

PROTIVITI FLASH REPORT

Congress Passes Finance Reform Bill with Section 404(b) Exemption for Non-Accelerated Filers Included

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Following reconciliation in conference of the separate versions of the financial reform legislation previously passed by the House and the Senate into a single bill, Congress passed the reconciled bill yesterday making it a virtual certainty to become law. The reform bill, entitled the Dodd-Frank Act, provides what the Associated Press calls the “stiffest restrictions on banks and Wall Street since the Great Depression, clamping down on lending practices and expanding consumer protections to prevent a repeat of the 2008 meltdown that knocked the economy to its knees.” The new law will give the government new powers to act in ways that are unprecedented, including the ability to break up companies that threaten the economy, create a new agency to guard consumers in their financial transactions and shine a spotlight into shadow financial markets that previously escaped the oversight of regulators.

While there are many provisions in this new legislation that are commanding the headlines, one provision of interest to smaller public companies relates to Section 404(b) of the Sarbanes-Oxley Act. The new legislation provides that companies with a public float below \$75 million (the so-called “non-accelerated filers”) will be exempt from complying with the attestation requirements of Section 404(b) of the Sarbanes-Oxley legislation. Under Section 404(b), the companies’ auditors are required to issue an opinion on the effectiveness of the audit client’s internal control over financial reporting (ICFR). Section 989G of Dodd-Frank provides that:

- Subsection (b) of Section 404 shall not apply to non-accelerated filers, and
- The Securities and Exchange Commission (SEC) shall conduct a study to determine how to reduce the burden of applying Section 404(b) to companies with a market capitalization between \$75 million and \$250 million “while maintaining investor protections for such companies.”

The study is required to be completed no later than nine months following enactment of the bill.

The Dodd-Frank bill commissions a second study with the Comptroller General of the United States on the impact of the above amendments to Section 404(b). This study is to include an analysis of the following:

- Whether the exempt issuers have fewer or more restatements of published financial statements than issuers which must comply with the attestation requirements of Section 404(b);
- How the cost of capital of issuers exempt from Section 404(b) compares to the cost of capital of issuers that are required to comply with Section 404(b);

- Whether there is any difference in the confidence of investors in the integrity of financial statements of issuers that comply with Section 404(b) and issuers that exempt from such compliance;
- Whether issuers that do not receive an attestation of ICFR should be required to disclose the lack of such attestation to investors; and
- The costs and benefits to issuers that are exempt from Section 404(b) that voluntarily have obtained an attestation from their external auditor.

This study is required to be completed no later than three years following enactment of the bill.

Once the President signs the bill (which is imminent), it becomes law. The SEC had previously issued a final rule in 2009 requiring all non-accelerated filers to comply with Section 404(b) beginning with their annual reports for fiscal years ending on or after June 15, 2010. The exemption in the Dodd-Frank bill effectively obviates the SEC's final rule, providing a permanent exemption from the auditor attestation requirement for the eligible smaller companies. That said, the results of the aforementioned GAO study will provide Congress an opportunity to revisit the issue in three years.

The provisions of Section 404(a) requiring an internal control report, in which management must make an assertion as to the effectiveness of ICFR, continue to remain in force. Companies are advised to be familiar with the requirements set forth in the SEC's interpretive guidance, which articulates the SEC staff's expectations as to both the process management must apply to support its assertion in the internal control report and the required supporting documentation. The SEC staff's guidance remains as guiding principles for non-accelerated filers to follow.

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