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The SEC's Recent Amendments to Smaller Reporting Company Disclosures--Updated Summary of Financial Statement Requirements

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In December 2007, the Securities and Exchange Commission (the "SEC") released its final rules relating to the reporting requirements for "smaller reporting companies."^[1] These new rules include, among other things, several changes to:

- the required financial statements for "smaller reporting companies," as defined in SEC Rule 405;
- the required age of financial statements ("going stale") in registration statements for these companies; and
- the required financial statements for businesses acquired or to be acquired.

Accordingly, for the convenience of our clients, we set forth in this client alert summary tables and explanations as to these requirements, as they apply to registration statements filed by U.S. issuers (both large and small) under the Securities Act of 1933 (the "Securities Act"). This information gives effect to the new rules, which became effective on February 4, 2008.

The rules relating to foreign private issuers were not revised in connection with the recent amendments, although the new rules give all foreign private issuers the option to report as smaller reporting companies.^[2] For the sake of completeness, where appropriate, this client alert will indicate the applicable rules relating to foreign private issuers that do not make this election.^[3]

Of course, we remind readers that this client alert is only a summary, and issuers and their underwriters should discuss the specific financial statement requirements of any registration statement or report filed under the Securities Exchange Act of 1934 (the "Exchange Act") with the applicable auditing firm at the earliest possible stage of the offering or filing process.^[4]

Highlights of the New Rules

Under the amended rules:

- smaller reporting companies will only be required to furnish two years of audited income statements and statements of cash flows;
- smaller reporting companies will not be required to file "selected financial information," "supplementary financial information" or a "ratio of earnings to fixed charges";
- at the time of the initial filing of a registration statement, a smaller reporting company will only be required to file financial statements that are as recent as the most recent annual or quarterly report that it would otherwise be required to file with the SEC as of the filing date; and
- smaller reporting companies that make significant acquisitions will not be required to file more than two years of audited financial statements of the target.

In addition, the SEC revised Regulation S-X to provide that, regardless of an acquiror's size, only a

maximum of two years of audited financial statements of the target need to be filed if the net revenues of the target in the most recent fiscal year were less than \$50 million.

Part I: Required Financial Statements

The following table sets forth the basic issuer financial information that must be contained in a registration statement filed under the Securities Act. In the case of a company that is eligible to file a registration statement on Form S-3,^[5] the financial statement requirements are typically satisfied through the incorporation by reference of the company's annual and quarterly reports filed under the Exchange Act. The different rules that apply to smaller reporting companies are set forth in italicized text.

Required Annual Financial Statements	Required Interim Financial Statements	Other Required Financial Information
Audited balance sheets as of the end of each of the two most recent fiscal years. ^[6] (Rule 3-01(a); Rule 8-02) (See discussion below relating to "going stale.")	Unaudited balance sheet as of the end of the most recently ended fiscal quarter. ^[7] (Rule 3-01(b) and (e); Rule 8-03) (See discussion below relating to "going stale.")	Selected income statement and balance sheet data for each of the last five fiscal years and any subsequent interim period. ^[8] (Item 301(a) of Regulation S-K). <i>This information is not required for smaller reporting companies, although many will provide this information in their registration statements for marketing reasons and the convenience of the reader.</i>
Audited income statements, cash flow statements and statements of stockholders' equity for each of the three most recent fiscal years. (Rule 3-02(a); Rule 3-04) <i>Smaller reporting companies only need to provide this information for the two most recent fiscal years. (Rule 8-02)</i>	Unaudited income statements, cash flow statements, and statements of stockholders' equity for: <ul style="list-style-type: none"> the interim period ending as of the balance sheet date provided according to the row above this row; and the corresponding interim period of the prior fiscal year. (Rule 3-02(b); Rule 3-04; Rule 8-03)	Supplementary income statement data as to specified income statement items for each full quarter within the two most recent fiscal years and any subsequent interim period. This information is often provided in the footnotes to the company's financial statements. (Item 302(a) of Regulation S-K) <i>This information is not required for smaller reporting companies.</i>
		In the case of an offering of debt securities or preferred stock, the ratio of earnings to fixed charges (or, for preferred stock, the ratio of combined fixed charges and preference dividends to earnings) for the last five fiscal years and for any subsequent interim periods presented. (Item 503(d) of Regulation S-K) <i>This information is not required for smaller reporting companies, although many will provide this information in their registration statements for marketing reasons and for the benefit of the reader.</i>

Part II: Age of Financial Statements: "Going Stale"

An organizational meeting for a public offering is rarely complete without a discussion of when the issuer's financial statements "go stale."^[9] As set forth below, a registration statement cannot be declared effective without financial statements that conform to the SEC's requirements as to age.

Please note that for purposes of the dates described in this section, if the last day that any financial statements may be used under the "going stale" rules falls on a weekend or a holiday, SEC Rule 417 under the Securities Act permits the filing to be made on the next business day. This rule often has the effect of postponing the "staleness date" one or two calendar days.

Audited Financial Statements

Initial Public Offerings by Companies that Are Not Smaller Reporting Companies	Public Offerings by Reporting Companies that Are Not Smaller Reporting Companies	Public Offerings by Smaller Reporting Companies
<p>The most recent audited financial statements may not be more than one year and 45 days old when the registration statement becomes effective. (Rule 3-12(d))</p> <p>Foreign private issuers must file the IPO registration statement with audited financial statements that are not older than 12 months at the time of filing. (Item 8.A.4 of Form 20-F) This requirement may be waived under some circumstances provided in the instructions to that Item of the Form.</p>	<p>"Loss Corporation"^[10]: the most recent audited financial statements may not be more than one year and 45 days old when the registration statement is filed or becomes effective. (Rule 3-01(a), (c)-(d); Rule 3-12(d))</p>	<p>"Loss Corporation": the most recent audited financial statements may not be more than one year and 45 days old when the registration statement becomes effective. (Rule 8-08(a))</p>
	<p>"Non-Loss Corporation" that is a "Large Accelerated Filer": the most recent audited financial statements may not be more than one year and 60 days old when the registration statement is filed and when it becomes effective. (Rule 3-01(c); Rule 3-12(g)(2)(i))</p>	<p>"Non-Loss Corporation" the most recent audited financial statements may not be more than one year and 90 days old when the registration statement becomes effective. (Rule 8-08(b))</p>
	<p>"Non-Loss Corporation" that is an "Accelerated Filer": the most recent audited financial statements may not be more than one year and 75 days old when the registration statement is filed and when it becomes effective. (Rule 3-01(c); Rule 3-12(g)(2)(ii))</p>	<p><i>For the initial filing, audited financial statements are only needed for the most recent fiscal year if the filing occurs more than 90 days after the end of the most recent fiscal year, at which time a smaller reporting company's annual report is due. (Rule 8-08)</i></p>
	<p>"Non-Loss Corporation" that is <i>not</i> a Large Accelerated Filer or an Accelerated Filer (and foreign private issuers): the most recent audited financial statements may not be more than one year and 90 days old when the registration statement is filed and when it becomes effective. (Rule 3-01(c); Rule 3-12(g)(2)(iii); Item 8.A.4 of Form 20-F^[11])</p>	

Please note that if, notwithstanding the table above, audited financials for the most recently ended fiscal year are in fact available before the "staleness date," they must be included in the registration statement. (Rule 3-01(b); Rule 3-12(b); Rule 8-08(a))

Unaudited Interim Financial Statements

As to unaudited financial statements, staleness is generally measured from the end of the issuer's most recent fiscal year.

Large Accelerated Filers and Accelerated Filers	All Other Issuers that Are Not Smaller Reporting Companies	Smaller Reporting Companies
<p>Unless more recent financial statements are required or available, the date of the most recent unaudited interim balance sheet may be the as of the end of the third fiscal quarter of the prior year at the time of filing. (Rule 3-01(b)-(c))</p> <p>If the registration statement is filed or scheduled to be declared effective 130 days or more after the end of the most recent fiscal year, the most recent unaudited interim balance sheet must be dated within 130 days prior to the filing. (Rule 3-01(e)-(f)); Rule 3-12(a))</p> <p>When the expected effective date of a filing falls within 60 days (75 days for accelerated filers) after the end of a fiscal year, the filing needs to include financial statements through the third quarter of the prior fiscal year, unless the audited financial statements for the prior fiscal year are available or unless the expected effective date falls after 45 days after the end of the fiscal year and the issuer is a Loss Corporation (in which case audited financial statements for the prior fiscal year are required). (Rule 3-12(b))</p>	<p>Unless more recent financial statements are required or available, the date of the most recent unaudited interim balance sheet may be the as of the end of the third fiscal quarter of the prior year at the time of filing. (Rule 3-01(b)-(c))</p> <p>If the registration statement is filed or scheduled to be declared effective 135 days or more after the end of the most recent fiscal year, the most recent unaudited interim balance sheet must be dated within 135 days prior to the filing. (Rule 3-01(e)); Rule 3-12(a))</p> <p>When the expected effective date of a filing falls within 90 days after the end of a fiscal year, the filing needs to include financial statements through the third quarter of the prior fiscal year, unless the audited financial statements for the prior fiscal year are available or unless the expected effective date falls after 45 days after the end of the fiscal year and the issuer is a Loss Corporation (in which case audited financial statements for the prior fiscal year are required). (Rule 3-12(b))</p>	<p>At the date of filing, interim financials must be no less current than the financial statements that would be required in Forms 10-K and Form 10-Q, if such report were required to be filed. (Rule 8-08)</p> <p>If the required financial statements as of the time of effectiveness are as of a date 135 days or more prior thereto, the financial statements must be updated to include an interim period ending within 135 days of the effective date. (Rule 8-08)</p>
<p>Example for a U.S. company with a 12/31 year end:</p> <ul style="list-style-type: none"> • If the registration statement is filed after May 8, 2008 (the 129th day of the year; 2008 is a leap year), then the registration statement should include a March 31, 2008 balance sheet. 	<p>Example for a U.S. company with a 12/31 year end:</p> <ul style="list-style-type: none"> • If the registration statement is filed after May 13, 2008 (the 134th day of the year; 2008 is a leap year), then the registration statement should include a March 31, 2008 balance sheet. 	

The interim financial statements in the registration statement must be at least as current as the financial statements included in the issuer's most recent Form 10-Q filing. (Rule 3-01(f); Rule 3-12(a); Rule 8-03)

Shelf Registration Statements

The "going stale" rules described in this client alert generally relate to a company's state of affairs as of the filing date and/or the effective date of the registration statement.

In the case of a shelf offering on Form S-3 or F-3, the “going stale” rules are applied as of those two measurement dates. In addition, after nine months have passed from the effective date of the registration statement, the audited balance sheet can be no more than 16 months old. (See Rule 427 under the Securities Act, which relates to Section 10(a)(3) of the Securities Act.)

Part III: Financial Statements Relating to Acquisitions

Both completed and proposed acquisition transactions can have a material impact upon how investors view an acquiror’s prior financial results and its prospects. Accordingly, the SEC’s rules require an acquiror to include in its registration statements the financial statements of a significant acquired “business” that has closed. For this purpose, the term “business” includes not only an entire company or entity, but may also include the acquisition of a line of business in the form of an asset purchase. Financial statements of the target may also be required when the acquisition becomes “probable.”^[12]

In order for an investor to better understand the impact of an acquisition, Article 11 of Regulation S-X requires pro forma financial information^[13] for the most recent fiscal year and for the most recent interim period when a material acquisition has occurred, or is “probable.” The pro forma information is designed to show the combined results of the acquiror and the target, as if the two entities had actually been combined during the relevant fiscal periods.

As will be seen below, the extent of the financial statements to be required depends upon the “significance” of the acquisition. Significance of an acquisition is generally evaluated under Rule 1-02(w) (the “significant subsidiary” test)^[14] based upon three tests, as applied (in most cases) to acquiror’s most recent audited financial statements:

- the amount of the acquiror’s investment in the acquired business compared to the acquiror’s total assets;
- the total assets of the acquired business compared to the acquiror’s total assets; or
- the pre-tax income (or loss) of the acquired business compared to the acquiror’s pre-tax income (or loss).

In each case, this comparison is expressed as a percentage. The acquisition is deemed to be at the highest significance level generated by the above three tests. For example, if an acquiror with \$50 million in assets spends \$26 million to buy the target, the acquisition will be above the 50% significance level, notwithstanding the results of the analysis under the other two tests.

The following table summarizes the required financial statements that must be set forth under these rules. The different rules that apply to smaller reporting companies are set forth in italicized text.

Type of Acquisition	Required Financial Statements
Acquisition at or below the 20% significance level.	<ul style="list-style-type: none"> ● No financial statements required as to the target. (Rule 3-05(b)(2)(i); Rule 8-04(c)(1)) ● No pro forma financial statements required.
Acquisition exceeds the 20% significance level, but does not exceed the 40% significance level.	<ul style="list-style-type: none"> ● Audited target financials for the most recent fiscal year, and unaudited target financial statements for any interim periods. (Rule 3-05(b)(2)(ii); Rule 8-04(c)(1)) ● Pro forma financials for the most recent fiscal year and any interim period. (Rule 11-01; Rule 8-05)
Multiple acquisitions of unrelated businesses that are individually below the 20% significance level, but in excess of the 50% level when viewed in the aggregate.	<ul style="list-style-type: none"> ● Audited target financial statements for the most recent fiscal year and any interim periods are required for a “substantial majority” of the individually insignificant acquisitions. (Rule 3-05(b)(2)(i); Rule 8-04(c)(3))

	<ul style="list-style-type: none"> • Pro forma financial statements for the most recent fiscal year and any interim periods are required for a “substantial majority” of the individually insignificant acquisitions. (Rule 11-01; Rule 8-05)
Individual acquisition exceeds the 40% significance level, ^[15] but does not exceed the 50% significance level.	<ul style="list-style-type: none"> • Audited target financials for the two most recent fiscal years, and unaudited target financial statements for any interim periods. (Rule 3-05(b)(2)(iii); Rule 8-04(c)(1)) • Pro forma financials for the most recent fiscal year and any interim period. (Rule 11-01; Rule 8-05)
Individual acquisition above the 50% significance level.	<ul style="list-style-type: none"> • Audited target financials for the three most recent fiscal years (including the two most recent balance sheets), and unaudited target financial statements for any interim periods. The financial statements for the earliest of the three years may be omitted if net revenues of the acquired business in the most recent fiscal year are less than \$50 million. (Rule 3-05(b)(2)(iv)) <i>Financial statements for the oldest of these three years are not required if the acquiror is a smaller reporting company.</i> (Rule 8-04(c)(1))^[16] • Pro forma financials for the most recent fiscal year and any interim periods. (Rule 11-01; Rule 8-05)

Please note that under Rule 3-06, financial statements covering a period of nine to 12 months may be used to satisfy a requirement for filing financial statements for a period of one year of an acquired company’s financials.

In the case of an acquisition structured as a stock-for-stock merger, in which the acquiror files a registration statement on Form S-4 or Form F-4 to register the securities that it will issue in the acquisition, these forms describe some of the financial statements of the target that need to be filed, depending in part on whether (a) the target is a U.S. or foreign issuer, (b) whether it is registered under the Exchange Act and (c) whether it is Form S-3 (or F-3) eligible.

In the case of an acquiror that is a smaller reporting company, the balance sheet of the acquired business is not required when the smaller reporting company’s most recent audited balance sheet is stated as of a date after the closing of the acquisition. (Rule 8-04(c)(2))

For acquisitions below the 50% significance level, no audited financial statements are required for probable acquisitions or for completed acquisitions that closed up to 74 days before the date of the offering, and such financial statements have not yet been otherwise filed. (Rule 3-05(b)(4)(i); Rule 8-04(c)(4)) Of course, for a material acquisition, there may be good reason for a company or its underwriters to consider the adequacy of the financial disclosure in the prospectus without this information.

Footnotes:

[1] The adopting release may be found at: <http://www.sec.gov/rules/final/2007/33-8876.pdf>. Our recent client alert, that includes a summary of the new rules may be found at: <http://www.mofo.com/news/updates/files/13119.html>.

[2] To do so, foreign issuers must prepare their financial statements in accordance with U.S. GAAP.

[3] Except as noted, all rule references are to SEC Regulation S-X, which governs the form and content of financial statements. All these rule references that begin with the number “8-,” such as “8-01,” are part of new Article 8 of Regulation S-X, which relates to smaller reporting companies.

[4] Please also note that Rule 3-13 enables the SEC (a) to consent to the omission of one or more financial statements or (b) require additional financial statements, all depending on the relevant circumstances.

[5] See <http://www.sec.gov/about/forms/forms-3.pdf>, particularly General Instruction I.A and Items 11 and 12.

[6] In the case of foreign private issuers, if the company's home jurisdiction does not require a balance sheet for the earliest year of the three most recent fiscal years (or if the financial statements are prepared in accordance with U.S. GAAP), that balance sheet may be omitted. (Instructions to Item 8.A.2 of Form 20-F)

[7] Note that comparative interim balance sheet information is not required. For example, if an interim balance sheet is shown for September 30th of a fiscal year, the interim balance sheet as of the preceding September 30th need not be included. (Compare to the box immediately below this one). Foreign private issuers, which are not required to file quarterly financial statements, must provide interim consolidated financial statements covering at least the first six months of the fiscal year if the registration statement becomes effective more than nine months after the end of the last audited fiscal year. (Item 8.A.5 of Form 20-F)

[8] Although not explicitly required by the SEC's rules, it has been fairly standard for some or all of this information to appear in the summary section of a prospectus, under a caption such as "Summary Financial Information." This table in the summary section may also include key operating statistics that are viewed as material to investors.

[9] The applicable provisions of Regulation S-X do not use the word "stale." Rather, they use more technical terms, and are organized in a manner that some readers find difficult to follow. We hope that this section will help facilitate the reader's understanding.

[10] This term (which is also not part of the SEC's rules) refers to a company that does not expect to report positive income after taxes but before extraordinary items and the cumulative effect of a change in accounting principle for the most recently completed fiscal year or has not done so in at least one of the prior two fiscal years. (Rule 3-01(c)) In the case of smaller reporting companies, "income from continuing operations before taxes" is considered instead of income after taxes but before extraordinary items and the cumulative effect of a change in accounting principle. (Rule 8-08 (b))

[11] Form 20-F refers to a period of 15 months, as opposed to one year and 90 days. This period can be extended to 18 months under the circumstances described in the instructions to Item 8 of Form 20-F.

[12] In this context, the term "probable" does not necessarily refer to the likelihood of completion of the acquisition. For example, the execution of a letter of intent between two parties is generally sufficient to render an acquisition "probable," even if there are substantial hurdles or obstacles to closing.

[13] For purposes of this client alert, the term "pro forma" refers to the acquisition-related financial statements governed by Regulation S-X, as opposed to the non-GAAP financial information governed by Regulation G.

[14] For acquirors that are smaller reporting companies, these requirements are set forth in Rule 8-04(b), including certain leniencies relating to the computation of income for the most recent fiscal year.

[15] In the case of an acquiror that is a smaller reporting company, this row is applicable for any acquisition that exceeds the 40% significance level.

[16] See preceding note.