

# Clients & Friends Memo

## **Amendments to SOX, Including Section 404(b) Exemption for Nonaccelerated Filers, Under the Dodd-Frank Wall Street Reform and Consumer Protection Act\***

**July 20, 2010**

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Act") has now been passed by both houses of Congress and is awaiting signature by President Obama. The Act, once implemented by the required regulations, will completely alter the U.S. financial regulatory system. Financial institutions will be materially affected by these regulations, and non-financial institutions will be affected at least indirectly through their use of regulated financial products. Additionally, the Act's amendments to the Sarbanes-Oxley Act of 2002 ("SOX") and broad changes to executive compensation and corporate governance rules will impact public companies in the United States.

This memorandum is focused on certain provisions of Title IX of the Act that relate to SOX Section 404, including an amendment to SOX Section 404 which exempts nonaccelerated filers from the SOX Section 404(b) requirement to obtain an auditors' report on management's assessment of the effectiveness of the company's internal control over financial reporting.

### **I. Exemption for Nonaccelerated Filers**

Title IX of the Act amends SOX Section 404 to exempt nonaccelerated filers (including smaller reporting companies) from the SOX Section 404(b) requirement to obtain an auditors' report on management's assessment of the effectiveness of the company's internal control over financial reporting. The text of the new subsection (c) reads in its entirety as follows:

"(c) EXEMPTION FOR SMALLER ISSUERS.—Subsection (b) shall not apply with respect to any audit report prepared for an issuer that is neither a 'large accelerated filer' nor an 'accelerated

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\* Cadwalader has prepared a short summary of the Act and a series of memoranda focused on the Act's application to specific industries, entities and transactions. To see these other memoranda please see a [Summary of the Dodd-Frank Wall Street Reform and Consumer Protection Act](#) (Appendix A links to the various topic-focused memoranda) or visit our website at [http://www.cadwalader.com/list\\_client\\_friend.php](http://www.cadwalader.com/list_client_friend.php).

filer' as those terms are defined in Rule 12b-2 of the Commission (17 C.F.R. 240.12b-2)."

In addition, the Act directs the Commission to conduct a study to determine how the Commission could reduce the burden of complying with SOX Section 404(b) for companies whose market capitalization is between \$75,000,000 and \$250,000,000 while maintaining investor protections for such companies. The Commission is also directed to consider whether any such methods of reducing the compliance burden or a complete exemption for such companies from compliance with SOX Section 404(b) would encourage companies to list their initial public offerings on exchanges in the United States. The Commission is directed to provide its report of such study to Congress not later than nine months after the date of the enactment of the Act.

## **II. GAO Study Regarding Exemption for Smaller Issuers**

The Act also directs the Comptroller General of the United States to carry out a study on the impact of the amendment to SOX Section 404, including an analysis of:

1. whether issuers that are exempt from SOX Section 404(b) have fewer or more restatements of published accounting statements than issuers that are required to comply with SOX Section 404(b);
2. the cost of capital for issuers that are exempt from SOX Section 404(b) compared to the cost of capital for issuers that are required to comply with SOX Section 404(b);
3. whether there is any difference in the confidence of investors in the integrity of financial statements of issuers that comply with SOX Section 404(b) and issuers that are exempt from compliance with SOX Section 404(b);
4. whether issuers that do not receive the attestation for internal controls required under SOX Section 404(b) should be required to disclose the lack of such attestation to investors; and
5. the costs and benefits to issuers that are exempt from SOX Section 404(b) that voluntarily have obtained the attestation of an independent auditor.

The Comptroller General is directed to provide its report of such study to Congress not later than three years after the date of the enactment of the Act.

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If you have any questions regarding the contents of this memorandum, please do not hesitate to contact the following attorneys:

Louis J. Bevilacqua	+1 212 504 6057	<a href="mailto:louis.bevilacqua@cwt.com">louis.bevilacqua@cwt.com</a>
Penny M. Williams	+1 212 504 6403	<a href="mailto:penny.williams@cwt.com">penny.williams@cwt.com</a>