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Capital Markets

SEC Significantly Expands Smaller Reporting Company Eligibility for Scaled Disclosures and Modifies Threshold for Certain Acquisition Financial Statements

July 2, 2018

On June 28, 2018, the Securities and Exchange Commission announced: (i) significant amendments to the definition of “smaller reporting company” (SRC) that expand the eligibility requirements for the scaled disclosure accommodations available to SRCs that are summarized in Appendix A and (ii) a corresponding amendment to the financial statement acquisition reporting threshold under Rule 3-05 of Regulation S-X.

According to SEC Chairman Jay Clayton, “Expanding the smaller reporting company definition recognizes that a one size regulatory structure for public companies does not fit all. These amendments to the existing SRC compliance structure bring that structure more in line with the size and scope of smaller companies while maintaining our long-standing approach to investor protection in our public capital markets. Both smaller companies—where the option to join our public markets will be more attractive—and Main Street investors—who will have more investment options—should benefit.”

The amendments are effective 60 days after publication in the federal register, and the formal adopting release is available here. Our prior analysis of the proposed amendments—announced on July 8, 2016, nearly two years ago—is available here.

The final rules largely track the July 2016 proposal and substantially increase the relevant financial thresholds for scaled disclosure eligibility afforded to SRCs: the new smaller reporting company definition incorporates the proposed definition, permitting companies with less than \$250 million of public float¹ to provide the scaled disclosures, as compared with the \$75 million threshold under the prior definition. The final rules also expand the definition to include the following additional companies: (i) companies without a public float if annual revenues in the most recently completed fiscal year for which audited financial statements are available do not exceed \$100 million (compared to the current threshold of \$50 million), and (ii) in a departure from the proposal, companies that both (x) have a public float of less than **\$700 million** and (y) whose annual revenues in the most recently completed fiscal year for which audited financial statements are available do not exceed the \$100 million threshold. This latter expansion of SRC eligibility is a potential boon to pre-revenue biotechnology companies and other similarly situated reporting companies.

The SRC thresholds, summarized above, apply only to a company's initial determination for eligibility under the new amendments. For existing reporting companies, this means a company will determine eligibility based on its public float as of the last day of its most recently completed second fiscal quarter. For example, as explained in the final rules, an existing reporting company with a September 30 fiscal year end that previously was not a SRC and that had a public float of \$220 million as of March 30, 2018 (the last business day of its most recently completed second quarter) will qualify as a SRC for the fiscal year ending September 30, 2018. If a company did not initially qualify as a SRC at the end of its first fiscal year after effectiveness of the amendments, the company will remain unqualified unless it satisfies public float and/or revenue thresholds as of the next determination date. These subsequent qualification thresholds are set at 80% of the initial qualification thresholds, meaning that a company that did not initially qualify as a SRC could subsequently qualify as a SRC only if it satisfies one of the following lower qualification thresholds at the next relevant determination date (*i.e.*, the end of its next second fiscal quarter): (i) a public float of less than \$200 million, or (ii) annual revenues of less than \$80 million and a public float of less than \$560 million. The SEC believes the lower subsequent determination thresholds are necessary so that small fluctuations in a company's public float or revenues do not cause it to frequently enter and exit smaller reporting company status.

In addition to the changes to the smaller reporting company qualification thresholds, the final rules include two additional significant changes. *First*, the final rules also amend Rule 3-05(b)(2)(iv) of Regulation S-X to increase the revenue threshold under which certain acquirers may omit the earliest of the three fiscal years of audited financial statements of certain acquisition targets, from \$50 million to \$100 million, matching the new SRC definition. The proposal did not include the amendment to Rule 3-05, but did call for commentary on the question.

Second, the final rules amend the definitions of “accelerated filer” and “large accelerated filer” in Rule 12b-2 to preserve the application of the current public float thresholds in those definitions. Consistent with the proposed amendments, the final rules eliminate a provision in each definition that specifically excludes registrants that are eligible to use the smaller reporting company requirements under Regulation S-K for their annual and quarterly reports. The result of this means that companies with a public float of \$75 million or more that qualify as a SRC therefore remain subject to requirements applicable to accelerated filers and, in certain cases, large accelerated filers, including the timing of the filing of periodic reports and the auditor’s attestation of management’s assessment of internal control over financial reporting required by Section 404(b) of the Sarbanes-Oxley Act of 2002. However, the adopting release makes clear that Chairman Clayton has directed the staff of the SEC’s Division of Corporation Finance, and the staff has begun, to “formulate recommendations to the Commission for possible additional changes to the ‘accelerated filer’ definition to reduce the number of companies that qualify as accelerated filers in order to further reduce compliance costs for those companies.”

As adopted, the scaled disclosure accommodations summarized in Appendix A become available to a significantly expanded number of reporting companies. Consistent with the existing rules, these newly eligible SRCs will be permitted to take advantage of the scaled disclosure accommodations beginning with their first quarterly report on Form 10-Q following the determination. The disclosure accommodations will reduce or eliminate certain disclosure requirements in periodic reports on Form 10-K and Form 10-Q, registration statements and proxy statements, including significant executive compensation disclosures such as eliminating the requirement for a Compensation Discussion and Analysis. The disclosure accommodations also permit reduced financial statement requirements in certain circumstances with respect to the company and its acquirees and equity investees.

APPENDIX A

The following table summarizes the scaled disclosure accommodations available to reporting companies qualifying as SRCs:

Regulation S-K	
Item	Scaled Disclosure Accommodation
101 – Description of Business	A company may satisfy disclosure obligations by describing the development of its business during the last three years rather than five years. Business development description requirements are less detailed than disclosure requirements for non-smaller reporting companies.

201 – Market Price of and Dividends on the Registrant’s Common Equity and Related Stockholder Matters	Stock performance graph not required.
301 – Selected Financial Data	Not required.
302 – Supplementary Financial Information	Not required.
303 – Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A)	<p>Two-year MD&A comparison rather than three-year comparison.</p> <p>Two year discussion of impact of inflation and changes in prices rather than three years.</p> <p>Tabular disclosure of contractual obligations not required.</p>
305 – Quantitative and Qualitative Disclosures About Market Risk	Not required.
402 – Executive Compensation	<p>Three named executive officers rather than five.</p> <p>Two years of summary compensation table information rather than three.</p> <p>Not required:</p> <ul style="list-style-type: none"> ▪ Compensation discussion and analysis ▪ Grants of plan-based awards table ▪ Option exercises and stock vested table ▪ Pension benefits table ▪ Nonqualified deferred compensation table ▪ Disclosure of compensation policies and practices related to risk management ▪ Pay ratio disclosure
404 – Transactions With Related Persons, Promoters and Certain Control Persons ²	Description of policies/procedures for the review, approval or ratification of related party transactions not required.
407 – Corporate Governance	<p>Audit committee financial expert disclosure not required in first year.</p> <p>Compensation committee interlocks and</p>

	insider participation disclosure not required. Compensation committee report not required.
503 – Prospectus Summary, Risk Factors and Ratio of Earnings to Fixed Charges	No ratio of earnings to fixed charges disclosure required. No risk factors required in Exchange Act filings.
601 – Exhibits	Statements regarding computation of ratios not required.

Regulation S-X	
Rule	Scaled Disclosure Accommodation
8-02 – Annual Financial Statements	Two years of income statements rather than three years. Two years of cash flow statements rather than three years. Two years of changes in stockholders' equity statements rather than three years.
8-03 – Interim Financial Statements	Permits certain historical financial data in lieu of separate historical financial statements of equity investees.
8-04 – Financial Statements of Businesses Acquired or to Be Acquired	Maximum of two years of acquiree financial statements rather than three years.
8-05 – Pro forma Financial Information	Fewer circumstances under which pro forma financial statements are required.
8-06 – Real Estate Operations Acquired or to Be Acquired	Maximum of two years of financial statements for acquisition of properties from related parties rather than three years.
8-08 – Age of Financial Statements	Less stringent age of financial statements requirements.

¹ “Public float” refers to the aggregate worldwide market value of the reporting company’s voting and non-voting common equity held by its non-affiliates (*i.e.*, the company’s market capitalization adjusted to exclude shares held by affiliates). A reporting company calculates its public float as

of the last business day of its most recently completed second fiscal quarter. A registrant filing its initial registration statement under the Securities Act of 1933 or Securities Exchange Act of 1934 calculates its public float as of a date within 30 days of the date the registration statement is filed by multiplying the aggregate worldwide number of shares of its voting and non-voting common equity held by non-affiliates before the registration plus, in the case of a Securities Act registration statement, the number of such shares included in the registration statement by the estimated public offering price of the shares.

² Item 404 also contains the following expanded disclosure requirements applicable to smaller reporting companies:

(1) rather than a flat \$120,000 disclosure threshold, the threshold is the lesser of \$120,000 or 1% of total assets,

(2) disclosures are required about each parent company and the basis of the parent's control as well as underwriting discounts and commissions where a related person is a principal underwriter or a controlling person or member of a firm that was or is going to be a principal underwriter, and (3) an additional year of Item 404 disclosure is required in filings other than registration statements.

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