

SEC ADOPTS SCALED DISCLOSURE REQUIREMENTS FOR SMALLER REPORTING COMPANIES

Introduction and Overview

With the adoption of SEC Release No. 33-8876¹, the Securities and Exchange Commission, or SEC, recently amended its disclosure and reporting requirements for smaller public companies. Effective February 4, 2008, the new rules significantly expand the number of companies that are able to take advantage of reduced disclosure requirements and:

- replace the “small business issuer” category of companies with the new “smaller reporting companies” category;
- expand the companies that can take advantage of the scaled disclosure requirements to companies with public common equity float of less than \$75 million, or, if a company is unable to calculate public equity float, less than \$50 million in revenue in the last fiscal year;²
- permit all foreign companies to qualify as smaller reporting companies provided they otherwise meet the requirements of the new rules;
- phase out the Regulation S-B scaled disclosure requirements and the current S-B forms and replace them with reduced and streamlined reporting requirements for small business issuers relocated to Regulation S-K;

¹ Release 34-56994, *Smaller Reporting Company Regulatory Relief and Simplification*, 73 Fed. Reg. 3 (Jan. 4, 2008).

² Previously, small business issuers were defined as companies with both less than \$25 million in public common equity float and less than \$25 million in annual revenues.

- move financial statement requirements from Item 310 of Regulation S-B to a new Article 8 of Regulation S-X; and
- permit smaller reporting companies to choose scaled disclosure requirements on an “a la carte” basis.

Smaller Reporting Companies

The new rules establish a category of reporting companies called “smaller reporting companies,” which effectively combines the categories of non-accelerated filers and smaller business issuers. A company qualifies as a smaller reporting company if it has less than \$75 million in public equity float (i.e., the market value of common equity held by the public) or, if it is unable to calculate its public equity float,³ it has revenues of less than \$50 million in the last fiscal year. Additionally, foreign companies can qualify as smaller reporting companies if they meet the foregoing criteria, file on domestic company forms and submit financial statements in accordance with U.S. GAAP.

A company’s public equity float will be calculated as of the last business day of its most recently completed second fiscal quarter. If a smaller reporting company determines that it is no longer eligible for smaller reporting company status, it will not be required to satisfy the larger company disclosure requirements until the first quarterly report of the fiscal year after the year in which it determines that it is no longer eligible for smaller reporting company status. Conversely, if a company that had been subject to the larger company reporting requirements determines that it has become eligible for smaller reporting company status, it will be able to use the scaled disclosure requirements for the quarter in which it determines such eligibility.

Once an issuer determines that it does not qualify for smaller reporting company status, it remains unqualified, and thus subject to larger company reporting requirements, until it determines that

its public equity float was less than \$50 million as of the last business day of its most recently completed second fiscal quarter. A company without calculable public equity float will qualify as a smaller reporting company until its revenues exceed \$50 million. Once an issuer fails to qualify under this revenue test, it will not become eligible for smaller reporting company status again until its annual revenues are less than \$40 million.

Phase-out and Relocation of Disclosure Requirements

The amendments move 12 non-financial Regulation S-B disclosure requirements to Regulation S-K and move the financial statement requirements of Item 310 of Regulation S-B to a new Article 8 of Regulation S-X.

Regulation S-B previously contained 12 non-financial scaled disclosure requirements.⁴ The amendment moves these disclosure requirements to new paragraphs in Regulation S-K that specify the disclosure requirements for smaller reporting companies where these differ from the standard Regulation S-K disclosures. By consolidating these disclosure requirements, the SEC hopes to eliminate redundancies and make the disclosure system easier to use. The amendments also eliminate the current forms used for smaller company reporting. Prior to the amendments, small business issuers used forms 10-SB, 10-KSB and 10-QSB. After the amendments, smaller reporting companies will file forms 10, 10-K and 10-Q. As is discussed in more detail below, smaller reporting companies will have the option to choose, on an “a la carte” basis, whether to comply with either the Regulation S-K

³ A company may be unable to calculate its public equity float if it has no common equity outstanding or there is no readily determinable market price for its outstanding common equity.

⁴ The 12 scaled item requirements are: (1) Description of Business (Item 101); (2) Market Price of and Dividends on Registrant's Common Equity and Related Stockholder Matters (Item 201); (3) Selected Financial Data (Item 301); (4) Supplementary Financial Information (Item 302); (5) Management's Discussion and Analysis of Financial Condition and Results of Operations (Item 303); (6) Quantitative and Qualitative Disclosures about Market Risk (Item 305); (7) Executive Compensation (Item 402); (8) Transactions with Related Persons, Promoters and Certain Control Persons (Item 404); (9) Corporate Governance (Item 407); (10) Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges (Item 503); (11) Use of Proceeds (Item 504); and (12) Exhibits (Item 601).

disclosure requirements for smaller reporting companies or the Regulation S-K reporting requirements for larger companies.

The amendments add a new Article 8 to Regulation S-X, which sets forth the financial statement reporting requirements for smaller public companies that, prior to the amendments, were provided in Item 310 of Regulation S-B. The financial statement reporting requirements now contained in Article 8 of Regulation S-X require smaller reporting companies to disclose two years of audited balance sheet data as opposed to one year, as was previously required by Item 310 of Regulation S-B.

Filing as Smaller Reporting Company

Once a company determines that it qualifies for smaller reporting company status, it will be required to check the new box for smaller reporting companies on a registration statement or periodic report (e.g., Form 10-K and 10-Q) whether or not it chooses to use the scaled disclosure standards.

Electing Scaled Disclosure Standards on an “A La Carte” Basis

Under the new rules, smaller reporting companies can choose to comply with either the scaled disclosure requirements available to smaller reporting companies or the larger company disclosure requirements in Regulation S-K on an item-by-item basis. Notwithstanding the flexibility permitted by the a la carte approach, smaller reporting companies must comply with the disclosure mandates of Securities Act Rule 408 and Exchange Act Rule 12b-20, which require registrants to disclose all material facts that are necessary to make the statements included in a registration statement or report not misleading. The requirements of these rules may require disclosures in excess of the line item requirements. In addition, in situations where there is an applicable scaled disclosure standard that is more rigorous than the larger reporting company equivalent, a smaller reporting company is required

to comply with the more rigorous scaled disclosure requirement. Currently, the only example where there may be a more rigorous standard for smaller reporting companies is under Item 404 of Regulation S-K.

Transitioning to the New Rules

The new rules outlined in this summary became effective on February 4, 2008. A company choosing to use these new rules may do so when filing its next periodic report following the effective date. Companies that qualified as small business issuers prior to the amendments have the option to file their next annual report for fiscal years ending on or after December 15, 2007 on either Form 10-KSB, using Regulation S-B disclosure requirements, or Form 10-K, using the new scaled disclosure requirements. A small business issuer may also continue to use the S-B forms when filing periodic reports until its next annual report is filed. After a company files its next annual report, subsequent periodic reports must be filed on non-S-B forms.