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SEC Amends Smaller Reporting Company Definition

On June 28, 2018, the SEC voted unanimously to adopt amendments to the “smaller reporting company” (SRC) definition to expand the number of smaller companies eligible to comply with certain scaled disclosure accommodations.¹ The final rule was adopted generally in the form in which it was proposed two years ago, except for several changes that are described below.

Although the final rule amendments did not change the applicable threshold in the “accelerated filer” definition (which carries with it the requirement to provide an outside auditor’s attestation of management’s assessment of internal control over financial reporting), Chairman Clayton has directed SEC staff to formulate recommendations to the SEC for possible, additional changes to the “accelerated filer” definition.

Background

The SEC established the SRC category of companies in 2008 in an effort to provide general regulatory relief for smaller companies. SRCs may provide certain scaled disclosures under SEC rules, including providing two, instead of three, years of audited financial statements and omitting certain disclosures relating to executive compensation and the CEO pay ratio. For a summary of scaled disclosure accommodations available to SRCs, please see [Appendix A](#).

Under the previous definition, a company qualified as an SRC if (i) its public float was less than \$75 million or (ii) it had no public float or no market price for its public equity and less than \$50 million in annual revenues.

Amendments to the SRC Definition

Consistent with the 2016 proposal, the final rules increase the threshold for determining SRC status based on public float from \$75 million to \$250 million. In a change from the proposal, the SRC definition also includes companies that have annual revenues of less than \$100 million and a public float of less than \$700 million. SRC status is determined on an annual basis.

Thus, under the final rules, SRCs generally are companies with:

- a public float of less than \$250 million; or
- annual revenues of less than \$100 million and either no public float or a public float of less than \$700 million.

Under the amended revenue test, companies with a large public float (i.e., equal to or greater than \$250 million but less than \$700 million) but with little to no revenues (i.e., less than \$100 million in annual revenues) are eligible for SRC status. This change from the proposal, which had significant support in the biotech community, should permit additional companies to qualify as SRCs.

In addition, consistent with the previous definition, once a company determines that it does not qualify as an SRC under the initial qualification thresholds, it will remain unqualified unless and until it meets one or more lower qualification thresholds, which are set at 80% of the initial qualification thresholds. Under the final rules, a company that did not previously qualify as an SRC because its public float was \$250 million or more would subsequently qualify as an SRC if its public float dropped below \$200 million, regardless of its revenues. In addition, once a

company determines that it does not qualify as an SRC because it exceeded either or both of the \$100 million annual revenue and \$700 million public float thresholds, it will remain unqualified unless and until it meets one or both thresholds that have been exceeded:

Prior Annual Revenues	Prior Public Float	
	None or less than \$700 million	\$700 million or more
Less than \$100 million	Neither threshold exceeded.	<p>Public float Less than \$560 million; and</p> <p>Revenues Less than \$100 million.</p>
\$100 million or more	<p>Public float None or less than \$700 million; and</p> <p>Revenues Less than \$80 million.</p>	<p>Public float Less than \$560 million; and</p> <p>Revenues Less than \$80 million.</p>

By requiring that a company satisfy a separate, lower threshold to re-qualify for SRC status, the SEC has attempted to strike a balance between avoiding situations in which companies frequently enter and exit SRC status due to small fluctuations and not imposing an undue burden on companies seeking to qualify for SRC status.

Amendments to the Financial Statement Requirements of Acquired Businesses

When an SEC reporting company acquires a business, Rule 3-05 of Regulation S-X generally requires it to provide separate audited annual and unaudited interim pre-acquisition financial statements of the business if it is significant to the SEC reporting company, based on various investment, asset, and income tests. Previously, when at least one Rule 3-05 test was exceeded at the 50 percent level, a third year of financial statements was required unless net revenues of the acquired business were less than \$50 million in its most recent fiscal year, a threshold that was based on the revenue threshold in the previous SRC definition.

In another change from the 2016 proposal, the SEC increased the net revenue threshold in Rule 3-05(b)(2)(iv) of Regulation S-X from \$50 million to \$100 million, which is consistent with the increase made to the revenue threshold in the revised SRC definition. As a result, companies may omit financial statements of businesses acquired or to be acquired for the earliest of the three fiscal years otherwise required by Rule 3-05 of Regulation S-X if the net revenues of that business are less than \$100 million.

Amendments to Accelerated Filer and Large Accelerated Filer Definitions

The final rules preserve the application of the current thresholds contained in the “accelerated filer” and “large accelerated filer” definitions in Exchange Act Rule 12b-2. As a result, companies with \$75 million or more of public float that qualify as SRCs will remain subject to the requirements that apply to accelerated filers, including the timing of the filing of periodic reports and the requirement that accelerated filers provide the auditor’s attestation of management’s assessment of internal control over financial reporting required by Section 404(b) of the Sarbanes-Oxley Act. However, Chairman Clayton has directed SEC staff, and the staff has begun, to formulate recommendations to the SEC for possible, additional changes to the “accelerated filer” definition.

Practical Considerations

The final rules will become effective 60 days after official publication in the Federal Register. The final rules also contain minor, technical revisions to the cover pages of Securities Act Forms S-1, S-3, S-4, S-8, and S-11 and Exchange Act Forms 10, 10-Q, and 10-K. Companies should ensure that these technical updates are reflected in such Forms (and check all applicable check boxes thereto) for filings made with the SEC once the final rules are effective.

Based on SEC staff estimates, 966 additional companies will become eligible for SRC status in the first year under the new SRC definition. Smaller public companies should begin to evaluate whether they may qualify as an SRC as of a relevant measurement date² and assess the potential impact(s) of transitioning to scaled disclosures. For purposes of the first fiscal year ending after effectiveness of the final rules, a company will qualify as an SRC if it meets one of the initial qualification thresholds in the revised definition as of the date it is required to measure its public float or revenues, even if such company previously did not qualify as an SRC. For example, a company with a December 31 fiscal year end that previously was not an SRC and that had a public float of \$220 million as of June 29, 2018 (the last business day of its most recently completed second quarter) will qualify as an SRC for the fiscal year ending December 31, 2018.

Emerging growth companies (EGCs) are also eligible for a variety of accommodations, including scaled disclosure requirements. However, there are differences between the scaled disclosure requirements for an EGC versus an SRC. EGCs that may potentially exit EGC status and qualify for SRC status should seek to understand those differences to determine the impact on their required public disclosures.

In addition, since the final rule amendments did not change the applicable threshold in the “accelerated filer” definition, some companies may qualify as both SRCs and accelerated filers. As a result, SRCs will need to monitor whether they also become accelerated filers, which would subject those companies to the requirements that apply to accelerated filers, including the timing of the filing of periodic reports and the requirements of Section 404(b) of the Sarbanes-Oxley Act. These companies should also monitor any future SEC rulemaking on changes to the “accelerated filer” definition that would possibly reduce the number of SRCs that qualify as accelerated filers.

Please feel free to contact any member of Ropes & Gray’s [securities & public companies](#) practice group or your usual Ropes & Gray contact with any questions about this Alert.

Appendix A
Scaled Disclosure Accommodations for SRCs

Regulation S-K	
Item	Scaled Disclosure Accommodation
101 - Description of Business	May satisfy disclosure obligations by describing the development of the registrant’s business during the last three years rather than five years. Business development description requirements are less detailed than disclosure requirements for non-SRCs.
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”)	Two-year MD&A comparison rather than three-year comparison. Two-year discussion of impact of inflation and changes in prices rather than three years. Tabular disclosure of contractual obligations not required.
305 - Quantitative and Qualitative Disclosures About Market Risk	Not required.
402 - Executive Compensation	Three named executive officers rather than five. Two years of summary compensation table information rather than three. Not required: <ul style="list-style-type: none"> • Compensation discussion and analysis (“CD&A”). • 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. • CEO pay ratio disclosure.
404 - Transactions With Related Persons, Promoters and Certain Control Persons	Description of policies/procedures for the review, approval or ratification of related party transactions not required.

Regulation S-K	
Item	Scaled Disclosure Accommodation
407 - Corporate Governance	Audit committee financial expert disclosure not required in first annual report. Compensation committee interlocks and 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
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.