

SEC Reporting Update

New definition of a smaller reporting company will provide significant disclosure relief for many companies

In this issue:

Overview	1
Initial qualification test	2
Existing registrants.....	2
Initial public offering (IPO) registrants	2
Recurring annual determinations	3
Timing and thresholds for annual determination test	3
Entry and exit reporting in periodic filings.....	4
Scaled disclosure requirements for SRCs	4
Form and content of financial statements and other financial-related disclosures	4
Financial statements of other entities	5
Scaled disclosure requirements for SRCs...	6
Appendix A – SRC requirements for Form 10-K	9
Appendix B – SRC requirements for Form 10-Q	11

What you need to know

- ▶ The SEC changed its definition of a smaller reporting company and estimated that nearly 1,000 more public companies will now qualify to provide scaled disclosures.
- ▶ The new thresholds for qualifying are (1) public float of less than \$250 million or (2) annual revenue of less than \$100 million in annual revenue and public float of less than \$700 million (including no public float).
- ▶ Smaller reporting companies qualify for significant disclosure relief, including fewer years of annual financial statements and related disclosures as well reduced nonfinancial disclosures, including those related to governance, executive compensation, business and risks.
- ▶ The rule change is effective 10 September 2018.

Overview

The Securities and Exchange Commission (SEC or Commission) recently [changed its definition of a smaller reporting company \(SRC\)](#)¹ to expand the number of registrants that qualify to provide scaled disclosures.

The rule change, which is effective 10 September 2018, is expected to reduce compliance costs for smaller registrants and promote capital formation. The Commission estimates that nearly 1,000 more registrants will now qualify as SRCs.

While historically SRCs have not been accelerated filers, the SEC didn't raise the threshold for accelerated filer status from \$75 million of public float. As a result, SRCs with public float greater than \$75 million will be subject to the accelerated filing deadlines and the requirement to obtain an annual audit of internal control over financial reporting (ICFR). However, the SEC said its staff is working on recommendations to change the definition of an accelerated filer, which would require additional SEC rulemaking, and could reduce the number of companies subject to those requirements.

Investment companies, including business development companies, and issuers of asset-backed securities don't qualify for SRC status. Foreign companies are eligible for SRC status only if they file domestic forms and provide financial statements in accordance with US GAAP.

Initial qualification test

Existing registrants

For purposes of the first fiscal year ending after 10 September 2018, a registrant qualifies as an SRC if it meets either of these thresholds:

- ▶ Its public float is less than \$250 million.
- ▶ Its annual revenue for its last completed year is less than \$100 million and its public float is less than \$700 million (including no public float).

A company's public float is determined by multiplying the aggregate number of voting and non-voting common shares held by non-affiliates by the price at which the common shares were last sold, or the average of the bid and asked prices, in the principal market for the registrant's common shares. Thus, the determination of public float is premised on the existence of a public trading market for the issuer's common equity securities.

For purposes of determining both SRC status and accelerated filer status, a company calculates its public float as of the last business day of its most recent second fiscal quarter. For example, a calendar year-end company would calculate its public float based on its stock price on 29 June 2018, the last business day before 30 June 2018, for purposes of determining its SRC status and accelerated filer status for its fiscal year ending 31 December 2018.

The SEC staff announced in its [Small Entity Compliance Guide for Issuers](#) that a company newly qualifying as an SRC has the option to transition to the SRC scaled disclosure accommodations in its:

- ▶ Next periodic or current report due on or after 10 September 2018
- ▶ Registration or proxy filing or amended filing made on or after 10 September 2018

For example, a calendar year-end company that now qualifies as an SRC can apply scaled disclosures in its third quarter Form 10-Q and its year-end Form 10-K.

Initial public offering (IPO) registrants

The public float of a company that files an initial registration statement under the Securities Act for shares of its common equity is determined based upon the estimated public offering price multiplied by the sum of the aggregate shares held by non-affiliates prior to the filing and the additional shares that will be sold in the IPO. If the estimated public float is below \$250 million, or the company has less than \$100 million in annual revenue and its estimated public float is less than \$700 million, the company would qualify as an SRC.

SRCs with public float greater than \$75 million will have to comply with the accelerated periodic reporting deadlines and the requirement to obtain an annual ICFR audit.

New issuers have the option to redetermine their status as an SRC for subsequent periodic reports based upon the actual offering price and the actual number of shares held by non-affiliates at the conclusion of their IPO. Similarly, for purposes of transitioning to the new thresholds, a company that completed its IPO after the end of its most recent second fiscal quarter may elect to use the amount of public float estimated upon initially filing its IPO registration statement or as of the conclusion of the IPO based on the actual offering price and number of shares held by non-affiliates.

Companies registering shares that are already outstanding, or listing their existing equity or debt securities for the first time on a national exchange without an offering, file registration statements under the Exchange Act. A company filing an initial Exchange Act registration statement that has public float would determine its public float as measured on any day (at the company's choice) within 30 days of the filing date and would qualify as an SRC if such float is below \$250 million. If that company does not have public float (no public common equity outstanding or no market price for its common equity), it would qualify as an SRC if its annual revenue for the most recently completed fiscal year was below \$100 million.

A company that is conducting an IPO as an EGC should perform the new SRC qualification test to determine whether it also qualifies for SRC disclosure accommodations that go beyond those provided for EGCs.

How we see it

Companies that plan to submit a draft registration statement or file an IPO registration statement before the effective date (10 September 2018) and believe they would qualify as SRCs after the rule change becomes effective should consider discussing with their SEC staff reviewer whether it is appropriate to provide scaled SRC disclosures in the submission or filing.

Recurring annual determinations

Timing and thresholds for annual determination test

The annual determination test for SRC status is performed as of the last business day of the company's second fiscal quarter. For a calendar year-end company, the annual determination test for the year ending 31 December 2019 would be performed on 28 June 2019, the last business day before 30 June 2019.

The SEC set different entry and exit thresholds for SRC status to minimize moves from one category to the other due to relatively small changes in public float. The subsequent qualification thresholds are 80% of the initial qualification thresholds. That is, a registrant that did not initially qualify as an SRC may subsequently qualify only if it meets either of the following thresholds:

- Public float of less than \$200 million
- Annual revenue of less than \$80 million for the year completed before the determination date and public float of less than \$560 million at the determination date

A registrant that qualifies as an SRC maintains that status until (1) its public float exceeds \$250 million and its annual revenue exceeds \$100 million, (2) its annual revenue exceeds \$100 million and it has no public float or (3) its public float exceeds \$700 million, regardless of annual revenue.

SRCs can omit the contractual obligations table and related disclosures.

Entry and exit reporting in periodic filings

An issuer that qualifies as an SRC for the first time as of the last business day of its second fiscal quarter may choose to reflect its change in status in its quarterly report on Form 10-Q for the second quarter and start making scaled disclosures immediately.

An issuer that no longer qualifies as an SRC at its determination date may continue to provide scaled disclosures through its annual report on Form 10-K for the year that it failed the measurement test and begin providing the larger company disclosures in its first Form 10-Q for the following fiscal year.

Scaled disclosure requirements for SRCs

SRCs may choose to comply with either the scaled disclosure requirements for SRCs or the larger company disclosure requirements on an item-by-item basis in each filing. However, if a scaled disclosure requirement is more rigorous than the corresponding requirement for larger companies, an SRC is required to comply with the more rigorous requirement. SRCs should also apply whatever approach they select consistently from filing to filing to allow investors to make period-to-period comparisons.

The tables in Appendices A and B show the itemized instructions of Form 10-K and Form 10-Q, the location of their respective disclosure instructions in Regulations S-X and S-K and a summary of where scaling is available. Disclosure items that are modified or scaled for SRCs are discussed below.

Form and content of financial statements and other financial-related disclosures

Annual financial information

SRCs may choose to comply with either the requirements for SRC financial statements in Article 8 or those for non-SRCs elsewhere in Regulation S-X. Article 8 of Regulation S-X requires SRCs to file an audited balance sheet as of the end of the two most recent fiscal years and audited statements of income, comprehensive income, cash flows and changes in stockholders' equity and noncontrolling interests for the two most recent fiscal years. Larger registrants are required to file audited financial statements for three fiscal years.

SRCs always have to comply with the following:

- ▶ Article 2 of Regulation S-X, which outlines the requirements for the report and qualifications of the auditor
- ▶ Rule 4-10 regarding the accounting and reporting for oil and gas producing activities

SRCs should also provide all information required by any applicable SEC industry guide.

SRCs that choose to prepare their financial statements in accordance with Article 8 are not required to follow the presentation requirements of Rules 5-02 and 5-03 of Regulation S-X or provide the related footnote disclosures. SRCs can also omit the financial schedules required by Rule 5-04 and any footnote disclosures required by Rule 4-08 (with the exception of the derivative disclosures required by Rule 4-08(n)(7)).²

SRCs also are not required to provide the five-year selected financial data table required by Item 301 of Regulation S-K, the quarterly financial data table required by Item 302 of Regulation S-K, and the market risk disclosures required by Item 305 of Regulation S-K.

How we see it

The option to omit the selected financial data table could provide significant relief for SRCs that have retrospective accounting changes or discontinued operations because they would only need to determine the effect for the two years of financial statements presented rather than the five years required in the table.

SRCs can also choose to discuss in management's discussion and analysis (MD&A) the results of operations and effects of price changes and inflation for only the two most recent years for which they have provided financial statements and can omit the contractual obligations table required by Item 303(b).

Interim financial information

For the most part, SRCs do not get relief from interim financial reporting. However, they can condense their interim financial statements and include fewer line items than non-SRCs. For example, interim balance sheets only need to include separate captions for each component that represents 10% or more of total assets, with totals for current assets and current liabilities if the SRC presents a classified balance sheet. However, an SRC needs to present cash and retained earnings, regardless of their relative significance to total assets.

In their interim income statements, SRCs need only include revenue, each cost and expense category presented in the annual financial statements that exceeds 20% of revenues, provision for income taxes and discontinued operations. Interim cash flow statements can be condensed to show only cash flows from operating, investing and financing activities.

Financial statements of other entities

Financial information for equity method investees

SRCs are not required to provide separate financial statements of significant equity method investees. However, under Rule 8-03(b)(3), they are required to provide summarized financial data, including sales, gross profit, net income from continuing operations and net income for significant equity investees that individually represent 20% or more of their consolidated assets, equity or income from continuing operations attributable to the registrant in both annual and interim financial statements. While this requirement is similar to the interim reporting requirement for larger companies, the threshold for SRCs is higher (20%) than the threshold for summarized information in annual financial statements for larger companies (10%), and SRCs aren't required to provide any balance sheet data.

Financial statements for acquired businesses

SRCs may provide only two years of financial statements of an acquired business under Rule 8-04 for an acquisition greater than 50% significant, rather than the three years of financial statements required of larger registrants.

When an SRC acquires a significant non-reporting business, the financial statements of the non-reporting acquiree may also comply with the scaled reporting requirements outlined in Article 8 of Regulation S-X. If the SRC is filing the non-reporting target financial statements on Form S-4 for a merger, such target financial statements may be prepared in accordance with Article 8 only if the target would qualify as a smaller reporting company if it were a registrant (i.e., if it had annual revenue of less than \$100 million).

For pro forma financial information, the requirements for SRCs and larger companies are similar, and SRCs can look to the requirements in Article 11 of Regulation S-X for complying with Rule 8-05 of Regulation S-X.

Other financial statement requirements

SRCs must comply with the requirements of the following rules but they can provide information for two years rather than three years:

- Rule 3-10 for separate financial statements of subsidiary issuers and guarantors or condensed consolidating financial information in specified circumstances
- Rule 3-16 for separate financial statements of affiliates whose securities collateralize the registrant's securities

How we see it

SRCs should monitor developments related to the rules on guaranteed or collateralized securities. In July 2018, the SEC proposed³ rule changes that would significantly decrease the volume of financial information required for subsidiary issuers and guarantors and affiliates whose securities collateralize those of the registrant.

Like other registrants, SRCs can also avail themselves of the provisions of Rule 3-13 of Regulation S-X to request relief from providing required financial statements when the relief is consistent with the protection of investors.

Scaled disclosure requirements for SRCs

Upon qualifying as an SRC, a registrant can omit from its Form 10-K its legacy disclosures about risk factors, market risks, selected financial data, selected quarterly financial data and financial schedules if the information is not material to its investors. SRCs must continue to provide risk factor disclosures in their Securities Act registration statements.

Item 101. Description of business

While SRCs and non-SRCs have to discuss one year of business developments in Form 10-K, an SRC can discuss developments over only the last three years in a registration or proxy statement rather than the five years non-SRCs need to discuss.

A registrant that newly qualifies for SRC status could significantly abbreviate its business discussion by removing the financial information about its separate segments, geographic areas and firm backlog orders.

SRCs that operate their business in two or more reportable segments or across multiple geographic regions must continue to provide the disclosures required by Accounting Standards Codification 280, *Segment Reporting*, in the notes to their audited financial statements. Further, an SRC's MD&A discussion of operating results should also be organized by reportable segment or other relevant business division if necessary to help users understand the business and its overall financial condition and operating results.

Item 402. Executive compensation

Items 402(l) through 402(r) of Regulation S-K set forth the executive compensation disclosure requirements applicable to SRCs.

An SRC can provide only the following compensation-related tables along with related narrative disclosures, with slight modifications to some of the reporting thresholds:

- The summary compensation table
- The table of outstanding equity awards at fiscal year end
- The director compensation table

SRCs can omit the pay ratio and other executive compensation disclosures.

SRCs still must provide more granular disclosures about transactions with related parties than other registrants.

SRCs can omit the following narrative discussions and tables:

- Compensation discussion and analysis
- Table of grants of plan-based awards
- Table of option exercises and stock vested
- Pension benefits table
- Nonqualified deferred compensation table
- Disclosure of compensation policies and practices related to risk management
- Pay ratio disclosure

SRCs can provide compensation information for three named executive officers (NEOs) rather than five NEOs, meaning they need to disclose compensation only for their Principal Executive Officer and the next two most highly compensated officers. If they haven't already provided more information in an earlier filing, SRCs can provide compensation data for only two years (or only the last fiscal year if they did not have periodic reporting obligations in the prior year).

SRCs should be aware that, while they can omit the pension benefits table and associated notes, they are required under Item 402(q) of Regulation S-K to provide a narrative description of the material terms of each plan that provides for the payment of retirement benefits or benefits that will be paid primarily after retirement.

SRCs are also expected to disclose the material terms of each contract, agreement or plan that provides for payments to one or more NEOs upon a change in control of the registrant regardless of whether the payments are at, following or in connection with his or her resignation, retirement or a change in the NEO's responsibilities following a change in control.

How we see it

We expect issuers that qualify for SRC status for the first time to significantly reduce their executive compensation disclosures, as emerging growth companies have done.

Item 404. Transactions with related persons, promoters and certain controlled persons

The only more granular disclosures SRCs are required to make under Regulation S-K are those described in Item 404. An SRC cannot opt to provide the less rigorous disclosure for a non-SRC. These expanded disclosures are required for the last two years and include:

- Item 404(a): Disclose transactions with related persons that exceed the lesser of \$120,000 or 1% of average total assets for the last two completed fiscal years, meaning SRCs with total assets of less than \$12 million would have a lower disclosure threshold than a non-SRC's threshold of \$120,000
- Item 404(d): Provide specific information about underwriting discounts and commissions when a related person as specified in Item 404(a) is the principal underwriter or is the controlling person or member of a firm that is the principal underwriter
- Item 404(d): Provide a list of parent entities, the percentages of voting securities they own and describe the basis of their control

However, SRCs are not required to describe their policies and procedures for review, approval or ratification of related party transactions.

Item 407. Corporate governance

Item 407(g) of Regulation S-K permits SRCs to omit the following information from their annual reports or annual proxy statements:

- The compensation committee report
- Compensation committee interlocks and insider participation
- Audit committee financial expert disclosure (only in the first annual report after an SRC's IPO)

How we see it

In evaluating the accommodations, companies that newly qualify for SRC status should consider whether removing any existing disclosures would result in the omission of material information for investors.

Endnotes:

- ¹ SEC Release No. 33-10513; 34-83550, *Smaller Reporting Company Definition*.
- ² On 13 July 2016 in Release No. 33-10110; 34-78310; IC-32175, *Disclosure Update and Simplification*, the SEC proposed deleting substantially all disclosure requirements about derivatives and hedging in Rule 4-08(n).
- ³ SEC Release No. 33-10526, *Financial Disclosures about Guarantors and Issuers of Guaranteed Securities and Affiliates whose Securities Collateralize a Registrant's Securities*.

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Appendix A – SRC requirements for Form 10-K

Form Item	Form 10-K instructions	Disclosure requirement	Scaling for SRCs
Part I			
Item 1	Business	S-K Item 101	Scaled
Item 1A	Risk factors	S-K Item 503(c)	Not required
Item 1B	Unresolved staff comments	Material unresolved SEC staff comment letters received more than 180 days before the fiscal year end	Required if SRC is accelerated filer
Item 2	Properties	S-K Item 102	Same as non-SRC
Item 3	Legal proceedings	S-K Item 103	Same as non-SRC
Item 4	Mine safety disclosures	S-K Item 104	Same as non-SRC
Part II			
Item 5	Market for registrant's common equity and related stockholder matters	S-K Item 201 S-K Item 701 S-K Item 703	Same as non-SRC except stock performance graph in Item 201(e) Same as non-SRC Same as non-SRC
Item 6	Selected financial data	S-K Item 301	Not required
Item 7	Management's discussion and analysis	S-K Item 303	Scaled
Item 7A	Quantitative and qualitative disclosures about market risk	S-K Item 305	Not required
Item 8	Financial statements Supplementary financial information	S-X Rules 3-01 through 3-04 S-X Articles 4 and 5 S-X Article 7 if the registrant is an insurance company or Article 9 if it's a bank holding company S-K Item 302	Scaled in Article 8 of Regulation S-X Not required
Item 9	Changes in and disagreements with accountants on accounting and financial disclosure	S-K Item 304(b)	Same as non-SRC
Item 9A	Controls and procedures	S-K Items 307 and 308	Same as non-SRC An SRC is required to include an audit report on its ICFR only if it is also an accelerated filer
Item 9B	Other information	Any information required to be disclosed on Form 8-K during the quarter but not reported	Same as non-SRC
Part III			
Item 10	Directors, executive officers and corporate governance	S-K Items 401, 405, 406 and 407(c)(3), (d)(4) and (d)(5)	Scaled corporate governance disclosures under Item 407
Item 11	Executive compensation	S-K Items 402 and 407(e)(4) and (e)(5)	Scaled executive compensation disclosures under Item 402
Item 12	Security ownership	S-K Items 201(d) and 403	Same as non-SRC
Item 13	Certain relationships and related transactions, and director independence	S-K Items 407(a) and 404(c) S-K Items 404(a) and (d) S-K Item 404(b)	Same as non-SRC Expanded for SRCs Not required
Item 14	Principal accountant fees and services	Item 9(e) of Schedule 14A	Same as non-SRC

Form Item	Form 10-K instructions	Disclosure requirement	Scaling for SRCs
Part IV			
Item 15	Exhibits	S-K Item 601 Exhibits	Same as non-SRCs except statement regarding computation of ratios
	Financial statement schedules	S-X Article 12 Financial Statement Schedules	Not required
Item 16	Form 10-K summary	Optional	Optional

Appendix B – SRC requirements for Form 10-Q

Form Item	Form 10-Q instructions	Disclosure requirement	Scaling for SRCs
Part I			
Item 1	Financial statements	S-X Rule 10-01	Scaled in Article 8-03 of Regulation S-X
Item 2	Management's discussion and analysis	S-K Item 303(b)	Same as non-SRC
Item 3	Quantitative and qualitative disclosures about market risk	S-K Item 305	Not required
Item 4	Controls and procedures	S-K Item 307 S-K Item 308(c)	Same as non-SRC
Part II			
Item 1	Legal proceedings	S-K Item 103	Same as non-SRC
Item 1A	Risk factors	Material changes in risk factors since those disclosed in last 10-K	Not required
Item 2	Unrestricted sales of equity securities and use of proceeds	S-K Item 701 if not previously included in a Form 8-K S-K Item 703	Same as non-SRC Same as non-SRC
Item 3	Defaults upon senior securities	Disclose if not previously included in a Form 8-K	Same as non-SRC
Item 4	Mine safety disclosures	S-K Item 104	Same as non-SRC
Item 5	Other information	Any information required to be disclosed on Form 8-K during the quarter but not reported S-K Item 407(c)(3) changes to procedures to nominate members of the board of directors	Same as non-SRC Same as non-SRC
Item 6	Exhibits	S-K Item 601	Same as non-SRC