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# SEC Expands Smaller Reporting Company Definition and Issues New Small Entity Compliance Guide

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On June 28, 2018, the Securities and Exchange Commission (the "***SEC***") adopted amendments to expand the definition of a "smaller reporting company" ("***SRC***") to include companies with public floats of less than $250 million and higher annual revenues. The staff provided additional guidance on the amended definition on August 10, 2018 through the adoption of a new small entity compliance guide.

Companies qualifying as SRCs under the expanded definition may avail themselves of the scaled disclosure requirements afforded to SRCs, including the provision of two (versus three) years of audited financial statements and scaled (*i.e.*, less rigorous) disclosure requirements concerning executive compensation. However, the amendments did not change the threshold for determining accelerated filer status or the requirement that accelerated filers provide an auditor's attestation of management's assessment of internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act of 2002. As a result, more issuers will qualify as SRCs, but their status as SRCs will no longer be determinative as to the due dates for their quarterly and annual reports or whether they are required to provide an auditor's attestation of management's assessment of internal control over financial reporting. See Appendix A for a list of scaled disclosure requirements applicable to companies qualifying as SRCs. The new rules will be effective on September 10, 2018.

**Initial Smaller Reporting Company Determination**

A company may qualify as an SRC by meeting a public float test or a revenue test. Currently, a company qualifies as an SRC if: (1) it had a public float of less than $75 million, or (2) it had no public float and less than $50 million in annual revenues. The amended definition will increase the public float[1] test threshold to $250 million, increase the revenue test threshold to $100 million in annual revenues[2] and permit companies with less than $700 million in public float to qualify under the revenue test. Under the amended definition, a company will initially qualify as an SRC if it had: (1) a public float of under $250 million, or (2) less than $100 million in annual revenues and either (i) no public float or (ii) a public float of less than $700 million.

For purposes of their first fiscal year ending after September 10, 2018, all current reporting companies under the Securities Exchange Act of 1934 (the "***Exchange Act***") are permitted to qualify as SRCs if they meet either of the initial SRC public float or revenue tests, rather than the more stringent thresholds under the subsequent qualification tests. Thus, a registrant having a December 31 fiscal year end that did not previously qualify as an SRC, but that meets one of the qualification thresholds as of the relevant measurement date (*see*, "Timing of

[1] Public float for an existing public company is computed as of the last business day of its most recently completed second fiscal quarter by multiplying the aggregate worldwide number of shares of the company's voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity, in the principal market for the common equity.

[2] Annual revenues are calculated as of the most recently completed fiscal year for which audited financial statements are available.

SRC Determination” below), may choose to comply with the scaled SRC disclosure requirements for its quarterly report on Form 10-Q for the third quarter ending September 30, 2018.

The table below summarizes the amendments to the definition of an SRC for companies initially determining their SRC status:

| Test | Current SRC Definition | Revised SRC Definition |
|---|---|---|
| **Public Float Test** | Public float of less than $75 million | Public float of less than $250 million |
| **Revenue Test** | Less than $50 million of annual revenues and no public float | Less than $100 million of annual revenues and<br>• No public float, or<br>• Public float of less than $700 million |

**Subsequent Qualification as a Smaller Reporting Company**

Existing public companies that have not qualified as SRCs or that have lost SRC status will continue to be non-SRCs unless they meet the public float test or revenue test, each having thresholds set at 80 percent of the initial qualification thresholds under the amended rules. Under the amended rules, existing public companies will only be required to satisfy the more stringent qualification thresholds with respect to the specific criteria for which they have previously failed to qualify. For any thresholds that the registrant previously met, the 100 percent qualification thresholds will continue to apply.

The table below summarizes the amendments to the SRC definition for companies seeking to qualify as SRCs after having lost their SRC status or not having qualified as SRCs:

| Test | Current SRC Definition | Revised SRC Definition |
|---|---|---|
| **Public Float Test** | Public float of less than $50 million | Public float of less than $200 million (if it had $250 million or more of public float as of the last trading day of the second quarter of the preceding fiscal year)[3] |
| **Revenue Test** | Less than $40 million of annual revenues and no public float | Both of the following criteria must be met:<br>• Less than $100 million of annual revenues (or less than $80 million of annual revenues if the issuer had $100 million or more of annual revenues in the second preceding fiscal year)<br>• No public float, or public float of less than $700 million (or less than $560 million of public float if the issuer had $700 million or more of public float as of the last trading day of the second quarter of the preceding fiscal year) |

[3] A registrant that previously was not an SRC, but that subsequently qualifies based on a public float of less than $200 million will qualify as an SRC regardless of its revenues.

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For example, if a company with less than $100 million of annual revenues in 20X1 failed the SRC test in 20X2 because it had more than $700 million of public float as of the end of its second fiscal quarter of 20X2, it could subsequently qualify as an SRC in 20X3 if it had less than $100 million of annual revenues in 20X2 and less than $560 million of public float as of the end of the second fiscal quarter of 20X3.

**Timing of SRC Determination**

The timing for determining SRC status remains unchanged under the amendments. SRC status is determined on an annual basis by examining a company's (i) public float as of the last trading day of its most recently completed second fiscal quarter and (ii) annual revenues for the most recently completed fiscal year for which audited financial statements are available. If a company meets the SRC definition, it must reflect this determination beginning with its quarterly report on Form 10-Q for the first fiscal quarter of the next year. However, issuers that are newly eligible to be an SRC as a result of meeting the applicable public float requirement may begin availing themselves of the scaled disclosure requirements beginning with their quarterly report for their third fiscal quarter, rather than waiting until the first fiscal quarter of the next year.

**Implications on Accelerated Filer Status**

In enacting the new SRC amendments, the SEC also unlinked the determinations of SRC status and non-accelerated filer status by removing the automatic exclusion of SRCs from the definitions of "accelerated filer" and "large accelerated filer" under Rule 12b-2 of the Exchange Act. The amended accelerated filer definition retains a $75 million public float threshold, which means that an issuer may qualify for both accelerated filer status and SRC status.[4] Even if it is newly eligible to avail itself of SRC scaled disclosure requirements, a company that meets the definition of "accelerated filer" must comply with the regulations applicable to accelerated filer status, including accelerated due dates for quarterly and annual reports as well as the obligation to provide an auditor's attestation of management's assessment of internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act of 2002.

**Financial Statements of Acquired Businesses**

In addition, the SEC made adjustments to Rule 3-05(b)(2)(iv) of Regulation S-X concerning the provision of financial statements of businesses acquired or to be acquired. The rule previously required issuers to provide three years of financial statements for any acquired or to-be-acquired business, unless the business' net revenues fell under $50 million, in which case only the two most recent fiscal years of financial statements would be required. The amended rule will allow companies to provide financial statements of an acquired or to-be-acquired business for only the two most recent fiscal years if the net revenues of that business for the most recent fiscal year were less than $100 million.

**Amendments to Forms**

The SEC also adopted technical revisions to modify the cover page of certain forms, including Forms S-1, S-3, S-4, S-8 and S-11 under the Securities Act of 1933, as well as Forms 10, 10-Q, and 10-K under the Exchange

[4] In certain cases, an issuer may qualify for both large accelerated filer status and SRC status.

Act. These amendments remove the parenthetical next to the “non-accelerated filer” definition that states “(Do not check if a smaller reporting company).” Accordingly, after the amendments go into effect, companies should check all applicable boxes on the cover page addressing, among other things, non-accelerated, accelerated or large accelerated filer status as well as SRC status and emerging growth company status.

**Implications**

The SEC expects that approximately 966 additional companies will be eligible to file as SRCs as a result of the expansion of the SRC definition. While the scaled disclosure requirements may be welcomed by companies that newly qualify as SRCs, companies having $75 million or more of public float that also qualify as SRCs under the amended rules will remain subject to the more burdensome requirements that apply to accelerated filers, such as the accelerated filing deadlines and the requirement to provide an auditor’s attestation of internal control over financial reporting.

Please contact any member of Haynes and Boone’s Capital Markets and Securities practice group if you have any questions regarding your company’s SRC or accelerated filer status.

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**Appendix A**

**Summary of Scaled Disclosure Requirements Applicable to Smaller Reporting Companies**[5]

| **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.<br><br>The development of business 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 Supplementary Financial Information | 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.<br><br>Two-year discussion of impact of inflation and changes in prices rather than three years.<br><br>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.<br><br>Two years of summary compensation table information rather than three.<br><br>Not required:<br>• Compensation discussion and analysis<br>• Grants of plan-based awards table<br>• Option exercises and stock vested table<br>• Pension benefits table<br>• Nonqualified deferred compensation table |

[5] SEC Release No. 33-10513. The adopting release contains helpful tables and graphs to assist in determining the precise status of a registrant.

| | |
|---|---|
| | • Disclosure of compensation policies and practices related to risk-taking incentives and risk management practices<br>• Pay ratio disclosure |
| 404—Transactions with Related Persons, Promoters and Certain Control Persons[6] | Description of policies/procedures for the review, approval or ratification of related party transactions not required. |
| 407—Corporate Governance | Audit committee financial expert disclosure not required in first annual report after initial registration statement.<br><br>Compensation committee interlocks and insider participation disclosure not required.<br><br>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.<br><br>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.<br><br>Two years of cash flow statements rather than three years.<br><br>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. |

[6] Item 404 of Regulation S-K requires SRCs to comply with certain expanded disclosure requirements, including an additional year of Item 404 disclosures in filings other than registration statements.