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Amendments to Smaller Reporting Company Definition

SEC Final Rules: (Issue Date: June 2018)

Link to Rule: Release Nos. 33-10513; 34-83550

Overview

The Securities and Exchange Commission ("SEC") released its final ruling Release Nos. 33-10513; 34-83550, Smaller Reporting Company Definition, in June 2018.

The ruling amended the definition of a Smaller Reporting Company ("SRC"). The intended effect is to expand the number of companies that can benefit from reduced disclosures that are available to SRCs, thus promoting capital formation and the reduction of compliance costs. The SEC estimates that 966 additional registrants will be eligible for SRC status in the first year under the new definition. The previous and new definitions are summarized below.

Initial Qualification Thresholds:

Criteria	Previous Definition	New Definition
Public Float*	Less than $75 million	Less than $250 million
Revenues	Annual revenues less than $50 million and no public float	Annual revenues less than $100 million and either no public float or public float less than $700 million.

If a registrant does not initially qualify as an SRC, the registrant continues to be unqualified unless and until it meets the below criteria at a future period.

Criteria	Previous Definition	New Definition
Public Float*	Less than $50 million	Less than $200 million, if it previously had at least $250 million
Revenues	Annual revenues less than $40 million and no public float	Annual revenues less than $80 million, if it previously had at least $100 million; and public float of less than $560 million, if it previously had at least $700 million

* Public float is calculated by multiplying the number of the company's common shares held by non-affiliates (not an executive officer, director, or large shareholder) by the market price, or the average of the bid and asked prices, in the principal market of the company's common shares. In the case of an IPO, adding to that number the product obtained by multiplying the common shares that will be covered by the registration statement by their estimated public offering price. A company may have no public float because it has no public common shares outstanding or because there is no market price for its common shares.

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Consideration Regarding Status of Accelerated Versus Non-Accelerated Filer:

In the past, companies that qualified as an SRC, also automatically qualified as a non-accelerated filer. SRCs will no longer automatically qualify as a non-accelerated filer under the new rules. Companies will now have to determine their filing status independent of whether they meet the definition of an SRC. As a result, some SRCs may remain subject to accelerated reporting deadlines and retain the requirement for an auditor attestation on internal control over financial reporting.

The SEC has indicated that changes to the accelerated filer criteria to realign with the SRC qualifications could be forthcoming.

Background

Treatment as an SRC is a form of reporting and disclosure relief that the SEC provides to companies that meet its definition. Qualifying as an SRC allows the company to reduce or eliminate disclosures including, but not limited to, the following areas:

- Annual Reporting
  - Income statement - two-year vs three-year presentation
  - Omission of Rule 5-04 and Rule 4-02 (with exceptions), which removes the requirement for the parent company's condensed financial information and footnote disclosures
  - 5-year selected financial data table
  - Quarterly financial data table
  - Market risk disclosures
  - However, must still provide SEC industry specific required information

- Interim Reporting
  - Separate captions in the Balance Sheet only required for each component that represents 10% or more of total assets
  - Cash and Retained Earnings must be presented, regardless of their relative significance to total assets
  - Cost and expense categories that exceed 20% of revenue are required

- Equity Method Investees
  - No Balance Sheet required
  - Summarized financial data needed - 20% threshold vs. 10% threshold of consolidated assets

- Acquired Business
  - Rule 8-04 - financial statements needed - two year vs. three year
  - Significant non-reporting business can apply scaled reporting

- Scaled Disclosures
  - Description of business – three year vs. five year of development discussion
  - Executive compensation – omit certain narrative discussions and tables
  - Corporate governance – scaled compensation committee report

- Other
  - Rigorous related party disclosures – disclose transactions that exceed $120,000
  - Rule 3-05 updated – omit financial statements of the company's acquired or to be acquired for the earliest of the three fiscal years

Illustration of SRC Qualification Criteria Changes:

Previous to the criteria changes, a company did not qualify as an SRC based upon the fact pattern below.

- 10 million shares outstanding available for trading by public investors,
- market price of $10 a share, and
- annual revenue of $90 million.
- Public Float* = 10 million shares * $10 = $100 million.

Under the previous definition, the company would not qualify as an SRC, as its public float exceeds $75 million. Under the new definition, the company would now qualify as an SRC. The Company meets the new guidelines having less than $100 million of revenue and a public float of less than $700 million.

Insights

As companies are prepare financial statements or file registration statements, they should be mindful of the changes in the SRC criteria. The revised guidance may allow an entity that would not have previously qualified to take advantage of SRC relief, potentially lowering ongoing compliance and initial filing costs. This new rule is one of many steps the SEC is taking to promote capital formation. The SEC has indicated that the amendments also reflect the need to solicit input and review rules in order to determine whether they are outdated or not functioning as intended.

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Final Thoughts

As companies address challenges surrounding capital formation and ongoing reporting requirements, the new definition of an SRC may provide some relief. This may allow entities to view an Initial Public Offering alternative in a better light, given the potential decrease in filing requirements and related decrease in compliance costs.

Effective Date Beginning September 10, 2018

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Please look for future updates on other technical accounting matters at www.fidatopartners.com

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