

Legal Updates & News

Legal Updates

SEC Proposes Simplifying Disclosure Obligations for Greater Number of Smaller Public Companies

July 2007

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On July 5, 2007, the Securities and Exchange Commission proposed to extend the simplified reporting benefits currently available under Regulation S-B to a broader group of companies (the "SEC Proposal").^[1] The SEC Proposal is in response to the March 2005 recommendations of its Advisory Committee on Smaller Public Companies and is the latest of several recent SEC proposals to modernize and simplify disclosure and capital raising for smaller public companies. Under the SEC proposal, companies, including foreign companies, with a public float of less than \$75 million ("Smaller Reporting Companies") would be eligible for the less stringent reporting requirements currently available to "small business issuers" under Regulation S-B. In addition, the substantive disclosure requirements of Regulation S-B would be folded into Regulation S-K, and small business forms including Forms SB-1, SB-2, 10-SB, 10-QSB, and 10-KSB would be eliminated.

Scaled Back Regulation S-B Disclosure

Regulation S-B currently permits scaled down '33 Act and '34 Act disclosure for small business issuers. These reduced requirements include: two years vs. three years GAAP financial statements; an audited balance sheet only as of the end of the most recent fiscal year; relief from the more stringent requirements of SEC's Regulation S-X; reduced executive compensation disclosure (including no requirement for a CD&A); scaled back MD&A related party and corporate governance disclosure; and no requirement for selected financial data, quantitative and qualitative disclosures about market risk or compensation committee interlock and insider participation disclosure. Under Regulation S-B, "small business issuers" essentially are domestic companies that have both a public float and revenues of less than \$25 million.

Eligibility Requirements

The SEC Proposal would provide the benefits of simplified Regulation S-B disclosure to a significantly greater number of companies by creating a new category of eligible issuers, Smaller Reporting Companies, defined as any company (other than a shell company) with a public float of less than \$75 million.^[2] There would be no additional revenue test for eligibility except where an issuer had no common equity public float or market price (e.g. a company with only publicly traded debt outstanding) in which case the issuer would be required to have less than \$50 million in revenue for the most recently completed fiscal year for which audited results are available.

^[3] Foreign issuers, currently excluded under Regulation S-B, would be eligible for the scaled back reporting for Smaller Reporting Companies if the foreign company met the less than \$75 million in public float test (or the less than \$50 million revenue test where the company had no public float).

^[4] Under the SEC Proposal, the \$75 million float and \$50 million revenue ceilings would be adjusted for inflation on September 1, 2012, and every fifth year thereafter. Generally, the calculation of a company's public float for Smaller Reporting Company eligibility purposes would be done as of the same date currently used to determine accelerated filing status — the last business day of a company's second fiscal quarter — and would use the price at which the shares of the company's public equity were last sold or the average of the bid and asked price of the company's shares on its principal market on that date.^[5] If a company is eligible for Smaller Reporting Company status, it would be required to so indicate by checking the Smaller Reporting Company box on the cover page of its SEC filings.

Elective "A La Carte" Disclosure

The SEC proposal would integrate the substantive provisions of current Regulation S-B into Regulation S-K and eliminate Regulation S-B and all the S-B forms. A Smaller Reporting Company would not be required to take advantage of any or all of the truncated reporting options available under revised Regulation S-K but could choose, on an item by item or “a la carte” basis, to provide either the same level of disclosure required under Regulation S-K of larger companies or the truncated disclosure permitted for Smaller Reporting Companies. However, in the case of financial statements, a Smaller Reporting Company would be required to provide for all periods in a single fiscal year financial statements either in the simplified format permitted to Smaller Reporting Companies (as currently set forth in Item 310 of Regulation S-B) or the more extensive requirements under Regulation S-X and would not be permitted to switch back and forth from one to the other in different filings within a single year.

Transition to and from Smaller Company Reporting Status

Under the SEC Proposal, a Smaller Reporting Company would lose that status beginning with the first fiscal year following a year in which its public float rises above \$75 million as of the last business day of its second fiscal quarter. In the case of an issuer that does not currently qualify as a Smaller Business Issuer, that company would be required to transition to Smaller Reporting Company status in the year following the year in which its public float falls below \$50 million as of the last business day of its second fiscal quarter. In cases where a company has no public market for its common stock but meets the “less than \$50 million in revenue” test for Smaller Reporting Company eligibility, the company would be able to continue to report as a Smaller Reporting Company until its annual revenue exceeds \$50 million. Thereafter, it would remain unqualified to take advantage of the scaled disclosure requirements for Smaller Reporting Companies until its annual revenues fell below \$40 million. If a company relying on the revenue test for Smaller Reporting Company status subsequently develops a public float of \$75 million or more the issuer would remain a Smaller Reporting Company through the end of the year.

Footnotes:

[1] See Release No. 33-8819

[2] The SEC Proposal notes that currently approximately 32% of all companies filing annual reports with the SEC were “small business issuers” as defined under Regulation S-B. Under the SEC Proposal, an additional 10% (1,227 issuers) would be eligible for scaled back disclosure as Smaller Reporting Companies.

[3] Companies that currently are either “small business issuers” under Regulation S-B or non-accelerated filers (i.e. companies with less than \$75 million in public float that do not qualify as either “larger accelerated filers” or as “accelerated filers” under the SEC’s rules) would qualify as Smaller Reporting Companies under the proposed rules.

[4] Foreign issuers who wish to take advantage of the scaled back financial statement disclosure requirements available to Smaller Reporting Companies would be required to present those financials in accordance with U.S. GAAP even though under present rules a “foreign private issuer” is permitted to prepare and present financial statements on a basis other than U.S. GAAP if certain conditions are met. A “foreign private issuer” that qualifies as a Smaller Reporting Company would have to choose whether to use the domestic forms (e.g. Forms S-1, S-3, 10-Q and 10-K) and take advantage of the truncated disclosure available to it as Smaller Reporting Company or to use the forms available only to foreign private issuers (e.g. Forms F-1, F-3, F-4 and 20-F) and comply with the disclosure requirements of those forms.

[5] In the case of a registration statement for an initial public offering, the public float test would be calculated as of a date within 30 days of the filing of the registration statement using the estimated public offering price times the sum of the shares held by non-affiliates before the offering and the number of new shares to be sold by the company under the registration statement.