

CLIENT ALERT

SEC Eliminates Auditor Attestation Requirement for Smaller Reporting Companies

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On March 12, 2020, the Securities and Exchange Commission adopted amendments¹ to the definitions of accelerated filer and large accelerated filer to exempt certain smaller reporting companies (“SRCs”) from the requirement, under Section 404(b) of the Sarbanes-Oxley Act, to have their independent auditors attest to management’s assessment of the effectiveness of their internal control over financial reporting. The amendments as adopted are substantially as proposed by the SEC last May.² Like various other recent SEC proposals,³ the amendments aim to promote capital formation by reducing compliance costs, particularly for smaller reporting issuers, following the SEC’s expansion of the definition of SRC in 2018, which created overlaps with the accelerated filer and large accelerated filer definitions.⁴

The amendments are effective 30 days following publication in the Federal Register and apply to annual reports due on or after such date even if they relate to a fiscal year ending prior to such date.

Under the current definitions, because the public float tests in the SRC and accelerated filer definitions overlap, an issuer meeting the accelerated filer definition⁵ would be both an SRC and an accelerated filer if it had: a) a public float,

¹ See SEC Release No. 34-88365, *Amendments to the Accelerated Filer and Large Accelerated Filer Definitions*, March 12, 2020, available [here](#).

² See our client alert *SEC Proposes to Exempt Additional Companies from Auditor Attestation Requirement*, May 17, 2019, available [here](#).

³ See, for example, our recent client alert *SEC Proposes MD&A Amendments that Continue Shift to Principles-Based Disclosure*, February 6, 2020, available [here](#).

⁴ The SRC definition was expanded to enable more companies to qualify for the scaled disclosure accommodations applicable to SRCs. See our client alert *SEC Expands “Smaller Reporting Company” Definition*, July 9, 2018, available [here](#).

⁵ Under Securities Exchange Act Rule 12b-2, to be an accelerated filer, an issuer also must have been subject to the requirements of Exchange Act Section 13(a) or 15(d) for a period of at least twelve calendar months and have filed at least one annual report pursuant to those sections.

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measured as of the last business day of its most recently completed second fiscal quarter, of \$75 million or more, but less than \$250 million, regardless of its annual revenues; or b) less than \$100 million in annual revenues, and a public float of \$250 million or more, but less than \$700 million. As a result, under the current rules, these SRCs are required, in addition to having their management assess the effectiveness of their internal control over financial reporting, to have their independent auditors attest to such management's assessment.

To better balance the benefits and burdens of compliance mandates for these companies, the amendments exclude from the definitions of accelerated filer and large accelerated filer an issuer that has a public float of less than \$700 million and revenues of less than \$100 million, as summarized in the following table:

<u>Status</u>	<u>Current Rules</u>		<u>New Rules</u>	
	<u>Public Float</u>	<u>Annual Revenues</u>	<u>Public Float</u>	<u>Annual Revenues</u>
SRC and Non-Accelerated Filer	Less than \$75 million	N/A	Less than \$75 million	N/A
			\$75 million to less than \$700 million	Less than \$100 million
SRC and Accelerated Filer	\$75 million to less than \$250 million	N/A	\$75 million to less than \$250 million	\$100 million or more
	\$250 million to less than \$700 million	Less than \$100 million		
Accelerated Filer (not SRC)	\$250 million to less than \$700 million	\$100 million or more	\$250 million to less than \$700 million	\$100 million or more
Large Accelerated Filer (not SRC)	\$700 million or more	N/A	\$700 million or more	N/A

To avoid frequent changes of status, under current rules, once an issuer is an accelerated or large accelerated filer, it will not become a non-accelerated or accelerated filer until its public float falls below a specified threshold lower than the threshold that it had initially needed to become an accelerated or large accelerated filer. The amendments modify these transition rules to set the exit thresholds for the public float test at 80% of their initial amounts, as described in the following table.

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<u>Initial Public Float Determination</u>	<u>Resulting Filer Status</u>	<u>Current Rules</u>		<u>New Rules</u>	
		<u>Subsequent Public Float Determination</u>	<u>Resulting Filer Status</u>	<u>Subsequent Public Float Determination</u>	<u>Resulting Filer Status</u>
\$700 million or more	Large Accelerated Filer	\$500 million or more	Large Accelerated Filer	\$560 million or more	Large Accelerated Filer
		Less than \$500 million but \$50 million or more	Accelerated Filer	Less than \$560 million but \$60 million or more	Accelerated Filer
		Less than \$50 million	Non-Accelerated Filer	Less than \$60 million	Non-Accelerated Filer
Less than \$700 million but \$75 million or more	Accelerated Filer	Less than \$700 million but \$50 million or more	Accelerated Filer	Less than \$700 million but \$60 million or more	Accelerated Filer
		Less than \$50 million	Non-Accelerated Filer	Less than \$60 million	Non-Accelerated Filer

Consistent with the addition of the revenue test to the amended SRC definition, the amendments also add a revenue test to these transition rules for accelerated and large accelerated filers.

The amendments similarly apply to business development companies, using an investment income test instead of the revenue test used for other companies. Foreign private issuers are not eligible to use these accommodations as SRCs unless they use the forms required for U.S. domestic companies and provide financial statements prepared in accordance with U.S. GAAP.

To better highlight for investors whether the registrant is availing itself of this exemption, the amendments also add a new check box to the cover page of Forms 10-K and 20-F to indicate whether an internal control over financial reporting attestation is included in the filing.

SEC Commissioner Allison Herren Lee, currently the sole Democrat commissioner, dissented from the proposal, stating that the amendments remove a “critical gatekeeping function” in financial reporting performed by the independent accountants. Chairman Jay Clayton, however, pointed to the SEC’s history of providing scaled disclosure for smaller issuers and the various other protections that still apply to SRCs, including management’s certification of the company’s internal control over financial reporting as well as the independent accountants’ audit of the financial statements, which must take the company’s internal control over financial reporting into consideration as part of the audit.

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If you have any questions regarding this client alert, please contact the following attorney or the Willkie attorney with whom you regularly work.

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