

Nasdaq Proposes Change to Listing Standards to Require that Listed Companies Have an Internal Audit Function

The NASDAQ Stock Market LLC (“Nasdaq”) recently filed with the Securities and Exchange Commission (“SEC”) a proposed rule change requiring that listed companies establish and maintain an internal audit function (the “Proposed Rule Change”).¹ The SEC is soliciting comments from interested parties up until March 29, 2013.²

I. Nasdaq’s Proposed Rule Change

Nasdaq Stock Market Rule 5600 designates the Corporate Governance Requirements for companies to be listed on Nasdaq’s stock exchange.³ Nasdaq is proposing to add to those requirements by adding a new Rule 5645:

5645. Internal Audit Function

Each Company must establish and maintain an internal audit function to provide management and the audit committee with ongoing assessments of the Company’s risk management processes and system of internal control. The Company may choose to outsource this function to a third party service provider other than its independent auditor. The audit committee must meet periodically with the internal auditors (or other personnel responsible for this function) and assist the Board in its oversight of the performance of this function. The audit committee should also discuss with the outside auditor the responsibilities, budget and staffing of the internal audit function.

A Company listed on Nasdaq on or before June 30, 2013, must establish an internal audit function by no later than December 31, 2013. A Company listed after June 30, 2013, must establish an internal audit function prior to listing.⁴

Nasdaq clarified in its SEC filing that although companies may outsource this function to a third party service provider other than their independent auditor, their internal audit committees would have sole responsibility to oversee the internal audit function. The New York Stock Exchange already has a similar rule in place.⁵

II. Nasdaq’s Rationale for the Proposed Rule Change

In addition to being consistent with Section 6(b)(5) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”),⁶ Nasdaq stated that the Proposed Rule Change is designed to help ensure that listed

¹ Nasdaq’s Proposed Rule Change is available at <http://nasdaq.cchwallstreet.com/NASDAQ/pdf/nasdaq-filings/2013/SR-NASDAQ-2013-032.pdf>.

² See SEC Release No. 34-69030; File No. SR-NASDAQ-2013-32, available at <http://www.sec.gov/rules/sro/nasdaq/2013/34-69030.pdf>.

³ The full electronic manual of Nasdaq’s rules is available at <http://nasdaq.cchwallstreet.com/NASDAQ/>.

⁴ SEC Release No. 34-69030; File No. SR-NASDAQ-2013-32, available at <http://www.sec.gov/rules/sro/nasdaq/2013/34-69030.pdf>.

⁵ See Listed Company Manual Section 303A.07(c), available at <http://nysemanual.nyse.com/lcm/>.

⁶ See 15 U.S.C. § 78f(b)(5) (requiring that national securities exchanges’ rules be “designed to prevent fraudulent and

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companies have a mechanism in place to regularly assess their internal controls and weaknesses. This would also assist listed companies' efforts to comply with their federal securities law obligations, including the certification requirements of Rules 13a-14 and 15d-14 under the Exchange Act.⁷

III. Conclusion

The Proposed Rule Change is unlikely to affect any fundamental changes, as many public companies already have internal audit functions to be consistent with best practices and to comply with their federal securities law obligations. Companies listed or seeking to be listed on Nasdaq should review their existing internal procedures to ensure that they comply with the Proposed Rule Change.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.

manipulative acts and practices, to promote just and equitable principles of trade...and, in general, to protect investors and the public interest").

⁷ See 17 C.F.R. §§ 240.13a-14, 240.15d-14 (requiring each principal executive officer and principal financial officer of an issuer, or persons performing similar functions, to certify as to the effectiveness of such issuer's internal control over financial reporting).

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