



FENWICK & WEST LLP

Corporate and Securities Law Update

Good News for Potential IPOs

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Late last week the SEC announced the extension of compliance dates for Sarbanes-Oxley Section 404 reports by non-accelerated filers until their first fiscal year ending after July 15, 2007. This is welcome news for smaller public companies. In addition, the announcement has special significance for private companies contemplating the possibility of an initial public offering within the next 15 months. Because the extension postpones until 2007 the obligation of non-accelerated filers to provide management's internal control assessment (and the accompanying auditor's report), it may change the balance of benefits and costs of going public for some companies. This may lead some companies to pursue an initial public offering next year instead of postponing it or following an acquisition exit strategy.

Section 404 of the Sarbanes-Oxley Act of 2002, as implemented by the SEC, requires that every public company provide a report, as part of its annual report on Form 10-K, of management's assessment (and an accompanying auditor's report) of the company's internal control over financial reporting. It also requires quarterly evaluation of changes in internal control over financial reporting, and CEO and CFO certification of related disclosures. The implementation of adequate internal controls is expensive and time consuming, and can impact a company's decision to go public.

The SEC adopted the original rules implementing Sarbanes-Oxley Section 404 in June 2003. In February 2004 the SEC extended the compliance dates for companies that are accelerated filers (to fiscal years ending after November 15, 2004) and for companies that are **not** accelerated filers (to fiscal years ending on or after July 15, 2005). The additional time was required due to the time and resources needed for both company and auditor implementation of the new rules. In

March 2005 the SEC approved a further one-year extension (to fiscal years ending on or after July 15, 2006) for non-accelerated filers, and on September 22, 2005 it approved the third compliance date extension (to fiscal years ending on or after July 15, 2007) for those non-accelerated filers.

Companies that are not accelerated filers include companies that have completed an IPO but have not yet been public for 12 months.¹ These recently-public companies typically only meet the definition of an accelerated filer as of their second fiscal year-end after the IPO. For example, a company that went public in June 2005 that has a fiscal year ending December 31 will not be an accelerated filer at December 31, 2005, but will be one at December 31, 2006 (assuming it meets the size requirements of the definition). For that company, the first Section 404 report will be required with its 2006 Form 10-K.

December 31 fiscal year illustration: A company with a December 31 fiscal year is considering an IPO in 2006. If it completes the IPO in March 2006, it will file its first Section 404 report with its Form 10-K for the year ending December 31, 2007. When it files its 2006 Form 10-K, it is not an accelerated filer. Relying on this latest extension, its first Section 404 report is due with the Form 10-K for its first fiscal year ending on or after July 15, 2007, or the 2007 Form 10-K. The result is the same regardless of when in 2006 it completes the IPO.²

This latest compliance date extension takes pressure off any companies contemplating a potential IPO in 2006, enabling them to focus on core business activities and getting through the IPO window while it remains open.

To discuss how this change applies to your company, please contact any member of your Fenwick & West team. You may

also contact Horace Nash (hnash@fenwick.com), Bill Schreiber (bschreiber@fenwick.com) or Dan Dorosin (ddorosin@fenwick.com), each of whom contributed to the preparation of this update, or send an inquiry to fwcsu@fenwick.com.

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¹A company is an accelerated filer if, at the end of its fiscal year:

- The aggregate market value of the voting and non-voting common equity held by non-affiliates (measured using the closing price on the last trading day of its fiscal second quarter) is \$75 million or more;
- The company has been an Exchange Act reporting company for at least 12 calendar months, and has filed at least one annual report pursuant to the Exchange Act; and
- The company is not a small business filer.

²June 30 fiscal year illustration (March IPO): A company with a June 30 fiscal year is considering an IPO in 2006. If it completes the IPO in March 2006, it will file its first Section 404 report with its Form 10-K for the year ending June 30, 2007. When it files its 2006 Form 10-K, it is not an accelerated filer. Its first Section 404 report is due with the Form 10-K for its first fiscal year ending on or after July 15, 2007, or the 2007 Form 10-K.

June 30 fiscal year illustration (September IPO): Same example as above, except now the company completes the IPO in September 2006 (after its fiscal year end, rather than before). Here, it will file its first Section 404 report with its Form 10-K for the year ending June 30, 2008. It files no 2006 Form 10-K. When it files its 2007 Form 10-K, it is not an accelerated filer. Its first Section 404 report is due with the Form 10-K for its first fiscal year ending on or after July 15, 2007, or the 2008 Form 10-K.