., and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

- 4. Section 228.308 is amended by:
a. Adding an "s" to the word "instruction" in the heading at the end of the Section.
b. Redesignating the existing instruction to Item 308 as Instruction 2.
c. Adding new Instruction 1.
The additions read as follows:

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

\* \* \* \* \*

1. A small business issuer need not comply with paragraphs (a), (b) and (c) of this Item until it previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m or 78o(d)).

\* \* \* \* \*

4a. Section 228.308T is added 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 an annual report filed by the small business issuer for a fiscal year ending on or after December 15, 2007 but before December 15, 2008.

(a) Management's annual report on internal control over financial reporting. Provide a report of management on the small business issuer's internal control over financial reporting (as defined in § 240.13a-15(f) or § 240.15d-15(f) of this chapter). This report shall not be deemed to be filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the small business issuer 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. The report must contain:

(1) A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the small business issuer;

(2) A statement identifying the framework used by management to evaluate the effectiveness of the small business 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 small business issuer's internal control over financial reporting as of the end of the registrant'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 small business issuer's internal control over financial reporting identified by management. Management is not permitted to conclude that the small business issuer's internal control over financial reporting is effective if there are one or more material weaknesses in the small business issuer's internal control over financial reporting.

(b) Changes in internal control over financial reporting. Disclose any change in the small business 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 small business issuer's last fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably

likely to materially affect, the small business issuer's internal control over financial reporting.

*Instructions to paragraphs (a) and (b) of Item 308T*

1. A small business issuer need not comply with paragraphs (a) and (b) of this Item until it previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m or 78o(d)).

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

(c) This temporary Item 308T, and accompanying note and instructions, will expire on June 30, 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, 79e, 79j, 79n, 79t, 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 229.308 is amended by:
- Adding an "s" to the word "instruction" in the descriptive heading at the end of the section.
  - Redesignating the existing instruction to Item 308 as Instruction 2.
  - Adding new Instruction 1.
- The additions read as follows:

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

\* \* \* \* \*

1. A registrant need not comply with paragraphs (a), (b) and (c) of this Item until it previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m or 78o(d)).

\* \* \* \* \*

6a. Section 229.308T is added 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 an annual report filed by the registrant for a fiscal year ending on or after December 15, 2007 but before December 15, 2008.

(a) *Management's annual report on internal control over financial reporting.* Provide a report of management on the registrant's internal control over financial reporting (as defined in § 240.13a-15(f) or § 240.15d-15(f) of this chapter). This report shall not be deemed to be filed for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the registrant 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. The report must contain:

- (1) A statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the registrant;
- (2) A statement identifying the framework used by management to evaluate the effectiveness of the registrant'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 registrant's internal control over financial reporting as of the end of the registrant'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 registrant's internal control over financial reporting identified by management. Management is not permitted to conclude that the registrant's internal control over financial reporting is effective if there are one or more material weaknesses in the registrant's internal control over financial reporting.

(b) *Changes in internal control over financial reporting.* Disclose any change in the registrant'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 registrant's last fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

*Instructions to paragraphs (a) and (b) of Item 308T*

1. A registrant need not comply with paragraphs (a) and (b) of this Item until it previously has been required to file an annual report pursuant to section 13(a)

or 15(d) of the Act (15 U.S.C. 78m or 78o(d)).

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

(c) This temporary Item 308T, and accompanying note and instructions, will expire on June 30, 2009.

**PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

7. The authority citation for Part 240 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11 and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

8. Section 240.13a-14 is amended by adding a sentence at the end of paragraph (a) to read as follows:

(a) \* \* \* The principal executive and principal financial officers of an issuer may omit the portion of the introductory language in paragraph 4 as well as language in paragraph 4(b) of the certification that refers to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting for the issuer until the issuer becomes subject to the internal control over financial reporting requirements in § 240.13a-15 or 240.15d-15 of this chapter.

\* \* \* \* \*

9. Section 240.13a-15 is amended by revising the first sentences of paragraphs (c) and (d) to read as follows:

**§ 240.13a-15 Controls and procedures.**

\* \* \* \* \*

(c) The management of each such issuer that previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)), other than an investment company registered under section 8 of the Investment Company Act of 1940, must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, the effectiveness, as of the end of each fiscal year, of the issuer's internal control over financial reporting.

\* \* \*

(d) The management of each such issuer that previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15

U.S.C. 78m(a) or 78o(d), other than an investment company registered under section 8 of the Investment Company Act of 1940, must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, any change in the issuer's internal control over financial reporting, that occurred during each of the issuer's fiscal quarters, or fiscal year in the case of a foreign private issuer, that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

\* \* \* \* \*

10. Section 240.15d-14 is amended by adding a sentence at the end of paragraph (a) to read as follows:

**§ 240.15d-14 Certification of disclosure in annual and quarterly reports.**

(a) \* \* \* The principal executive and principal financial officers of an issuer may omit the portion of the introductory language in paragraph 4 as well as language in paragraph 4(b) of the certification that refers to the certifying officers' responsibility for designing, establishing and maintaining internal control over financial reporting for the issuer until the issuer becomes subject to the internal control over financial reporting requirements in § 240.13a-15 or 240.15d-15 of this chapter.

\* \* \* \* \*

11. Section 240.15d-15 is amended by revising the first sentences of paragraphs (c) and (d) to read as follows:

**§ 240.15d-15 Controls and procedures.**

\* \* \* \* \*

(c) The management of each such issuer that previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)), other than an investment company registered under section 8 of the Investment Company Act of 1940, must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar functions, the effectiveness, as of the end of each fiscal year, of the issuer's internal control over financial reporting.

(d) The management of each such issuer that previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)), other than an investment company registered under section 8 of the Investment Company Act of 1940, must evaluate, with the participation of the issuer's principal executive and principal financial officers, or persons performing similar

functions, any change in the issuer's internal control over financial reporting, that occurred during each of the issuer's fiscal quarters, or fiscal year in the case of a foreign private issuer, that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting.

\* \* \* \* \*

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

12. 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.

\* \* \* \* \*

13. Form 10-KSB (referenced in § 249.310b) is amended by adding temporary Item 8A(T) to Part II after Item 8A.

The addition reads as follows:

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

Form 10-KSB

\* \* \* \* \*

PART II

\* \* \* \* \*

Item 8A(T). Controls and procedures.

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

(b) This temporary Item 8A(T) will expire on June 30, 2009.

\* \* \* \* \*

14. Form 10-K (referenced in § 249.310) is amended by adding temporary Item 9A(T) to Part II following Item 9A.

The addition reads as follows:

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

Form 10-K

\* \* \* \* \*

PART II

\* \* \* \* \*

Item 9A(T). 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 of Regulation S-K (17 CFR 229.307 and 229.308T) with respect to an annual report that the registrant is required to file for a fiscal year ending on or after December 15, 2007, but before December 15, 2008.

(b) This temporary Item 9A(T) will expire on June 30, 2009.

\* \* \* \* \*

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

a. adding an "s" to the word "Instruction" in the descriptive heading at the end of Item 15.

b. redesignating the existing Instruction to Item 15 as Instruction 2.

c. adding new Instruction 1 to Item 15.

d. revising Item 15T.

The additions and revision 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

\* \* \* \* \*

PART II

\* \* \* \* \*

Item 15. Controls and Procedures.

\* \* \* \* \*

1. An issuer need not comply with paragraphs (b), (c) and (d) of this Item until it previously has been required to file an annual report pursuant to Section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)).

\* \* \* \* \*

Item 15T. Controls and Procedures.

*Note to Item 15T:* This is a special temporary section that applies instead of Item 15 only to: (1) 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; or

(2) an issuer that is neither a "large accelerated filer" or an "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 December 15, 2007 but before December 15, 2008.

(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 shall not be deemed to be filed for purposes of section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the issuer 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. 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.

*Instructions to Item 15T*

1. An issuer need only comply with paragraphs (b) and (c) of this Item until it previously has been required to file an annual report pursuant to section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)).

2. 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 June 30, 2009.

\* \* \* \* \*

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

- a. redesignating existing Instruction 1 as Instruction 2.
- b. redesignating existing Instruction 2T as Instruction 3T.
- c. adding Instruction 1.
- d. revising newly redesignated Instruction 3T.

The addition and revision read 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

\* \* \* \* \*

GENERAL INSTRUCTIONS

\* \* \* \* \*

B. Information To Be Filed on This Form

\* \* \* \* \*

(6) \* \* \*

\* \* \* \* \*

1. An issuer need not comply with paragraphs (c), (d) and (e) of this Item until it previously has been required to file an annual report pursuant to the requirements of section 13(a) or 15(d) of the Act (15 U.S.C. 78m(a) or 78o(d)).

2. The issuer 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.

3T. Paragraph (d) of this General Instruction B.6 does not apply to: (1) 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; or (2) an issuer that is neither a "large accelerated filer" or an "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 December 15, 2007, but before December 15, 2008. Management's report on internal control over financial reporting that is included in an annual report filed by the type of issuer and within the period set forth in (1) or (2) above in this Instruction 3T shall not be deemed to be filed for purposes of section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the issuer 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.

This temporary Instruction 3T will expire on June 30, 2009.

\* \* \* \* \*

By the Commission.

Dated: August 9, 2006.

**Nancy M. Morris,**  
*Secretary.*

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