SEC Amends Requirements for Smaller Reporting Companies

On December 19, 2007, the Securities and Exchange Commission (SEC) issued final amendments to its disclosure requirements expanding the category and number of companies that may take advantage of scaled or reduced disclosure requirements and streamlining the disclosure process.

The adopted amendments to the SEC rules under the 1933 and 1934 Acts include:

- creating a new category of filer, the “smaller reporting company” to replace the “small business issuer” category
- expanding the availability of scaled disclosure requirements to filers with a public float of less than $75 million, or where no public float or market price for common equity exists, less than $50 million in annual revenues
- moving disclosure requirements in Regulation S-B to Regulation S-K and eliminating Regulation S-B and its various registration forms including Form SB-2
- allowing smaller reporting companies to choose scaled disclosure “a la carte”
- allowing foreign companies to file as smaller reporting companies.

The Smaller Reporting Company

To be eligible for the scaled smaller reporting company disclosure requirements, a company must:

1. not be an investment company or asset-backed issuer; and
2. have a non-affiliate public float of less than $75 million; or
3. have annual revenues of less than $50 million (if no public float).

The method of calculating the public float differs depending on whether the company seeking smaller reporting company status is a reporting or non-reporting company. Reporting companies will follow the same date guidelines set forth in Rule 12b-2 of the Exchange Act for accelerated filers (last day of second fiscal quarter), while non-reporting companies will calculate their public float based on their choice of a date within 30 days of the filing date of their initial registration statement.

Non-reporting companies that do not have a public float, or whose common equity is not priced by the market, may rely on a revenue test to qualify as smaller reporting companies. Such non-reporting companies must have annual revenues of less than $50 million during the last fiscal year before filing the registration statement to be eligible for smaller reporting company status.

The definition of smaller reporting company, however, contains no limitation on the citizenship of eligible companies, making this designation available to foreign companies.
This represents a departure from the definition of small business issuer which only applied to U.S. and Canadian companies.

**Eliminating the Small Business Issuer and Expanding the Availability of Scaled Disclosure Requirements**

U.S. or Canadian companies with a public float of less than $25 million were eligible to be small business issuers. Now, the smaller reporting company will subsume this type of filer, and expand the category to include U.S. and foreign companies with public floats of up to $75 million. The SEC estimates that nearly 1,600 additional companies will become eligible to file as smaller reporting companies.

The amendments expand the availability of scaled disclosure requirements to a larger group of companies than were embraced by the small business issuer definition. According to the SEC, this expansion is a reflection of changing times: the cost of compliance with respect to disclosure requirements represents a significant burden for a wide range of companies, some of which were historically considered “larger” reporting companies. The adoption of the new amendments reflects the SEC’s recognition that the definition of “smaller” companies has evolved and that disclosure requirements must change accordingly.

The chart on page 3 compares the most significant disclosure differences between the scaled smaller reporting company requirements and the larger reporting company requirements.

**Relocation of Disclosure and Financial Statement Requirements**

The adopted amendments move disclosure requirements in Regulation S-B to Regulation S-K, and the financial statements requirement in Item 310 of Regulation S-B to new Article 8 of Regulation S-X.

Regulation S-B sets forth 12 scaled disclosure requirements for small business issuers. These requirements, now applicable to smaller reporting companies rather than small business issuers, will be set out in separate paragraphs within Regulation S-K. The definition of a smaller reporting company will include an index of the location of each scaled requirement. This move makes all non-financial disclosure requirements for all reporting companies available in a single regulatory location, Regulation S-K. The new amendments eliminate all SB forms; instead, smaller reporting companies now will file Forms 10-K, 10-Q, and S-1, for example, using the scaled disclosure requirements.

Item 310 of Regulation S-B sets forth the requirements for preparation of financial statements for small business issuers that must be prepared in accordance with U.S. GAAP. With the elimination of the small business issuer, the financial statement requirement in Item 310 will apply to smaller reporting companies, including foreign companies, and will appear in Article 8 of Regulation S-X. The financial statement requirements for smaller reporting companies, however, now will require two years of comparative audited balance sheet data, rather than one year under Regulation S-B.

**Electing Scaled Disclosure “À La Carte”**

Smaller reporting companies will be able to choose on an item-by-item basis whether to disclose information according to the scaled requirements available to smaller reporting companies, or the requirements that larger reporting companies must satisfy. According to the release, the SEC staff will evaluate Regulation S-K compliance by smaller reporting companies solely with respect to the scaled disclosure requirements available to smaller reporters, despite the fact that smaller reporting companies have a choice regarding the level of disclosure they make under the regulation.

The only exception to this “à la carte” system is a case in which the disclosure requirement for smaller reporting companies is more rigorous than the same larger company item requirement. In such case, the smaller reporting company is required to comply with the more rigorous, smaller reporting company item requirement.

**Foreign Company Eligibility**

Unlike the small business issuer category, the smaller reporting company designation is available to foreign companies. Foreign companies whose public floats or annual revenues qualify them for smaller reporting company status must use Form S-3 instead of Form F-3 if they wish to file as smaller reporting companies. The difference in applicable form is significant because it requires the filing foreign company to prepare its financial statements in accordance with U.S. GAAP. Canadian companies will be particularly affected by this change, because they had previously been allowed to file as a small business issuer without being required to prepare financial statement according to U.S. GAAP.
Entering and Exiting Smaller Reporting Company Status

The rule amendments on entering and exiting smaller reporting company status in Item 10 of Regulation S-K are less restrictive than the Regulation S-B requirements, which had a significantly longer transition period and calculated eligibility based on two consecutive fiscal years. The new transition rules track the accelerated filer definition.

As adopted, the rules provide that a larger reporting company that determines it is a smaller reporting company as of the last business day of its most recently completed second fiscal quarter is permitted to file as a smaller reporting company in its quarterly report for such quarter. On the other hand, a smaller reporting company that is required to transition to the larger reporting company system after its determination date calculation will not be required to satisfy the larger company reporting requirements until the first quarter after the determination date fiscal year, i.e., the first quarter of the next year.

Comparison of Selected Disclosure Requirements

<table>
<thead>
<tr>
<th>Disclosure Item</th>
<th>Item</th>
<th>Scaled Disclosure Requirements</th>
<th>Larger Reporting Company Disclosure Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description of Business</td>
<td>Item 101</td>
<td>Describe key elements of the business for the past three years.</td>
<td>Describe key elements of the business (in greater depth) for the past five years.</td>
</tr>
<tr>
<td>Selected Financial Data</td>
<td>Items 310 (S-B), 301 (S-K)</td>
<td>• Provide selected financial data (income, cash flow, etc) for the past year. • Provide balance sheet data for the past two years.</td>
<td>Provide selected financial data for the past five years, plus any additional years required to ensure that the information provided is not misleading.</td>
</tr>
<tr>
<td>Supplementary Financial Information</td>
<td>Item 302</td>
<td>No such requirement applies to smaller reporting companies.</td>
<td>Provide data on net sales, gross profit, income (loss) before extraordinary items, per share data based upon such income (loss), and net income (loss), for each full quarter within the two most recent fiscal years.</td>
</tr>
<tr>
<td>MD&amp;A</td>
<td>Item 303</td>
<td>• Describe the &quot;plan of operation&quot; for the next year. • Describe fiscal condition for the last two years.</td>
<td>• Describe fiscal and operating condition for the last three years. • The disclosure is significantly more in-depth, including, <em>inter alia</em>, a tabular description of contractual obligations and a discussion of off-balance sheet arrangements.</td>
</tr>
<tr>
<td>Quantitative and Qualitative Disclosures about Market Risk</td>
<td>Item 305</td>
<td>No such requirement applies to smaller reporting companies.</td>
<td>Provide, in the reporter’s reporting currency, quantitative information about market risk as of the end of the latest fiscal year, in accordance with one of three disclosure alternatives.</td>
</tr>
<tr>
<td>Executive Compensation</td>
<td>Item 402</td>
<td>Provide “clear, concise and understandable disclosure” of all plan and non-plan compensation awarded to, earned by, or paid to:</td>
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<td>1. All principal executive officers (PEO) serving in the last fiscal year;</td>
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<td>2. Two most highly compensated non-PEO executive officers serving in the last fiscal year; and</td>
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<td>3. Up to two individuals who would have been included in category (2) above, but for the fact that they were not executive officers in the last fiscal year.</td>
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<td>Same requirements, except that disclosure is required with respect to the following additional people:</td>
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<td>1. Any person serving as CFO in the last fiscal year (regardless of comparative compensation); and</td>
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<td></td>
<td>2. Three most highly compensated officers (other than PEO and CFO).</td>
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</tr>
<tr>
<td>Transactions with Related Persons, Promoters and Certain Control Persons</td>
<td>Item 404</td>
<td>Describe any transaction in the last fiscal year or any proposed transaction, in which the reporter was or is to be a participant and the amount involved exceeds the lesser of $120,000 or one percent of the average of the reporter’s total assets at year-end for the last three completed fiscal years, and in which any related person had or will have a direct or indirect material interest.</td>
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<td>Same, except that there is no one percent test; if the transaction amount is greater than $120,000 and satisfies the other requirements, it must be reported pursuant to this item.</td>
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</tr>
</tbody>
</table>

1 Some disclosure requirements were omitted from this chart because they were very similar for both smaller reporting companies and larger reporting companies, with most difference being in the depth and breadth of required disclosure.

2 These scaled disclosure requirements were formerly available to small business issuers, and now will be available to smaller reporting companies.

3 These disclosure requirements are required for larger reporting companies, but are now available to smaller reporting companies on an “a la carte” basis.

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SEC Adopts New Exemptions for Compensatory Employee Stock Options

Effective December 7, 2007, the Securities and Exchange Commission (SEC) adopted two new exemptions from the registration requirements of the Securities Exchange Act of 1934 (the Exchange Act) for compensatory employee stock options. The first exemption is available to issuers that are not otherwise required to file periodic reports under the Exchange Act. The second exemption is available to issuers that are already required to file periodic reports, such as companies with securities traded on a national securities exchange. The exemptions apply only to the issuer’s compensatory employee stock options and do not extend to the class of security underlying those options, which is typically common stock.

Many companies, including private, non-reporting companies, use stock options to compensate their employees. The exemptions, described in more detail below, exempt issuers from the need to register under the Exchange Act and file periodic reports under the Exchange Act, such as Form 10-K, Form 10-Q and Form 8-K, by virtue of having 500 or more option holders and assets in excess of $10 million at the end of their most recently ended fiscal year. Registration under the Exchange Act also subjects the issuer and its security holders to other legal regimes including the tender offer rules, proxy rules and short-swing trading restrictions.

The new exemptions do not affect the need to register the issuance and exercise of stock options under the Securities Act of 1933, unless an exemption from such registration is available. Public companies will continue to be required to register their stock option plans on a Form S-8 registration statement, while private companies will generally look to Rule 701 or another exemption from Securities Act registration in connection with the administration of their stock option plans. The new exemptions relate solely to Exchange Act registration of a class of stock options, and the associated periodic reporting and other obligations flowing from such registration.

Exemption for Private, Non-reporting Issuers

Since 1992, the SEC’s Division of Corporate Finance has provided relief from Exchange Act registration, through no-action letters, to private issuers of stock options when specified conditions were present. In adopting the first of the two new exemptions, the SEC has codified many themes of such prior no-action letters and has provided further guidance as to the conditions that must be met to avoid triggering Exchange Act registration.

This exemption is available only to non-reporting issuers, i.e. those that do not already have a class of securities registered under the Exchange Act and are not otherwise subject to the reporting requirements of the Exchange Act.

Eligible Stock Options

- The exemption is only available for options that are issued under a written compensatory stock option plan.

- The exemption applies to all compensatory employee stock options issued under all written compensatory stock option plans established by the issuer, its parents, its majority owned subsidiaries or the majority owned subsidiaries of the issuer’s parents on a combined basis where the securities underlying such options are of the same class of equity securities of the issuer.

This exemption does not extend to any class of securities received or to be received on exercise of the compensatory stock options – typically the issuer’s common stock – or to other rights issued in connection with the compensatory employee stock options, such as stock appreciation rights, restricted stock units or shares of restricted stock.

Eligible Option Holders

- The options must be held by employees, directors or bona fide consultants or advisors of the issuer, its parents or majority owned, direct or indirect, subsidiaries of the issuer or its parents, or their permitted transferees (as described below).

Transferability Restrictions

To prevent a secondary trading market in stock options from developing, transferability restrictions apply as a condition of the exemption. Until the issuer becomes subject
to the reporting requirements of the Exchange Act, the stock options (and, before exercise, the shares to be issued on exercise of the stock options) may only be transferred:

- back to the issuer;
- to family members (including companies controlled by family members or trusts in which family members are the beneficiaries) by gift or pursuant to domestic relations orders;
- to an executor or guardian of the option holder upon death or disability of the option holder; or
- in connection with a change of control or other acquisition transaction involving the issuer if, following such transaction, the options no longer will be outstanding and the issuer no longer will be relying on the exemption.

In addition, before exercise, the options and the securities issuable upon exercise of those options cannot be the subject of a pledge, a short position, a “put equivalent position” or a “call equivalent position” by the option holder, until the issuer becomes subject to the reporting requirements of the Exchange Act.

The transferability restrictions set forth above must be contained in the written compensatory stock option plan, within the terms of individual written option agreements, or in another enforceable written agreement or in the issuer’s bylaws or articles of incorporation.

**Required Information**

The issuer must provide risk and financial information to option holders, including financial statements that are not more than 180 days old, not less frequently than semi-annually. The required information may be provided to the option holder either by physical or electronic delivery of the information or by notice to the option holder of the availability of the information on an Internet site.

In recognition of the fact that many private companies may not otherwise be providing risk and financial information to employees other than financial or senior management personnel, the new exemption provides that the issuer may condition the provision of the risk and financial information on the option holder agreeing to maintain the confidentiality of such information.

**Registering When No Longer Eligible for Exemption**

If a private, non-reporting issuer becomes ineligible to rely on this exemption, the issuer will be required to register the class of compensatory employee stock options under Exchange Act within 120 days from the date of ineligibility, resulting in the issuer becoming an SEC reporting company.

**Exemption for Exchange Act Reporting Issuers**

The second newly adopted exemption is available only to issuers that are already required to file reports pursuant to the Exchange Act, including issuers with common stock or other securities traded on a national securities exchange. Historically, few SEC reporting issuers have recognized the need to register compensatory stock options under the Exchange Act when the securities underlying such option are already separately registered under the Exchange Act and the issuance and sale of the options and equity securities issuable upon exercise of the options are already registered under the Securities Act of 1933 on Form S-8. The SEC believes this new exemption will provide important guidance regarding, and an appropriate exemption to eligible issuers from, the Exchange Act registration requirements for compensatory stock options.

In order for an SEC reporting company’s compensatory stock options to be exempt under this new exemption, the options must meet the following qualifications:

- **Options Are Pursuant To A Written Plan.**

The stock options must have been issued pursuant to one or more written compensatory stock option plans established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer’s parents.
• **Eligible Option Holders.**

The stock options must generally be held by employees, directors or bona fide consultants or advisors of the issuer, its parents or majority owned, direct or indirect, subsidiaries of the issuer or its parents, and permitted transferees. As is the case for private companies, permitted transferees include family members (including companies controlled by family members or trusts in which family members are the beneficiaries) who receive the options by gift or pursuant to domestic relations orders, as well as executors or guardians who acquire stock options upon the death or disability of the option holder.

The exemption may continue to be available where a small number of option holders do not fall within the permitted categories of option holders. To maintain this exemption, the number of option holders failing to meet the eligibility requirements must be insignificant as to the aggregate number of option holders and number of outstanding stock options, and the issuer must have made a good faith and reasonable attempt to ensure that options are held only by the permitted categories of option holders.

• **Registering When No Longer Eligible for Exemption**

For an issuer that becomes ineligible to rely on this exemption, such issuer will be required to register the class of compensatory stock options under the Exchange Act within 60 days from the date of ineligibility.


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**SEC to Accept IFRS Financial Statements without GAAP Reconciliation**

On December 21, 2007, the Securities and Exchange Commission (SEC) announced that it will allow foreign private issuers to include financial statements prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) without reconciliation to U.S. Generally Accepted Accounting Principles (U.S. GAAP). The revisions target Items 17 and 18 of Form 20-F, Regulation S-X, as well as several other rules and forms. The revisions become effective in February 2008.

The amendments are designed to fulfill a longstanding goal of the SEC: promoting the convergence of financial accounting standards into a single, globally accepted and high-quality set of standards to be followed by all reporting companies around the world. By allowing foreign private issuers to submit financial statements prepared in accordance with IFRS, the SEC is aligning itself with other prominent financial regulatory bodies in more than 100 countries and facilitating more efficient reporting by foreign companies.

**Financial Statement Preparation Options for Foreign Private Issuers**

Foreign private issuers will be permitted to prepare their financial statements in accordance with: (1) U.S. GAAP; (2) IFRS as issued by the IASB, with a U.S. GAAP reconciliation; (3) IFRS as issued by the IASB without a U.S. GAAP reconciliation; and (4) another accepted national accounting standard, with a U.S. GAAP reconciliation. The SEC revisions created the third option. Foreign private issuers choosing to file under an alternative national accounting standard will still have to reconcile such financial statements to U.S. GAAP.

**Accommodation for First-Time Adopters of IFRS**

In addition to eliminating the requirement of reconciliation of IFRS financial statements to U.S. GAAP, the revisions also extend indefinitely the accommodation granted to all first-time adopters of IFRS as issued by the IASB. In
2005, the SEC adopted a temporary accommodation for all first-time adopters of IFRS: such issuers were required to provide financial statements for only the last two years, rather than the last three years. This accommodation was intended to ease the burden on such first-time adopters of IFRS. The rule revisions will make this temporary accommodation available indefinitely.

**Financial Statement Preparation for Foreign Smaller Reporting Companies**

Under recently adopted amendments to the smaller reporting company filing requirements, foreign companies may qualify as smaller reporting companies. Qualifying foreign smaller reporting companies may prepare financial statements in accordance with U.S. GAAP, IFRS as issued by the IASB without reconciliation to U.S. GAAP, or another comprehensive accounting standard with a U.S. GAAP reconciliation.

**Implementation**

The SEC concluded that the revisions to accept financial statements for foreign private issuers prepared in accordance with IFRS as issued by the IASB will be applicable to annual financial statements for financial years ending after November 15, 2007, and to interim periods within those years, that are contained in filings made after the effective date of the rule amendments. Special transition rules apply to early adopters of IFRS under European Union requirements with respect to hedge accounting for certain financial instruments, as well as to financial statements in registration statements and transition period interim financial statements.

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