



## *Securities Law Alert*

### SEC Expands the Number of Companies That Qualify as Smaller Reporting Companies with Substantially Reduced Disclosure Requirements

By the Corporate & Securities Practice Group

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On September 10, 2018, the SEC's revised definition of Smaller Reporting Company ("SRC") took effect to expand the number of companies that are permitted to disclose less information than larger public companies. If a company qualified as an SRC in the past, but did not take advantage of the scaled disclosures, it is not prohibited from taking advantage of the scaled disclosures in the future, provided it continues to qualify as an SRC.

The new definition of SRC permitting scaled disclosures has increased the public float threshold to \$250 million from \$75 million (regardless of the amount of annual revenues). It also includes companies with less than \$100 million in annual revenues if their public float is less than \$700 million as compared to \$50 million in annual revenues and no public float under the prior definition.

Some of the more significant benefits of scaled disclosure for SRCs include:

- two years (as opposed to three) of financial statements and corresponding analysis in the MD&A section of the annual report on Form 10-K;
- executive compensation information for three named executive officers (rather than five) and for two years (rather than three);
- omission of the compensation discussion and analysis section (CD&A), several executive compensation tables, the compensation committee report and the pay ratio disclosure in the proxy statement;
- risk factors in Exchange Act filings, selected financial data, supplementary financial information, quantitative and qualitative disclosures about market risk, the table of contractual obligations, and related party policies and procedures are not required;
- fewer circumstances under which pro forma financial statements are required;
- more flexibility in the presentation of its financial statements; and
- a slightly abbreviated description of its business.

An SRC may choose either the SRC disclosure requirements or the larger company disclosure requirements on an item-by-item basis. For instance, many SRCs continue to disclose risk factors as a

way of protecting against liability for forward-looking statements in their SEC filings. However, the anti-fraud provisions remain in effect, which means that SRCs must continue to provide material information that is necessary to make any required statements, in the light of the circumstances under which they are made, not misleading.

The SEC expects that nearly 1,000 additional companies will be eligible for SRC scaled disclosure relief, some of which will be emerging growth companies (“EGCs”). These EGCs will be allowed to continue using abbreviated disclosure that they would normally lose after the end of the fifth fiscal year following their IPOs.

An SRC is required to redetermine its SRC eligibility annually by calculating its public float as of the last business day of its most recently completed second fiscal quarter. If an SRC exceeds the thresholds and is no longer an SRC, it may requalify as an SRC in the future only if it meets the SRC definition at 80% of the initial qualification thresholds: (i) a public float of less than \$200 million or (ii) less than \$80 million of annual revenues and a public float of less than \$560 million. In this way, companies should not frequently exit and re-enter SRC status due to small fluctuations in their public float.

As long as an SRC is a non-accelerated filer (currently, a public float below \$75 million), it is not required to provide auditor attestation of management’s assessment of internal control over financial reporting as required by Section 404(b) of the Sarbanes-Oxley Act, which substantially reduces its compliance costs. Unfortunately, the SEC did not amend the minimum public float threshold of \$75 million in the definition of accelerated filer. As such, an SRC with a public float between \$75 million and \$250 million will be an accelerated filer that is subject to auditor attestation and also be subject to the shorter deadlines to file its annual report on Form 10-K (60 days rather than 90) and its quarterly reports on Form 10-Q (40 days rather than 45). The SEC is considering whether to increase the threshold to be an accelerated filer from \$75 million to \$250 million to match the revised threshold for SRCs, which would permit many more companies to be able to avoid the costly auditor attestation requirement.

Although this amendment is intended to promote capital formation, companies eligible to become SRCs may wish to check with their financial advisors or investment bankers to understand the impact such reduced disclosure would have on their ability to raise capital and whether they might lose analyst coverage before deciding to switch to this lower disclosure regime available to SRCs.

For more information on the amendments to the definition of SRC or help in determining whether your company qualifies as an SRC, contact one of the attorneys in our Corporate & Securities Law Practice, including:

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*This summary is provided for information purposes based upon our review of the amendments related to smaller reporting companies, which could be subject to other interpretation or explanation upon further analysis and review. It does not contain legal advice or create an attorney-client relationship. The information provided should not be taken as an indication of future legal results; and any information furnished should not be acted upon without consulting legal counsel.*