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SEC proposes to redefine filer definitions

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KPMG reports on the SEC's proposal[1] that would exempt more companies from internal control audits.

Applicability

Public companies, including foreign filers.[2]

Key impacts

- The proposed amendments would exclude from the definitions of accelerated and large accelerated filer any company that could qualify as a smaller reporting company (SRC) under the revenue test.
- This would mean that more, but not all, SRCs would be exempt from the requirement to audit their internal control over financial reporting (ICFR).
- Certain transition thresholds between filer categories would increase, and a revenue test would be added for companies exiting accelerated or large accelerated status.
- Comments are due July 29, 2019.

Why is the SEC proposing to amend the definitions?

In September 2018, the SEC's amendments to the definition of an SRC[3] became effective, which broke the link with non-accelerated filers. By removing that connection, many newly qualified SRCs remained accelerated filers. While these companies enjoyed the benefits of being an SRC, they remained subject to the ICFR audit requirement.

What are the proposed amendments?

The SEC is proposing an additional exclusion from both the accelerated and large accelerated filer definitions. Any SRC whose most recent annual revenue was less than $100 million would be a non-accelerated filer. This would include any SRC that qualified using either the revenue test or the public float test[4] (less than $250 million).

1 SEC Release No. 34-85814, Amendments to the Accelerated Filer and Large Accelerated Filer Definitions

2 Includes Foreign Private Issuers that file Form 20-F.

3 For more information see KPMG's Defining Issues No. 2018-14, SEC updates smaller reporting company definition.

4 Determined as of the last business day of the company's most recently completed second fiscal quarter.

Additionally, the SEC is proposing increases to the thresholds at which companies exit accelerated and large accelerated filer status. For accelerated or large accelerated filers to become non-accelerated filers, the company's public float would need to fall below $60 million, rather than $50 million. For a large accelerated filer to become an accelerated filer, its public float would need to be above $60 million, but below $560 million. Currently, the upper limit is $500 million.

Alternatively, an accelerated or large accelerated filer may become a non-accelerated filer if it subsequently qualifies as an SRC under the revenue test.[5] For example, an accelerated filer that previously had more than $100 million of annual revenue would become an SRC and non-accelerated filer if its revenue fell below $80 million.

In general, the exit transition thresholds would be set below the qualifying thresholds to avoid companies oscillating between categories. The $560 million threshold also would align with the SRC public float transition threshold under the revenue test when a company previously exceeded $700 million in public float. This alignment would eliminate rare situations where a company could qualify as both an SRC and a large accelerated filer.

With these changes, a non-accelerated SRC would be exempt from obtaining an audit over its ICFR. However, the amendments would not change other requirements of the Sarbanes-Oxley Act, such as those related to independent audit committees, CEO and CFO certifications of financial reporting, or the requirement for management to establish, maintain and assess the effectiveness of ICFR. Additionally, these SRCs would not be subject to the accelerated or large accelerated filing deadlines for annual and quarterly reports.

SRCs that are also accelerated filers

After the change to the SRC definition last September, most new and some existing SRCs qualified as accelerated filers. This proposal would allow some SRCs to qualify as non-accelerated filers. However, those SRCs that qualify using the public float test with over $75 million in public float but more than $100 million of revenue in their most recently completed fiscal year would continue to be accelerated filers.

Proposed relationships between SRCs and non-accelerated and accelerated filers

Status	Public float	Annual revenues
SRC and non-accelerated filer	Less than $75 million	N/A
	$75 million to less than $700 million	Less than $100 million
SRC and accelerated filer	$75 million to less than $250 million	$100 million or more
Accelerated filer (not SRC)	$250 million to less than $700 million	$100 million or more

KPMG observation

The proposed changes are likely to have a disproportionate effect on certain industries. For example, the SEC said approximately 36% of new SRCs under the revenue test fall within the biotechnology, pharmaceutical product or medical equipment industries. The SEC intends the proposed changes to promote capital formation for SRCs by giving them relief from the costs associated with ICFR auditor attestation requirements, which could free up capital for their core business needs and redirect savings into growing their business.

[5] Large accelerated filers would need to have a public float less than $560 million to qualify.

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