

SEC Approves Amendments to NYSE Rules to Provide One-Year Transition Period for Internal Audit Requirement for IPO, Carve-Out and Spin-Off Listings

On August 22, 2013, the SEC approved proposed rule changes by the NYSE to provide a one-year transition period during which companies listing in connection with an initial public offering, or a carve-out or spin-off transaction need not comply with the internal audit requirement of Section 303A.07(c) of the NYSE Listed Company Manual.

Section 303A.07(c) of the NYSE's Listed Company Manual requires listed companies to maintain an internal audit function to provide management and the audit committee with ongoing assessments of the listed company's risk management processes and system of internal control.

Companies listing on the NYSE upon transfer from another national securities exchange that does not have an internal audit function requirement have one year from the date of listing to comply with the requirements of Section 303A.07(c).¹ However, prior to the amendments discussed herein, companies listing on the NYSE in connection with an IPO, or by means of a carve-out or spin-off transaction, were required to comply with those requirements at the time of listing. The NYSE has concluded that this distinction was anomalous. Accordingly, Section 303A.00 of the NYSE Listed Company Manual has been amended to extend the availability of the one-year transition period to comply with the internal audit function requirement to these categories of newly listed companies. All companies subject to Section 303A.07 are required to have an internal audit function no later than one year after their listing date.

Several provisions in Section 303A.07 set forth duties of the audit committee (and requirements for the audit committee's charter) with respect to the internal audit function requirement. These provisions have also been amended to clarify these duties (and charter provisions) during any transition period applicable to IPOs, transfers from another national securities exchange, carve-outs and spin-offs, as follows:

- Section 303A.07(b)(i)(A) requires the audit committee's charter to provide that the committee will assist board oversight of: (1) the integrity of the listed company's financial statements, (2) the listed company's compliance with legal and regulatory requirements, (3) the independent auditor's qualifications and independence, and (4) the performance of the listed company's internal audit function and independent auditors. If the listed company does not yet have an internal audit function because it is availing itself of a transition period, the audit committee's charter must provide that the committee will also assist board oversight of the design and implementation of the internal audit function.

¹ Neither the Nasdaq Stock Market LLC nor NYSE MKT LLC has such an internal audit function requirement.

- Section 303A.07(b)(i)(E) requires the audit committee's charter to provide that the committee will meet separately, periodically, with management, internal auditors (or other personnel responsible for the internal audit function) and independent auditors. If the listed company does not yet have an internal audit function because it is availing itself of a transition period, the audit committee must meet periodically with the company personnel primarily responsible for the design and implementation of the internal audit function.
- Section 303A.07(b)(i)(F) requires the audit committee's charter to provide that the committee will review with the independent auditor any audit problems or difficulties and management's response. This review is required to include, among other things, a discussion of the responsibilities, budget and staffing of the listed company's internal audit function. If the listed company does not yet have an internal audit function because it is availing itself of a transition period, this review should include a discussion of management's plans with respect to the responsibilities, budget and staffing of the internal audit function and the company's plans for the implementation of the internal audit function.
- Section 303A.07(b)(i)(H) requires the audit committee's charter to provide that the committee will report regularly to the board of directors to review, among other things, the performance of the company's internal audit function. If the listed company does not yet have an internal audit function because it is availing itself of a transition period, the audit committee should review with the board management's activities with respect to the design and implementation of the internal audit function.

Note that companies availing themselves of the one-year transition period are subject to the requirements of Section 13(b)(2)(B) of the Exchange Act, and the rules thereunder, that require registered companies to devise and maintain a system of internal accounting controls.

These amendments became effective on August 22, 2013.

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