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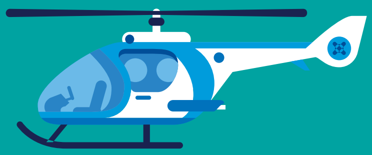

Defining Issues®

SEC updates smaller reporting company definition

July 24, 2018

KPMG reports on how the SEC's revised SRC definition allows more companies to make use of scaled disclosures.[1]

Applicability

Public companies.

Key facts and impacts

The SEC adopted new rules that change the definition of a smaller reporting company (SRC). Companies can qualify for the amended SRC definition through either a revised public float test or a new revenue test. These revisions will be effective September 10, 2018.

When the rule becomes effective, all companies will perform an initial qualification test based on the following revised qualification thresholds:

— public float of less than $250 million; or
— annual revenues less than $100 million as of the most recent fiscal year, and either no public float or a public float of less than $700 million.

The timing of recurring qualification tests that are performed at the end of a company's second fiscal quarter will not change. However, to qualify or maintain SRC status companies will use the revised qualification thresholds. In the future, companies that are not qualified as SRCs may later qualify under new thresholds, which are set at 80 percent of the initial ones.

The SEC also amended Rule 3-05 of Regulation S-X to increase the net revenue threshold from $50 million to $100 million for requiring three years of audited financial statements for an acquired business.

Accelerated filer status will continue to apply to companies with more than $75 million in public float.

Why did the SEC amend the SRC definition?

According to SEC Chairman Jay Clayton,[2] the revised SRC definition is intended to spur capital formation through reduced disclosure requirements and decreased barriers to entry. As an additional benefit, companies that newly meet the definition of an SRC should achieve compliance cost reductions.

Companies newly qualified as SRCs

The SEC indicated that nearly 1,000 entities will now qualify as SRCs that previously did not.

SRCs that are also accelerated filers

Because the SRC reference in the accelerated filer definition was removed, most newly qualified SRCs will remain accelerated filers (defined as public float that exceeds $75 million). While these companies may use the reduced disclosure requirements, they remain subject to accelerated filing deadlines as well as an annual audit of internal controls over financial reporting (ICFR).

1 SEC Release Nos. 33-10513; 34-83550, Smaller Reporting Company Definition

2 SEC Chairman Jay Clayton, Statement at Open Meeting on Amendments to Smaller Reporting Company Definition

Mr. Clayton requested that the SEC staff undertake an additional project and revisit the accelerated and large accelerated filer definitions. This project will focus on whether the SEC should realign the accelerated filer thresholds to those now associated with SRCs. In particular, the SEC staff will consider raising the public float requirement to $250 million to qualify as an accelerated filer.

Applying the qualification tests

Each company will apply the qualification tests under the final rule to determine whether it qualifies as an SRC, regardless of whether the measurement date has passed. This first test will use the initial thresholds, even if a company previously did not qualify as an SRC.

This table explains the differences between the old and new qualification tests.

Category	Old qualification test	New qualification test
Registrant	Public float of less than $75 million at end of second fiscal quarter; or Annual revenues of less than $50 million and no public float at end of second fiscal quarter.	Public float of less than $250 million at end of second fiscal quarter; or Annual revenues of less than $100 million in its most recently completed fiscal year and no public float, or public float of less than $700 million at end of second fiscal quarter.
Registrant Filing Initial Registration Statement	Public float of less than $75 million within 30 days of filing.	Public float of less than $250 million within 30 days of filing.
Non-Smaller Reporting Company That Seeks to Qualify as a Smaller Reporting Company Based on Public Float	Public float of less than $50 million at end of second fiscal quarter.	Public float of less than $200 million at end of second fiscal quarter.
Non-Smaller Reporting Company That Seeks to Qualify as a Smaller Reporting Company Based on Revenue	Revenues of less than $40 million in most recent fiscal year, and no public float at end of second fiscal quarter.	Revenues of less than $80 million in its most recently completed fiscal year, and no public float or public float of less than $560 million at end of second fiscal quarter.
Rule 3-05 of Regulation S-X; requirements for financial statements of businesses acquired	Earliest year of financial statements is omitted if the net revenues of the most recently completed fiscal year of the business acquired are less than $50 million.	Earliest year of financial statements is omitted if the net revenues of the most recently completed fiscal year of the business acquired are less than $100 million.

For filings before September 10, 2018, the amended rule will not apply. For example, a company with a fiscal quarter-end of June 30, 2018 that files its Form 10-Q on August 1, 2018 cannot use the reduced disclosure.

New qualification test for companies

Example 1. Company A performs its initial qualification test under the final rule, and has a September 30 year-end. It determines that it has $175 million of public float as of March 31, 2018 at the end of its second fiscal quarter. Consequently, Company A newly qualifies as an SRC, and may use the reduced disclosures for its Form 10-K for the year ended September 30, 2018. However, due to its public float, Company A remains an accelerated filer. Therefore, it will report on the accelerated filer dates and also need an annual audit of its ICFR.

Example 2. Company B, with a December 31 year-end, did not qualify as an SRC in 2018 because it had a public float of $760 million as of June 30, 2018. On June 30, 2019, Company B's public float falls to $550 million. Company B's revenues for its fiscal year ended 2018 were $85 million so it does **not** qualify as an SRC in fiscal year 2019. Although Company B's public float was reduced to less than $560 million (80 percent of the threshold $700 million), its revenue for its most recently completed fiscal year was not under $80 million (80 percent of the threshold $100 million).

Example 3. Company C acquires Company D on November 1, 2018, and the acquisition is over 50 percent significant. Company D's net revenues in its most recent fiscal year are $90 million. Because Company D's net revenues are less than $100 million, Company C presents two years of Company D's financial statements instead of three years even if it is not an emerging growth company.

The SEC plans to issue additional guidance to address other implementation matters, including whether companies that meet the initial qualification tests can use scaled disclosures beginning with their next fiscal quarter.

Reduced disclosures

SRCs can use reduced disclosures under Regulations S-K and S-X (see table).

Regulations S-K and S-X

Item	Reduced disclosures
101 – Description of Business	— May satisfy disclosure obligations by describing the development of its business during the last three, 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)	— Two-year, rather than three-year, MD&A discussion. — Two-year, rather than three-year, discussion about the effect of inflation and changes in prices. — Tabular disclosure of contractual obligations not required.

Regulations S-K and S-X	
Item	**Reduced disclosures**
305 – Quantitative and Qualitative Disclosures about Market Risk	Not required.
402 – Executive Compensation	— Three, rather than five, named executive officers. — Two, rather than three, years of summary compensation table information. — Not required: – 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; and – pay ratio disclosure.
404 – Transaction with Related Persons, Promoters, and Certain Control Persons	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 year. — 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 about computation of ratios not required.
8-02 – Annual Financial Statements	— Two, rather than three, years of income statements. — Two, rather than three, years of cash flow statements. — Two, rather than three, years of changes in stockholders' equity statements.
8-03 – Interim Financial Statements	Permits certain historical financial data in lieu of separate historical financial statements of equity investees.

Regulations S-K and S-X	
Item	**Reduced disclosures**
8-04 – Financial Statements of Businesses Acquired or to Be Acquired	Maximum of two, rather than three, years of acquiree financial statements.
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, rather than three, years of financial statements for acquisition of properties from related parties.
8-08 – Age of Financial Statements	Less stringent age of financial statements requirements.

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