

[Home](#) | [Print](#)**01/11/08*****Adoption of "Smaller Reporting Companies" Category and Integration of Regulation S-B Requirements into Regulations S-K and S-X***

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Currently, companies with annual revenues and a public float (the aggregate worldwide market value of voting and non-voting common equity held by non-affiliates) of less than \$25 million are defined as "small business issuers" under relevant rules of the Securities and Exchange Commission ("SEC"). Companies with a public float of less than \$75 million are considered "non-accelerated filers." Generally, small business issuers file their periodic reports and registration statements on alternative "SB" forms and have scaled disclosure requirements that in some instances are less onerous than the requirements that apply to other filers. For example, small business issuers are not required to include a "Compensation Discussion and Analysis" in their annual reports on Form 10-KSB or annual proxy statements. Non-accelerated filers, on the other hand, have additional time in which to file their annual and quarterly reports, are not required to disclose unresolved SEC Staff comments in their annual reports, and have been subject to a longer phrase-in schedule for the requirements with respect to management's report on internal control over financial reporting and the auditors' review and attestation thereof pursuant to Section 404(b) of the Sarbanes-Oxley Act of 2002.

As we reported in our Client Alert dated December 3, 2007, the SEC has adopted amendments to its rules and regulations that generally combined the existing "small business issuer" and "non-accelerated filer" categories into a new category of "smaller reporting companies." Smaller reporting companies will include issuers with a public equity float of less than \$75 million or, for companies without a calculable public float, annual revenues of less than \$50 million. While the non-accelerated filer definition will remain, unlike the situation that exists today, most companies that qualify as smaller reporting companies will qualify as non-accelerated filers.

The amendments also move the non-financial scaled disclosure requirements of Regulation S-B into Regulation S-K and the scaled financial statement requirements of Item 310 of Regulation S-B into Regulation S-X, add a new checkbox to the cover page of registration statements and periodic reports that companies that qualify as smaller reporting companies must check to indicate such status (even if they do not take advantage of the scaled disclosure requirements), eliminate the SEC's "SB" forms and eliminate references to the "small business issuer" category and "SB" forms from SEC rules and forms. The amendments, which are generally effective on February 4, 2008, are discussed in additional detail below.

## **I. "Smaller Reporting Companies"**

### **A. Eligibility and Exclusions**

As indicated above, new Item 10(f) of Regulation S-K defines a "smaller reporting company" as a company that has less than \$75 million in public equity float. This is the same requirement to qualify as a "non-accelerated filer" pursuant to Rule 12b-2 under the Securities Exchange Act of 1934. Companies without a calculable public float (either because they have no common equity outstanding or there is no market price for their common equity) or whose public float is zero will qualify as smaller reporting companies if their annual revenues are less than \$50 million.

Once a company's public float reaches \$75 million and it fails to qualify as a smaller reporting company, it will not again so qualify until its public float falls below \$50 million on the relevant determination date, as discussed below. A company that bases this determination on revenues because it does not have a calculable public float and no longer qualifies as a smaller reporting company because its annual revenues are \$50 million or more will remain so unqualified until its annual revenues fall below \$40 million.

Investment companies, asset-backed issuers and majority-owned subsidiaries of companies that are not smaller reporting companies may not qualify as a smaller reporting company.

### **B. Determination of Smaller Reporting Company Status**

## 1. Reporting Companies

As with the determination of non-accelerated filer status, reporting companies will determine whether they qualify for smaller reporting company status based on their public float as of the last business day of the second quarter of their previous fiscal year. This is determined by multiplying the number of shares of common equity held by non-affiliates of the company on such date by the price at which the common equity was last sold, or the average bid and asked prices of the common equity, in the principal market for the common equity on such date. Companies with zero or a non-calculable public float will determine their status based on annual revenues for their previous fiscal year. In each case, this determination will be made annually.

A smaller reporting company that determines that it instead qualifies as a large reporting company based on its public float on the last day of its second fiscal quarter will be required to comply with the larger company disclosure standards beginning with its first quarterly report for the following year. A company that newly qualifies for smaller reporting company status based on its public float at the end of the second quarter of its fiscal year, however, may elect to comply with the scaled disclosure requirements beginning with the report related to that quarter, and need not wait until its first quarterly report for the following year in order to comply with the scaled disclosure requirements available to smaller reporting companies.

Therefore, for example, a calendar year-end reporting company whose public float falls below \$75 million for the first time as of June 30, 2008 would otherwise qualify as a smaller reporting company for the year ended December 31, 2009. Under the amendments, however, such a company need not wait until its Form 10-Q for the quarter ended March 31, 2009 to check the

"smaller reporting company" box on the cover page of its reports and comply at its option with the scaled disclosure requirements for smaller reporting companies but instead may do so beginning with its next periodic report, which will be the Quarterly Report on Form 10-Q for the quarter ended June 30, 2008 due in August 2008. Such a company that, for whatever reason, does not choose to comply with the smaller reporting company scaled disclosure requirements must nevertheless check the box indicating that it is a smaller reporting company beginning with its quarterly report for the quarter ending March 31, 2009 and comply with the non-voluntary scaled disclosure requirements of Item 404 of Regulation S-K beginning with such periodic report. Similarly, a smaller reporting company with a calendar year-end that calculates its public float on June 30, 2008 to be \$75 million or more would no longer qualify as a smaller reporting company as of January 1, 2009 and would report using the non-scaled disclosure requirements of Regulation S-K and check the report cover page box indicating its accelerated filer (or, if applicable (though improbable), large accelerated filer) status beginning with its Form 10-Q for the quarter ended March 31, 2009 due in May 2009. Such a newly large reporting company may, however, use the scaled disclosure reporting requirements through its annual report on Form 10-K for the year ended December 31, 2008 (filed in March 2009) and the proxy statement disclosing information related to fiscal 2008.

As discussed further in Section IV below, companies that newly qualify as smaller reporting companies as of the effective date of the amendments based on their public float at the end of the second quarter of their previous fiscal year or their annual revenues in their previous fiscal year may take advantage of the scaled disclosure requirements in any reports filed after the effective date of the amendments, including annual reports for fiscal 2007 (filed in March

2008 for calendar year-end companies) and proxy statements relating to their annual meeting to be held in 2008. Companies that qualify as small business issuers currently and as smaller reporting companies under the new rules may either continue to file their periodic reports on the SEC's "SB" forms until their annual report for fiscal 2008 or may use the non-SB forms and scaled Regulation S-K disclosure format beginning with their first report due after the effective date of the amendments.

## **2. Non-Reporting Companies Filing an Initial Registration Statement**

Currently, non-reporting companies filing an initial registration statement under the Securities Act of 1933 or the Securities Exchange Act of 1934 determine whether they qualify as a small business issuer by calculating their public float using the last sold price or the average bid and asked price on a date within 60 days of filing and the number of shares of common stock held by non-affiliates on the date of determination. Under the amendments, a company filing a registration statement will calculate its public float as of a date within 30 days of filing its registration statement instead of 60 days, but (in the case of a Securities Act registration statement) using (i) the estimated offering price per share at the time of the initial filing of the registration statement multiplied by (ii) (A) the number of shares of common equity held by non-affiliates before the offering plus (B) the number of shares of common equity to be sold pursuant to the registration statement. Therefore, unlike the current method, companies filing a registration statement will base their calculation on the number of shares offered to the public via the registration statement, plus the number of shares currently held by non-affiliates, but using the estimated offering price instead of the last sales or average bid and asked price on the date of determination. Therefore, under the amendments the

calculated public float will be higher for companies making this initial determination as it will include not only additional shares (the number of shares being registered) but a price that is almost always going to be higher than the current market price.

The adopting release provides the following example: A company with 25,000,000 shares outstanding held by non-affiliates that registers 7,000,000 common shares in its initial public offering will calculate its public float for purposes of determining whether it is a smaller reporting company by multiplying 32,000,000 shares (7,000,000 + 25,000,000) by the estimated offering price per share in its IPO at the initial time of filing its registration statement.

A company will not recalculate its public float during the registration process, even if the estimated initial offering price or number of shares to be offered changes during that time. Such a company may, but is not required to, recalculate its public float at the completion of its IPO so that if the public float turns out to be less than \$75 million it can take advantage of the scaled disclosure requirements in its next periodic report. Otherwise, the determination made at initial filing will determine the company's reporting status until its next annual determination date, as discussed above. The adopting release states, therefore, that if a smaller reporting company's public float rises to \$75 million or more prior to effectiveness of its registration statement, such a company would not be required to transition to the larger company disclosure requirements prior to its annual determination "if the [company] made a bona fide eligibility determination at the time it filed the initial public offering registration statement."

A company making its initial filing on an Exchange Act registration statement would calculate its public float based on the number of shares of common equity

held by non-affiliates multiplied by the market price of the shares on a date within 30 days of filing the registration statement.

In both cases, if a company filing an initial registration statement had no calculable public float, then the determination of whether such a company would qualify as a smaller reporting company would be based on its revenues during its last fiscal year before filing the registration statement, as discussed further above. For companies that are filing an initial registration statement under the Securities Act, this should generally only be an issue when registering preferred or debt securities, since such a company's public float would otherwise be based on the number of shares of common equity it is registering and the initial estimated offering price of such shares.

### **3. Foreign Private Issuers**

Currently, only U.S. companies and Canadian companies that provide a reconciliation of their financial statements to U.S. Generally Accepted Financial Principals ("GAAP") may qualify as small business issuers. Under the amendments, all foreign private issuers may qualify as smaller reporting companies if they are eligible to file on a form that permits the scaled disclosure for reporting companies (i.e. an annual report on Form 10-K as opposed to Form 20-F). In order to do so, such companies must file their financial statements in accordance with U.S. GAAP. Therefore, Canadian companies may no longer file in Canadian GAAP with reconciliation to U.S. GAAP and still qualify for the scaled disclosure system.

## **II. Integration of Regulation S-B into Regulation S-K and Regulation S-X**

The amendments move 12 non-financial disclosure items of Regulation S-B into new paragraphs of Regulation S-K that contain the scaled disclosure requirements for smaller reporting companies,

including in several cases a statement that smaller reporting companies are not required to comply with the particular item. Twenty-four non-financial disclosure items of Regulation S-B that are substantially identical to their Regulation S-K counterparts are not being moved into Regulation S-K; for these items, smaller reporting companies will follow the same disclosure requirements that are applicable to other reporting companies.

In addition, the amendments amend Forms 10, 10-K and 10-Q to state that smaller reporting companies are not required to include risk factor disclosure. Currently, Forms 10-SB, 10-KSB and 10-QSB do not require small business issuers to provide risk factor disclosure, although many do. The amendments also revise Item 102 of Regulation S-K, Properties, to specifically reference Industry Guides 2 (Disclosure of oil and gas operations), 4 (Prospectus relating to interests in oil and gas programs), 5 (Preparation of registration statements relating to interests in real estate limited partnerships) and 7 (Description of property by issuers engaged in significant mining operations) and the instruction to Item 303 of Regulation S-K (Management's discussion and analysis) to specifically reference Industry Guides 3 (Statistical disclosure by bank holding companies) and 6 (Disclosure concerning unpaid claims and claim adjustment expenses of property-casualty insurance underwriters).

The items of Regulation S-K being amended to incorporate the scaled disclosure requirements include:

- Item 101, Description of business, to incorporate the alternative disclosure requirements currently applicable to small business issuers (three-year business development discussion as opposed to five years, less detailed business description, and no financial information about industry segments).
- Item 201, Market price of and dividends on common equity and related stockholder matters, to indicate that smaller reporting companies need not provide the stock performance graph.
- Item 303, Management's discussion and analysis, to indicate that smaller reporting companies' annual results of operations analysis need compare only two years instead



- of three years and that they need not provide the table of contractual obligations.
- Item 402, executive compensation, to include separate paragraphs incorporating the disclosure required of smaller reporting companies, which is identical to that currently required of small business issuers.
  - Item 404, Transactions with related persons, promoters and certain control persons to:
    - Provide an alternate disclosure threshold for smaller reporting companies of the lesser of \$120,000 or 1% of the average of the company's assets over the past two years, and that smaller reporting companies must provide this information for an additional prior year (i.e. the fiscal year preceding the company's most recent fiscal year);
    - Provide that smaller reporting companies need not disclose their policies and procedures for the review and approval of related person transactions;
    - Require smaller reporting companies to provide information about underwriting discounts and commissions where a related person is the principal underwriter or a controlling person thereof; and
    - Provide that smaller reporting companies must provide a list of all of its parents, showing the basis of control and percentage of voting securities owned by each parent.
  - Item 407, Corporate governance, to provide that the audit committee report is not required until a smaller reporting company's second annual report on Form 10-K and that smaller reporting companies need not provide disclosure regarding compensation committee interlocks or a compensation committee report.
  - Item 503, Prospectus summary, risk factors and ratio of earnings to fixed charges, to provide that smaller reporting companies

need not provide the ratio of earnings to fixed charges.

- Item 504, Use of proceeds, to clarify that new Article 8 of Regulation S-X governs whether financial statements of businesses proposed to be acquired must be included in a smaller reporting company's filing.
- Item 601, Exhibits, to clarify that Exhibit 12, the statement re computation of ratios, is not applicable to smaller reporting companies.
- Items (i) 301, Selected financial data, (ii) 302, Supplementary financial data, and (iii) 305, Quantitative and qualitative disclosures about market risk, to indicate that smaller reporting companies are not required to provide this information.

As a result, the substantive disclosure requirements applicable to smaller reporting companies will differ from those currently applicable to small business issuers in only three ways:

- The scaled disclosure requirements of Item 404 of Regulation S-K with respect to related person transactions requires disclosure if the amount involved exceeds the lesser of \$120,000 or 1% of the average of the smaller reporting company's assets at year-end over the last two years; Regulation S-B uses the average assets over the past three years for this determination threshold.
- The scaled disclosure requirements of Item 404 of Regulation S-K will require an additional year of disclosure (i.e. since the beginning of the company's last fiscal year *and the year preceding* the last fiscal year).
- Item 401(e) of Regulation S-K requires disclosure of any petition under the Federal bankruptcy laws or any state insolvency law filed by or against, or if a receiver, fiscal agent or similar officer was appointed by a court for the business or property of an executive officer or director, or any partnership in which he or she was a general partner at or within two years before the time of such filing, or any corporation or business association of which he or she was an executive officer at or within two years before the time of such filing. Item 401(d) of

Regulation S-B, on the other hand, only requires disclosure of bankruptcy petitions filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time, and not with respect to individual bankruptcy petitions or bankruptcy petitions under state insolvency laws. Under the amendments, smaller reporting companies will have to comply with the slightly more expansive requirement of Item 401(e) of Regulation S-K.

The amendments also move the scaled financial reporting requirements currently included in Item 310 of Regulation S-B into a new Article 8 of Regulation S-X, which contains the financial reporting requirements for other reporting companies. The scaled reporting requirements are substantially similar to the current Regulation S-B financial reporting requirements, except that Article 8 of Regulation S-X requires two years of audited balance sheet data instead of one year.

Under the amendments, smaller reporting companies, and only smaller reporting companies, may choose to comply with the scaled disclosure requirements (both the financial and non-financial requirements) on an item-by-item basis, except where the requirement for smaller reporting companies is more strict (as discussed further below), if the disclosure is provided consistently and is consistent with legal requirements of the federal securities laws, including Rule 408 under the Securities Act of 1933 and Rule 12b-20 under the Securities Exchange Act of 1934 which will require a smaller reporting company to provide any information beyond that required by the scaled disclosure requirements necessary to make the presentation not materially misleading.

The amendments permit smaller reporting companies to elect to comply with the scaled financial statement disclosure requirements on a quarterly basis, instead of having to make this election once for an entire fiscal year as proposed. In other words, under the amendments, a smaller reporting company may follow the financial reporting standards for larger companies in one quarter but the standards for smaller reporting companies the next. However, with respect to both financial and non-financial scaled disclosure, the SEC stresses in the adopting release the "importance of providing disclosure that permits investors to make period-to-period comparisons,

whether quarterly or annually."

Further, the relevant Regulation S-K items make clear that where the reporting requirement applicable to smaller reporting companies is more rigorous than that required of larger companies, smaller reporting companies will not have the option to comply with the requirements applicable to larger companies and must comply instead with the scaled disclosure requirements. Currently, the only item of Regulation S-K disclosure that will be more rigorous for smaller reporting companies is Item 404 with respect to related person transactions, as discussed above.

The adopting release also notes that the SEC expects that its staff will evaluate smaller reporting companies' disclosure compliance only with respect to the Regulation S-K requirements that are applicable to them, even if a company chooses to comply with the larger company requirements. However, the item-by-item approach will not affect a smaller reporting company's general requirements and liabilities with respect to disclosure, including the anti-fraud provisions of the Securities Act and Exchange Act. In other words, companies are liable for this disclosure if they make it, even if not required by the scaled disclosure requirements and/or not reviewed by the SEC Staff.

### **III. Other**

In addition, the SEC amended Rule 3-05(b)(2)(iv) of Regulation S-X, which governs inclusions of the financial statements of companies acquired or to be acquired in registration statements and Form 8-K. Currently, if the target companies' revenues for its last fiscal year are less than \$25 million, only two years, instead of three years, of financial statements are required. The amendments increase this threshold to \$50 million.

The amendments also eliminate references to "small business issuers," Regulation S-B and the SB forms in applicable SEC rules and forms, eliminate the transitional small business issuer format, and amend relevant SEC rules to reflect the SEC's current address.

### **IV. Effective Dates**

To allow the transition period for current small business issuers discussed below, Form 10-QSB will not be removed until October 31, 2008 and Form

10-KSB and Regulation S-B will not be removed until March 15, 2009. Otherwise, the amendments, including removal of Registration Statements on Forms SB-1, SB-2 and 10-SB, are effective on February 4, 2008.

Companies that currently qualify as small business issuers will have the option to file their next annual report for the fiscal year ending on or after December 15, 2007, on either Form 10-KSB using the Regulation S-B disclosure requirements or, assuming they qualify as smaller reporting companies, on Form 10-K using the scaled disclosure requirements in amended Regulation S-K. Such companies that file their next annual report on Form 10-KSB may then continue to file their periodic reports on the SEC's "SB" forms until their next annual report, which must then be filed on a form without the "SB" designation using the disclosure requirements of Regulation S-K (complying with the scaled requirements of Regulation S-K as such a company chooses). Such companies must begin to file their quarterly reports on Form 10-Q and subsequent annual reports on Form 10-K after filing their annual report on Form 10-K for years ending on or after December 15, 2008.

Companies that are not small business issuers but that newly qualify as smaller reporting companies after the effective date of the amendments based on their public float as of the end of their second quarter of fiscal 2007 or annual revenues during 2007 should continue to file their annual reports and quarterly reports on Forms 10-K and 10-Q, but may at their option comply with the scaled disclosure requirements of amended Regulation S-K beginning with their next periodic report filed after the effective date of the amendments. In other words, a company that currently does not qualify as a small business issuer, but whose public float was below \$75 million at the end of the second quarter of its last fiscal year (June 30, 2007 for calendar year-end companies) or, for companies without a public float, if revenues for its last fiscal year were below \$50 million, may file its upcoming annual report on Form 10-K for fiscal 2007 and related proxy statement for its 2008 annual meeting using the scaled disclosure requirements of Regulation S-K available to smaller reporting companies as of the effective date of the amendments. Such companies, then, for example, will not be required to provide a Compensation Discussion and Analysis, the expanded compensation disclosure required of larger public companies or a stock performance

graph in their upcoming annual reports and/or proxy statements.

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This memorandum contains only a general summary of the amendments discussed herein and should not be construed as providing legal advice. The adopting release with respect to the amendments, including the text of the amendments, is available at <http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/pdf/E7-24965.pdf>.

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## NOTES

The only exception would be a company with annual revenues of \$50 million or more without a calculable public float or a public float of zero.

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