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SEC Adopts New Rules Affecting Public Company Reporting

SEC Requires Use of Inline XBRL for Public Companies Including Funds, Eliminates XBRL Website Posting Requirement, Expands Companies Eligible for “Smaller Reporting Company” Scaled Disclosure and Modifies Rules for Financial Statements of Smaller Acquired Businesses

SUMMARY

On June 28, 2018, the SEC approved its previously proposed amendments to the XBRL rules for operating companies and open-end management investment companies (“funds”) that file reports with the SEC to require the use of Inline XBRL when filing financial statements and risk/return summaries. The amendment, which will become effective in accordance with a phase-in schedule described below, also eliminates the requirement for operating companies and funds to post XBRL information on their websites. Also, on June 28, 2018, the SEC approved amendments to the “smaller reporting company” definition to expand the number of companies that qualify for certain existing scaled disclosure accommodations under Regulation S-K and Regulation S-X, and increased the net revenue threshold in Rule 3-05 of Regulation S-X, which will allow companies to omit financial statements of businesses acquired or to be acquired for the earliest two of the three fiscal years otherwise required by Rule 3-05 if the net revenues of that business are less than \$100 million (increased from \$50 million). SEC Chairman Jay Clayton has also directed the SEC staff to formulate recommendations to the SEC for possible additional changes to the “accelerated filer” definition that, if adopted, would have the effect of reducing the number of companies that are accelerated filers.

XBRL AMENDMENTS

A. BACKGROUND

In 2009, the Securities and Exchange Commission (“SEC”) adopted rules requiring operating companies and funds to provide information from their financial statements and risk/return summaries, respectively, in machine-readable eXtensible Business Reporting Language (“XBRL”) format.¹ The XBRL information provides a means by which both numeric and narrative-based disclosures may be labeled, or “tagged,” by a machine for further processing and analysis by computer software. Once issuers submit XBRL information via the SEC’s EDGAR system, the EDGAR system validates the information and creates an interactive data file for review by investors. The SEC implemented rules requiring XBRL disclosures to improve the accessibility and usefulness to investors of filed financial statements and risk/return disclosure.

The XBRL rules are applicable to all companies that prepare their financial statements in accordance with U.S. GAAP or International Financial Reporting Standards. Operating companies are required to include the XBRL information in exhibits to their registration statements under the Securities Act of 1933 as well as their periodic and current reports under the Securities Exchange Act of 1934. Similarly, funds must include XBRL information in exhibits pursuant to the requirements on Form N-1A. Under existing rules, issuers and funds were required to make the XBRL information available separately on their websites as well.

B. NEW INLINE XBRL REQUIREMENTS FOR OPERATING COMPANIES AND FUNDS

The amendments adopted by the SEC require both operating companies and funds to submit financial statement and risk/return summaries utilizing Inline XBRL. As noted above, under existing rules, filers would include XBRL information as separate exhibits to their filings made through the EDGAR system, which are made available electronically to investors. Inline XBRL is a mechanism by which the filer integrates the XBRL information directly into the filing itself, eliminating the need for investors to also download the separate XBRL files for software analysis, as Inline XBRL is both human-readable and able to be extracted automatically into computer software programs for analysis. Beginning in June 2016, the SEC began accepting Inline XBRL filings and, based on the SEC’s analysis, 152 different operating companies had made filings using Inline XBRL as of May 21, 2018, representing approximately 1.8% of all filers.

The SEC anticipates that Inline XBRL will reduce the time and effort required by filers to submit the XBRL data, provide more control to the filer over the presentation of XBRL disclosures, reduce the likelihood of inconsistencies between the issuer’s main filing and the XBRL data and, more generally, further enhance the accessibility and transparency of the data.

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C. PHASE-IN FOR NEW XBRL REQUIREMENTS

All operating companies will be required to submit Inline XBRL filings beginning with their first Form 10-Q filed for a fiscal period ending on or after the applicable compliance date, as set forth below:

- Large accelerated filers that use U.S. GAAP will be required to comply beginning with fiscal periods ending on or after June 15, 2019 (i.e., for a calendar year filer, a filer's Form 10-Q for the six months ended June 30, 2019).
- Accelerated filers that use U.S. GAAP will be required to comply beginning with fiscal periods ending on or after June 15, 2020 (i.e., for a calendar year filer, a filer's Form 10-Q for the six months ended June 30, 2020).
- All other filers (such as non-accelerated filers and all filers that use IFRS) will be required to comply beginning with fiscal periods ending on or after June 15, 2021.

Form 10-Q filers will not become subject to the Inline XBRL requirements with respect to Form 10-K or any other form, however, until after they have been required to comply with the Inline XBRL requirements for their first Form 10-Q for a fiscal period ending on or after the applicable compliance date. Consequently, a filer with a fiscal year end on June 30 of the applicable year will not be required to comply until its first Form 10-Q for the quarter ended September 30 of the applicable year and will not be required to include Inline XBRL in its Form 10-K until the following year.

Foreign Private Issuers reporting under U.S. GAAP will be required to prepare Inline XBRL for their Form 20-F, although they will not benefit from the exemption for Form 10-Q filers. Foreign private issuers reporting under IFRS will not be required to present Inline XBRL filings until fiscal periods beginning after June 15, 2021.

Funds are required to begin use of Inline XBRL for their risk/return summaries according to the following phase-in schedule:

- Large fund groups (net assets of \$1 billion or more as of the end of their most recent fiscal year) will be required to comply by June 28, 2020.
- All other funds will be required to comply by June 28, 2021.

D. ELIMINATION OF REQUIREMENT TO POST XBRL DATA ON ISSUER WEBSITES

The amendments also eliminate the requirement for filers to make the XBRL information available on their websites. In citing a reason for the change, the SEC noted that industry commentators have observed very little use of the XBRL website filings, given that most users of XBRL data do not access the information directly via the filer's website but instead access the information directly through the EDGAR system.

SEC RELEASE REGARDING SMALLER REPORTING COMPANY DEFINITION AMENDMENTS

A. SMALLER REPORTING COMPANY DEFINITION

In 2008, the SEC adopted rules permitting “smaller reporting companies” to provide scaled disclosure under Regulation S-K and Regulation S-X in order to promote capital formation and to reduce compliance costs for certain smaller companies. For example, smaller reporting companies are permitted to provide less detailed disclosure with respect to their business, fewer years of analysis under the Management’s Discussion and Analysis of Financial Condition and Results of Operations section, scaled executive compensation disclosure and two years of financial statements pursuant to special rules found in Article 8 of Regulation S-X.

In order to avail itself of the scaled disclosure available to smaller reporting companies, an issuer must determine if it initially qualifies when it first becomes a reporting company. Even if a company does not meet the test initially, it may subsequently qualify as a smaller reporting company if, in the future, it meets certain other financial metrics. Under the existing definition, a company seeking to avail itself of the smaller reporting company at the time of its initial determination must meet *either* of the following criteria:

- A public equity float of less than \$75 million; or
- Annual revenues of less than \$50 million and no public float.

If a company did not meet either of the above criteria during its initial determination, a company may nonetheless subsequently become eligible for smaller reporting company status if it meets *either* of the subsequent qualification criteria set forth below:

- A public equity float of less than \$50 million; or
- Annual revenues of less than \$40 million and no public float.

The SEC’s June 28, 2018 amendments increase the dollar thresholds for both the initial qualification and subsequent qualification criteria discussed above in order to increase the scope of qualifying companies. Importantly, while the amendments expand the definition, the amendments do not revise the existing scaled disclosure accommodations available to smaller reporting companies under Regulation S-K or Regulation S-X.

The amendments revised the initial qualification criteria as set forth below.

- A public equity float of less than \$250 million; or
- Annual revenues of less than \$100 million and (i) no public float or (ii) a public float of less than \$700 million.

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The subsequent qualification criteria have also been revised as set forth below:

- A public equity float of less than \$200 million; or
- Annual revenues of less than \$80 million and less than \$560 million of public float.

The amendments become effective 60 days after their publication in the Federal Registrar.

B. AMENDMENTS TO RULE 3-05 OF REGULATION S-X FOR FINANCIAL STATEMENTS OF ACQUIRED BUSINESSES

On June 28, 2018, the SEC also amended Rule 3-05(b) of Regulation S-X, which sets forth certain requirements for financial statements of an acquired business or to be acquired business to be provided other than when a filer is registering securities to be offered to the security holders of the business to be acquired. Specifically, the SEC amended Rule 3-05(b)(iv), which previously required filers to provide full financial statements for three fiscal years of any acquired or to be acquired business if such business exceeded the 50% significant threshold under the investment test or income test of Regulation S-X, unless net revenues of the required business reported during its most recent fiscal year were less than \$50 million, in which case only two years of financial statements were required. Because the \$50 million net revenue threshold under the existing rule was based on the smaller reporting company definition, the SEC's amendment increased the \$50 net revenue threshold in Rule 3-05(b)(iv) to \$100 million to conform to the smaller reporting company definition changes discussed above.

C. SEC CHAIRMAN, JAY CLAYTON, DIRECTS SEC STAFF TO CONSIDER AMENDMENTS TO DEFINITIONS OF "ACCELERATED FILER" AND "LARGE ACCELERATED FILER" TO CONFORM TO SMALLER REPORTING COMPANY DEFINITION CHANGES

Under the existing rules, smaller reporting companies were automatically excluded from the requirements for "accelerated filers" and "larger accelerated filers," including the timing of the filing of periodic reports and the requirement that accelerated filers provide the auditor's attestation of management's assessment of internal control over financial reporting required by Section 404(b) of the Sarbanes-Oxley Act of 2002. On June 28, 2018, the SEC amended the accelerated filer and large accelerated filer definitions to remove this automatic exclusion for smaller reporting companies. Further, the SEC's amendments preserve the existing public float criteria requirements that apply to accelerated filers and large accelerated filers, currently \$75 million and \$700 million, respectively. As a result, a company that qualifies as a smaller reporting company by virtue of having a public float of less than \$250 million under the amended smaller reporting company definition will still be considered an accelerated filer. SEC chairman, Jay Clayton, has directed the staff to formulate recommendations to the SEC for possible changes to reduce the number of filers which are considered accelerated filers.

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ENDNOTES

- ¹ For further discussion regarding the SEC's 2009 XBRL rules, please see our Client Memorandum, *SEC Publishes Final Rules on Mandatory Filing of Interactive Financial Data*, dated March 5, 2009, available at [https://www.sullcrom.com/siteFiles/Publications/SC Publication SEC Publishes Final Rules on Mandatory Filing of Interactive Financial Data.pdf](https://www.sullcrom.com/siteFiles/Publications/SC%20Publication%20SEC%20Publishes%20Final%20Rules%20on%20Mandatory%20Filing%20of%20Interactive%20Financial%20Data.pdf).

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