



# **Smaller and Not-So-Small Reporting Companies Changing Rules and Best Practices**

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## **Presenters**

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## What the Panel Will Cover

- Smaller reporting company rules in context
- Review of changes to Regs. S-K and S-X
- Overview of eligibility issues
- Best practices and risk areas
- General counsel's perspective
- Q&As
- Additional information

## Smaller Reporting Companies

- What is a smaller reporting company (SRC)?
  - Less than \$75 million in public float
    - Public float means market value of common equity held by non-affiliates
  - or
  - If no public float, less than \$50 million in revenue

## **Smaller Reporting Companies (cont.)**

- Part of broader reforms in reporting and compliance for small public companies
  - Stems from recommendations of the Advisory Committee on Smaller Public Companies
  - 404 Sarbanes-Oxley
  - S-3 expansion
  - Rule 144

## **Smaller Reporting Companies (cont.)**

- Key expansion compared to S-B issuer eligibility
- \$25 million in revenue and public float vs. \$75 million in public float or \$50 million in revenue

## Overview of S-K and S-X Changes

- Phase-out of Reg. S-B (transition period for certain S-B filers)
- 12 nonfinancial disclosure item requirements in S-B moved to S-K
- S-K includes new paragraphs and instructions delineating alternative, “scaled” disclosure
- S-B Item 310 requirements now S-X Article 8
- SRCs can comply with requirements applicable to SRCs or the S-K large-company requirements, “a la carte”

## **S-K Disclosures That May Be Omitted**

- Compensation Discussion and Analysis (Item 402)
- Compensation Committee Report (Item 407)
- Risk Factors (Item 503)
- Selected Financial Data and Supplementary Financial Data (Items 301 and 302)



## **S-K Disclosures That May Be Omitted** **(cont.)**

- Quantitative and Qualitative Disclosures about Market Risk (Item 305)
- Compensation Committee Interlock and Insider Participation (Item 407)
- Performance Graph (Item 201)

## **Under Less Stringent Requirements, SRCs May...**

- Provide less detail about the business (Item 101)
- Provide two years of financial statements, rather than three years (new S-X Article 8)
- Provide two years of MD&A analysis if presenting only two years of financial statements (Item 303)
- Omit tabular disclosure of contractual obligations in MD&A (Item 303)

## Less Stringent Requirements (cont.)

- Provide executive-comp disclosure (generally) for three officers rather than five (Item 402)
- Provide Summary Compensation Table covering two years instead of three (Item 402)
- Provide only three compensation tables (Summary Compensation, Outstanding Equity Awards, and Director Compensation) rather than seven (Item 402)
- Omit footnote disclosure of grant-date fair value of equity awards in Director table (Item 402)

## Acquisitions of SRCs

- If pro forma financials must be disclosed
  - Then two years of financial statements rather than three years if target's revenues are less than \$50 million...
  - ...compared to \$25 million before rule changes

## Eligibility Issues

- Exit and entry of SRC system
- Affiliate issues
- Enforcement risk

## Exit and Entry of SRC System

- Smaller reporting companies must check box on cover of periodic report
- Less than \$75 million in public float or, if no public float, less than \$50 million in revenues in last fiscal year

## **Exit and Entry of Smaller-Reporting-Company System**

- Calculate public float on last business day of second fiscal quarter
  - June 30, 2008 for calendar-year companies
- Follows accelerated-filer status determination with added benefit
  - Once eligible for SRC status, next Form 10-Q can use new rules

## IPOs

- Calculate public float within 30 days of filing registration statement
  - Estimated offering price per share  
multiplied by
  - Number of shares held by non-affiliates before the offering  
plus
  - Number of shares to be sold in offering



## **IPOs (cont.)**

- Registrants can recalculate public float when completing IPO for next periodic report
- If S-1 initially follows large-company S-K but after close of offering, SRC status is satisfied:
  - First periodic report after IPO could use smaller reporting company
  - Opposite is not true (if IPO is filed using SRC system, it can remain until next determination date and next year)

## Exiting the SRC System

- Next fiscal year after public float rises above \$75 million as of last day of second quarter
- Once issuer fails to qualify, remains unqualified until public float falls below \$50 million as of last business day of second fiscal quarter

## Exiting the SRC System (cont.)

- For issuers with no public float:
  - Revenues of less than \$50 million
  - Once issuer crosses \$50 million it will not requalify unless revenues go below \$40 million in last fiscal year

## Affiliate Issues

- Calculating public float
  - Paragraph (f), Item 10, Regulation S-K:  
“number of outstanding shares of voting and non-voting equity held by non-affiliates”
  - Standard affiliate definition applies  
(see Rule 12b-2)

## Affiliate Issues (cont.)

- Affiliate categories
  - Directors, executive officers, other insiders
  - May include ESOPs, ESOTs, and similar entities
  - 10% stockholders
  - Non-insider, longstanding shareholders

## Enforcement Risk

- Hawk Corporation
  - December 2006 8-K announces SEC investigation into issuer's determination classification of affiliate and accelerated-filer status to avoid 404 of Sarbanes-Oxley

# Best Practices and Risk Areas

## Scaled vs. Large-Company Disclosure

- For non-accelerated filers with public float approaching \$75 million, supplying information required for larger public companies now may be more practical
- Disclosure of risk factors not required but probably good disclosure
  - Don't forget S-3 incorporation by reference



## **Scaled vs. Large-Company Disclosure (cont.)**

- Marginal cost of additional, larger-company disclosure compared to benefit to investors
- Conference calls and investor presentations

## A la Carte Disclosure

- No cherry-picking
  - Cannot provide more disclosure only in periods when expanded disclosure is favorable

## **A la Carte Disclosure (cont.)**

- Guidelines for making scaled disclosure on item-by-item basis
  - The item-by-item scaled disclosures must be consistent on a period-to-period basis to permit comparison by investors whether quarterly or annually

## **A la Carte Disclosure (cont.)**

- Where SRC scaled-item requirement is more rigorous than large-company counterpart, SRCs must comply with more rigorous requirement
- SRCs can't use large-company standard if it obviates the need for any disclosure

## Segment Reporting

- Financial information about segments not required under Item 101
- But SFAS 131
  - Disclosures about segments of enterprise and related information
  - Segment disclosure often required in financial footnotes

## Ratio of Earnings to Fixed Charges

- Statement regarding computation of ratios
  - Public debt
  - Indenture covenants

## **Rule 12b-20 of Exchange Act**

- “In addition to the information expressly requested to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made not misleading”

## SEC Review

- SEC staff expected to evaluate compliance by SRCs in accordance with SRC requirements, even if issuer follows S-K requirements for larger companies



# The General Counsel's Perspective

# Questions and Answers

## Additional Information

- “Changeover to the SEC’s New Smaller Reporting Company System by Small Business Issuers and Non-Accelerated Filer Companies: A Small Entity Compliance Guide”  
[www.sec.gov/info/smallbus/secg/smrepcosysguid.pdf](http://www.sec.gov/info/smallbus/secg/smrepcosysguid.pdf)
- SEC Release No. 33-8876: “Smaller Reporting Company Regulatory Relief and Simplification”  
[www.sec.gov/rules/final.shtml](http://www.sec.gov/rules/final.shtml)

## **Additional Information (cont.)**

- “Smaller Reporting Company: Compliance and Disclosure Interpretations”  
[www.sec.gov/info/smallbus/src-cdinterps.htm](http://www.sec.gov/info/smallbus/src-cdinterps.htm)
- Presentation appendix: “Guide to SRC Alternative Disclosure Under Regulation S-K”