

# SEC lowers threshold to qualify as a Smaller Reporting Company

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As part of the SEC's continuing effort to streamline disclosure for smaller companies, the Securities and Exchange Commission announced on June 28 that it had adopted a **final rule** to relax the thresholds required to qualify as a "smaller reporting company," or SRC. Many newly public companies and other existing registrants will fit within the new definition of SRC and will be able to take advantage of more abbreviated disclosures in their periodic filings. The final rule will become effective 60 days after its publication in the Federal Register.

## Background – Smaller Reporting Companies

The SEC adopted the smaller reporting company category in 2007, and granted SRCs a number of disclosure accommodations that are not available to more established companies or those with larger public floats.

Some of these accommodations are similar to those afforded to emerging growth companies, or EGCs: an SRC is only required to present two (rather than three) years of financial statements and corresponding management discussion & analysis; need only provide executive compensation information for three (rather than five) named executive officers; and may omit the compensation discussion & analysis. In addition, SRCs and EGCs need only present two (rather than three) years of information in the summary compensation table; and may omit several other executive compensation tables, pay-ratio disclosure and narrative descriptions of certain compensation policies and practices.

An SRC also has the flexibility to present financial statements in accordance with Article 8 of Regulation S-X, which does not stipulate a particular financial statement format, and may choose to omit financial statements of equity affiliates where such financial statements are not material to investors. Other accommodations an SRC may elect to follow are described in Item 10(f) of Regulation S-K and permit an SRC to omit the presentation of five years of selected financial data, quantitative and qualitative disclosures about market risk, and information summarizing contractual obligations, in addition to permitting an abbreviated description of the SRC's business.

As described further below, for so long as an SRC is a non-accelerated filer, it will not be required to provide an auditor attestation of management's assessment of internal controls over financial reporting required by Section 404(b) of the Sarbanes Oxley Act, substantially reducing compliance costs. Similarly, as a non-accelerated filer, it will benefit from longer periods to file annual reports (90 days rather than 60 days) and quarterly reports (45 days rather than 40 days).

## Expanded Definition of Smaller Reporting Company

Under the newly expanded definition, a company may qualify as an SRC under either of two tests: (1) the *Public Float Test*, which requires a company's public float to be less than \$250 million (as opposed to \$75 million under the prior definition), or (2) the *Annual Revenues Test*, which requires a company's annual revenues to be less than \$100 million (as opposed to \$50 million under the prior definition), where it has no public float or has a public float of less than \$700 million.

The prior definition and new definition are presented in the chart below.

Test	Prior Definition	New Definition
<b>Public Float</b>	Public float of less than \$75 million	Public float of less than \$250 million
<b>Annual Revenues</b>	Less than \$50 million of annual revenues and no public float	Less than \$100 million of annual revenues and <ul style="list-style-type: none"> <li>▪ No public float, or</li> <li>▪ Public float of less than \$700 million</li> </ul>

For any company that goes public in an initial public offering that is smaller than \$250 million, that company may benefit from being an SRC for some period of time. Similarly, IPO companies with revenues below \$100 million can enjoy these benefits. The new definition is also expected to benefit existing EGCs, particularly an EGC that is nearing the end of its fifth fiscal year following its IPO and will phase out of the abbreviated reporting accommodations applicable to EGCs. The SEC estimates that approximately 1,000 additional companies will be eligible for the SRC reporting accommodations.

### Requalification

An SRC must redetermine its eligibility annually by calculating its public float. Public float is calculated by multiplying the aggregate number of shares of voting and non-voting common equity held by non-affiliates by the price at which the common equity was last sold, or the average of the bid and asked prices of common equity in the principal market for the common equity, as of the last business day of the SRC's most recently completed second fiscal quarter. The amendments also revise the requalification thresholds, which are set at 80% of the initial qualification thresholds described above. These thresholds are designed to prevent a company from entering and exiting SRC status based on minor fluctuations in its public float. Once a company that qualified under the Public Float Test determines that it no longer qualifies as an SRC, it will remain unqualified until its public float falls below \$200 million. Similarly, a company that previously qualified under the Annual Revenues Test and determines it no longer qualifies as an SRC will remain unqualified until the applicable thresholds in the chart below are met.

Prior Annual Revenues	Prior Public Float		
	None or less than \$700 million		\$700 million or more
<b>Less than \$100 million</b>	Neither threshold exceeded		Public float: Less than \$560 million; and Revenues: Less than \$100 million
<b>\$100 million or more</b>	Public float: Revenues:	None or less than \$700 million; and Less than \$80 million.	Public float: Less than \$560 million; and Revenues: Less than \$80 million.

While more companies are expected to qualify as an SRC under the new definition, an SRC with a public float of \$75 million or more may nonetheless be an “accelerated filer.” Consequently, an SRC that is an accelerated filer must obtain the auditor attestation required by Section 404(b) of the Sarbanes Oxley Act, and file annual and quarterly reports on a shorter timeline. The SEC acknowledged that this overlap

creates “regulatory complexity,” and Chairman Clayton has directed the SEC staff to propose recommendations to reduce the number of companies that would qualify as accelerated filers, to further promote capital formation and reduce compliance costs.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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