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# SEC Proposes to Ease Qualifications for Nonaccelerated Filer Status

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## Introduction

On May 9, 2019, the SEC issued a [proposed rule](#)<sup>1</sup> that would amend the definitions of “accelerated filer” and “large accelerated filer” to exclude any issuer with both annual revenues of less than \$100 million and public float of less than \$700 million. The proposed amendments, which are intended to promote capital formation while maintaining investor protection, would expand the number of issuers that qualify as nonaccelerated filers and are thus eligible to take advantage of certain reporting accommodations offered to such issuers. The most significant of these accommodations is the elimination of the requirement that an issuer obtain an audit report on internal control over financial reporting (ICFR) from its independent auditor, as currently required under Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX).

## Background

On June 28, 2018, the SEC issued a [final rule](#)<sup>2</sup> that amended the definition of a smaller reporting company (SRC) and therefore expanded the number of issuers that qualified for the scaled disclosure requirements that apply to such entities. Under the final rule, an issuer qualifies as an SRC if it has public float<sup>3</sup> of either (1) less than \$250 million (public float test) or (2) less than \$700 million and revenue of less than \$100 million (revenue test). See Deloitte’s July 2, 2018, [Heads Up](#) for more information about the final rule.

<sup>1</sup> SEC Proposed Rule Release No. 34-85814, *Amendments to the Accelerated Filer and Large Accelerated Filer Definitions*.

<sup>2</sup> SEC Final Rule Release No. 33-10513, *Amendments to Smaller Reporting Company Definition*.

<sup>3</sup> Public float is the aggregate market value of the issuer’s outstanding voting and nonvoting common stock held by nonaffiliates. It is calculated by multiplying the number of the company’s voting and nonvoting common shares held by nonaffiliates by the market price. In the case of an IPO, public float is computed by multiplying the estimated public offering price of the shares by the sum of (1) the aggregate worldwide number of all shares outstanding held by nonaffiliates before the filing of the registration statement and (2) the number of such shares included in the registration statement.

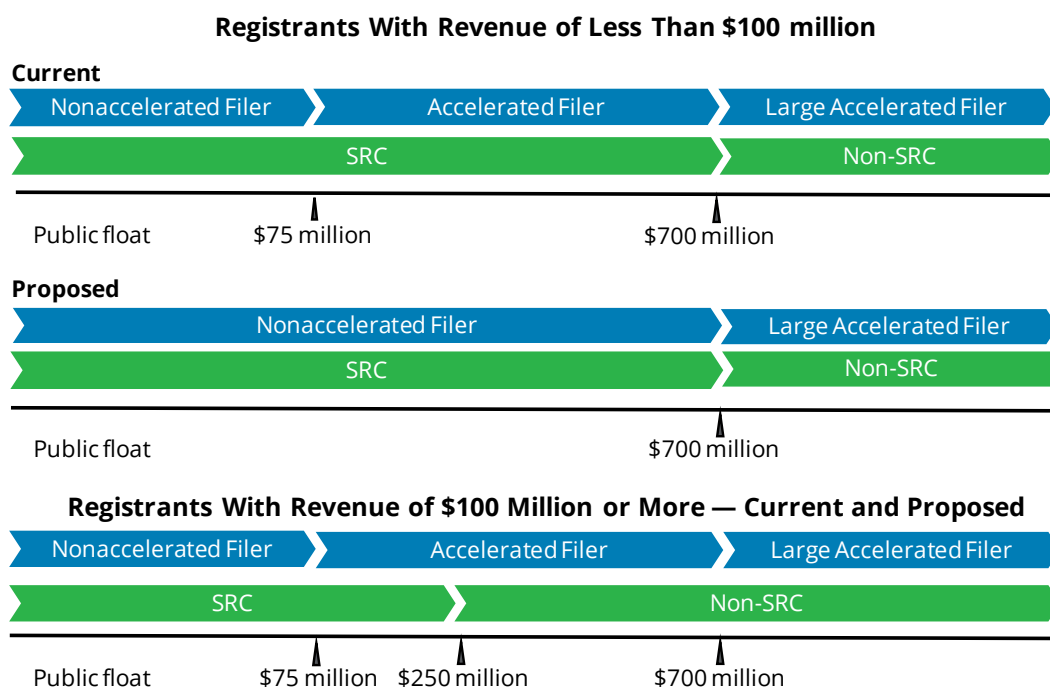
An issuer must also make an independent determination of its filer status as nonaccelerated, accelerated, or large accelerated. The issuer bases that determination, in part,<sup>4</sup> on public float thresholds of less than \$75 million for nonaccelerated filers, \$75 to \$700 million for accelerated filers, and \$700 million or more for large accelerated filers. Filer status can affect an issuer’s reporting obligations. For example, accelerated and large accelerated filers have shorter deadlines for periodic filings and, unless they qualify as emerging growth companies, must have their independent auditor report on the effectiveness of their ICFR.

Before the 2018 change to the SRC definition, an SRC would never have met the criteria to qualify as an accelerated filer. However, since the qualifying criteria now overlap, an SRC may also be an accelerated filer. When the SEC issued the amended SRC definition in 2018, Chairman Jay Clayton directed the staff to consider whether the accelerated filer definition should be changed in response to suggestions from stakeholders to more closely align the two definitions. The proposed rule is intended to address those suggestions.

### Key Provisions of the Proposed Rule

Under the proposal, the definitions of accelerated filer and large accelerated filer (under Rule 12b-2 of the Securities and Exchange Act of 1934) would be amended to exclude issuers that would have qualified as SRCs on the basis of the revenue test. Therefore, any issuer would be considered a nonaccelerated filer if it has (1) annual revenues of less than \$100 million in the most recent fiscal year for which audited financial statements are available and (2) public float of less than \$700 million as of the last business day of their second fiscal quarter.

However, issuers that qualify as SRCs solely on the basis of the public float test would not be excluded from the new definitions and would thus need to consider other accelerated filer criteria to determine their filing status, including the separate public float thresholds specified in those definitions (i.e., \$75 million or more to be considered an accelerated filer). While the proposed rule does not eliminate the overlap between SRCs and accelerated filers, it aligns the initial float assessment criteria for issuers with annual revenues under \$100 million. The chart<sup>5</sup> below illustrates the intersection between the revenue and public float requirements for an SRC and an accelerated filer under the current and proposed rules.



<sup>4</sup> See paragraphs 1340.1 and 1340.2 of the SEC’s Financial Reporting Manual for a full list of the criteria an issuer must meet, as assessed at the end of its fiscal year, to qualify as an accelerated filer and a large accelerated filer, respectively.

<sup>5</sup> The chart illustrates the current and proposed definitions on the basis of public float. It is assumed in the chart that all other criteria under Rule 12b-2 have been met for an issuer to qualify as an accelerated filer or a large accelerated filer.

The following table further summarizes the proposed initial assessment criteria on the basis of public float and revenue levels in the context of the SOX Section 404(b) requirements:

| Status                       | Proposed Definition                     |                         | Requirement        |
|------------------------------|---|-------------------------|--------------------|
|                              | Public Float                            | Annual Revenues         | SOX Section 404(b) |
| SRC and nonaccelerated filer | Less than \$75 million                  | N/A                     | No                 |
|                              | \$75 million to less than \$700 million | Less than \$100 million | No                 |
| SRC and accelerated filer    | \$75 million to less than \$250 million | \$100 million or more   | Yes                |

### Example 1

Under the proposed amendments, an issuer with a December 31, 2019, fiscal year-end would not qualify as an SRC under the public float test if it had \$400 million of public float as of June 30, 2019, and \$95 million in annual revenues for the fiscal year ended December 31, 2018. However, the issuer would qualify as an SRC under the SRC revenue test and would therefore also be a nonaccelerated filer.

### Example 2

On December 31, 2020, if the issuer's public float as of June 30, 2020, remained at \$400 million and its annual revenues for the fiscal year ended December 31, 2019, were \$105 million, the issuer would no longer qualify as an SRC under the SRC revenue test (in addition to the public float test) and thus it would become an accelerated filer.

The proposed rule would also change the public float criteria that are used to determine when an issuer will exit a filer status. The SEC established lower criteria than the entry-level thresholds to reduce the likelihood that issuers frequently change filer status. Currently, once an issuer becomes an accelerated filer or a large accelerated filer, it maintains that status until its float falls below \$50 million and \$500 million, respectively. The proposed rule would increase the transition thresholds for an accelerated filer to become a nonaccelerated filer from \$50 million to \$60 million and for a large accelerated filer to become an accelerated filer from \$500 million to \$560 million (i.e., 80 percent of the initial qualification thresholds). In addition, the proposed amendments would allow an issuer to exit accelerated filer or a large accelerated filer status to become a nonaccelerated filer if it becomes eligible for SRC status under the SRC revenue test at a revenue threshold of \$80 million (i.e., 80 percent of the initial qualification threshold).

If the proposed rule is finalized, certain SRCs would newly qualify as nonaccelerated filers and would no longer be subject to auditor attestation of ICFR under SOX Section 404(b). However, the proposed rule would not relieve management of its obligation to assess ICFR nor would it relieve an independent auditor of its obligation to consider ICFR in the performance of its financial statement audit of an issuer. For example, in a financial statement audit, the auditor is required to identify and assess the risks of material misstatement. The auditor is therefore required, in accordance with PCAOB AS 2110,<sup>6</sup> to "obtain a sufficient understanding of each component [of ICFR] to (a) identify the types of potential misstatements, (b) assess the factors that affect the risks of material misstatement, and (c) design further audit procedures." This understanding includes evaluating the design of the controls relevant to the audit and determining whether the controls have been implemented but it does not include testing the operating effectiveness of such controls. In addition, the proposed rule would not affect other

<sup>6</sup> Paragraph 18 of PCAOB Auditing Standard No. 2110, *Identifying and Assessing Risks of Material Misstatement*.

key SOX protections that do not depend on filer status, such as independent audit committee requirements, CEO and CFO certifications of financial reports, or the requirement that issuers continue to establish, maintain, and assess the effectiveness of their ICFR.

### **Request for Comment**

The SEC is interested in feedback from investors, issuers, and other market participants on the proposed rule and does not require a specific format for the submission of comments. The proposed rule includes 15 numbered requests for comment on a broad range of subjects in addition to those related to the proposed rule. For example, the SEC has requested comment on whether an issuer's filing status for a given year should be determined by using the average of an issuer's public float or by using some other metric such as the issuer's volume-weighted average price. Some commenters may choose to present their views in a narrative format without any reference to specific questions posed by the SEC, and others may choose to answer all, or only some, of the specific requests for comment. Comments can be submitted through the SEC's Web site and are due 60 days after the proposed rule's publication in the *Federal Register*. Any comments submitted will be posted to the SEC's Web site.

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