



## SEC Finalizes Revisions for Exempt Offering Rules

The SEC recently finalized revisions to Regulation A that raise the limit on exempt offerings from \$5 million to \$50 million within a 12-month period.<sup>1</sup> The revisions required by the Jumpstart Our Business Startups Act are designed to make it easier for small companies to raise capital while providing meaningful investor protection.<sup>2</sup>

### Key Facts

- The final rules:
  - Create a two-tier system with easier requirements for small offerings (up to \$20 million annually) compared to stricter requirements for larger offerings (up to \$50 million annually); and
  - Modernize the Regulation A filing process to be consistent with current practice for registered offerings.<sup>3</sup>
- The effective date is June 19, 2015.

### Key Impact

- Nonpublic issuers may raise up to \$50 million from non-accredited investors in a public offering.<sup>4</sup>

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<sup>1</sup> SEC Release Nos. 33-9741, 34-74578, and 39-2501, Amendments to Regulation A; the Securities Act of 1933, and the Securities Exchange Act of 1934, all available at [www.sec.gov](http://www.sec.gov).

<sup>2</sup> The Jumpstart Our Business Startups Act became law in April 2012.

<sup>3</sup> Securities Act of 1933, Regulation A, Conditional Small Issues Exemption, available at [www.sec.gov](http://www.sec.gov).

<sup>4</sup> Accredited investors include individuals with a net worth of at least \$1 million, excluding the value of their primary residence, with annual income of at least \$200,000 in each of the two most recent years.

## Current Regulation A Requirements

Regulation A offerings are public offerings that have no prohibition on general solicitation and advertising that are exempt from the filing requirements of the Securities Acts of 1933 and 1934. Before adoption of the final rules, Regulation A only permitted unregistered public offerings of up to \$5 million of securities in any 12-month period by non-SEC reporting U.S. and Canadian issuers. The Regulation A exemption requires issuers to file an offering statement with the SEC, which is similar to an abbreviated version of a prospectus in a registered offering, in a paper format.

### SEC Observation

The SEC states in its release that it estimates 250 offerings will be made each year under the amended Regulation A. This is an increase from the SEC's estimate of 26 Regulation A offering statements currently filed each year.

## Revisions to Regulation A

The revisions to Regulation A create two tiers of offerings. These offerings will be exempt from existing registration requirements if certain requirements are met, including those listed in the following table.

Tier 1	Tier 2
<b>Limit on Aggregate Offering Amount within the Prior 12 Months</b>	
\$20 million, including up to \$6 million by selling security holders	\$50 million, including up to \$15 million by selling security holders
<b>Investment Limitation (on a per Offering Basis)</b>	
None	None for accredited investors For non-accredited investors, no more than 10% of the greater of the investor's annual income or net worth
<b>Compliance with Blue Sky Laws</b>	
Required	Exempt from state securities law requirements

### SEC Observation

The revisions to Regulation A that were proposed in December 2013 limited the aggregate offering amount within the prior 12 months to \$5 million for Tier 1 offerings.<sup>5</sup> However, the SEC release states that it increased the offering limitation in the final rules for Tier 1 offerings in a 12-month period to \$20 million. The SEC wanted to increase the usefulness of the exemption for smaller issuers by providing them with additional options for capital formation and potentially increasing their proceeds.

**Eligible Securities.** The exemption under Regulation A is limited to equity securities, debt securities, and convertible debt securities. The revisions to Regulation A exclude asset-backed securities, as defined in Regulation AB.<sup>6</sup>

**Ineligible Issuers.** Exemption under Regulation A is not available for issuers:

- Whose principal place of business is outside the United States or Canada;
- With existing SEC reporting requirements;
- Who are investment companies as defined under the Investment Company Act of 1940;
- That have no specific business plan or a business plan to engage in a merger or acquisition with unidentified companies;
- That are disqualified under *bad actor* provisions if they or other relevant persons, such as underwriters, directors, officers, or significant shareholders have been convicted of, or are subject to, court or administrative sanctions for securities fraud or other violations of specified laws; and
- That have fractional, undivided interests in oil or gas rights, or similar interests in other mineral rights.

The revisions to Regulation A also disqualify issuers that have:

- Not fulfilled their obligation to file ongoing reports under the revised rules during the two years preceding the filing of a new offering statement; and
- Been ordered by the SEC to deny, suspend, or revoke the registration of securities during the five years preceding the filing of a new offering statement.

<sup>5</sup> See KPMG's Defining Issues No. 14-10, "SEC Proposes Changing Rules for Exempt Offerings under Regulation A," available at [www.kpmginstitutes.com](http://www.kpmginstitutes.com).

<sup>6</sup> Securities Act of 1933, Regulation AB, Asset-backed Securities, available at [www.sec.gov](http://www.sec.gov).

## Disclosure Requirements for Issuers

Issuers must file the forms required by the revised rules on EDGAR. The filings will be subject to SEC staff review and subject to anti-fraud and civil liability provisions under the Securities Act of 1933.

**Offering Statement Disclosure Requirements.** The revised rules require issuers to provide certain information on a revised Form 1-A (the offering document) including:

- General information about the issuer, its officers and directors, and the offering;
- Executive compensation data for the three highest paid officers or directors during the most recent year;
- A description of the business for the prior three years;
- Offering price and planned use of proceeds;
- Transactions with related-parties; and
- Management’s discussion and analysis (MD&A) of the issuer’s liquidity, capital resources, and results of operations for the two most recent years.

**Financial Reporting Requirements.** The revisions to Regulation A establish different financial reporting requirements for Tier 1 and Tier 2 offerings. Issuers conducting an eligible offering of up to \$20 million may elect to conduct the offering under either Tier 1 or Tier 2.

The following table summarizes the current and revised offering document financial statement requirements under Regulation A.

Current Requirements	Tier 1	Tier 2
<b>Balance Sheets</b>		
One year	Two years and an interim period (if required)	
<b>Statements of Income, Cash Flows, and Stockholders’ Equity</b>		
Two years and interim periods (if required)	Two years and interim periods (if required)	
<b>Basis of Accounting</b>		
U.S. GAAP	U.S. GAAP for U.S.-domiciled issuers Either U.S. GAAP or IFRS as issued by the IASB for Canadian issuers	

Current Requirements	Tier 1	Tier 2
<b>Compliance with Regulation S-X for Form and Content</b>		
No	No	Yes, as if the issuer was a smaller reporting company
<b>Annual Audit Requirements</b>		
Unaudited, unless the issuer has audited financial statements	Unaudited, unless the issuer has audited financial statements	Audited
<b>Applicable Auditing Standards</b>		
U.S. GAAS or PCAOB	U.S. GAAS or PCAOB	
<b>Auditors Required to Be Registered with the PCAOB</b>		
No	No	
<b>Auditors Required to Comply with SEC Independence Rules</b>		
Yes	Yes, unless the issuer has audited financial statements and the auditor followed the independence standards of the AICPA	Yes

### KPMG Observation

U.S. GAAP permits entities that don't meet the definition of a public business entity (PBE) to elect certain private company accounting alternatives (e.g., amortization of goodwill and not separately recognizing certain customer-related intangible assets from goodwill in a business combination). However, Tier 1 and Tier 2 issuers will meet the definition of a PBE because of the requirement to file financial statements with the SEC.

Tier 1 and Tier 2 issuers will need to reverse the effect of any private company alternatives previously elected in their financial statements before they file a Regulation A offering with the SEC. This requirement may be complicated and costly for companies that had previously elected private company alternatives.

**Option to Delay Implementation of New Accounting Standards.** Consistent with the treatment of emerging growth companies under the JOBS Act, the final rules permit issuers to delay the implementation of new financial accounting standards issued by the FASB to the extent these standards allow non-PBEs to delay implementation. Issuers that elect the extended transition period must disclose this choice at the time of filing the offering statement and may not elect the extended transition period for some standards but not others. If an issuer does not elect the extended transition period, it may not rely on the accommodation in any future filings. An issuer that has elected the extended transition period may early adopt a new or revised financial accounting standard if permitted by the standard, without being deemed to have elected non-PBE transition periods for purposes of subsequent new or revised financial accounting standards.

**Age of Financial Statements.** For filings made more than three months, but no more than nine months after the end of an issuer's most recently completed year, a balance sheet as of the two most recently completed fiscal year-ends must be included. For filings made more than nine months after the end of an issuer's most recently completed year, the balance sheet is required to be dated as of the two most recently completed fiscal year-ends and an interim balance sheet must be included as of a date no earlier than six months after the end of the most recently completed fiscal year. If interim financial statements are required, they must cover a period of at least six months and may be unaudited.

**Financial Statements Required for Entities Other Than the Issuer.** Issuers are required to comply with Regulation S-X for financial statement requirements for entities other than the issuer including:

Rule	Requirements
3-10	Financial statements of guarantors and the issuers of guaranteed securities
3-16	Financial statements of affiliates whose securities collateralize an issuance of securities
4-10	Financial statements provided in connection with oil and gas producing activities
8-04	Financial statements of businesses acquired or to be acquired
8-05	Pro forma financial information for business acquisitions
8-06	Income statements for real estate operations acquired or to be acquired

Issuers would follow the same requirements for the periods to be presented, including the age of financial statement and audit requirements listed above for the financial statements of entities other than the issuer. For a Tier 1 issuer, these financial statements would only be required to be audited to the extent the issuer had already obtained an audit of them for other purposes.

**Non-Public Submission of Draft Offering Statements.** Issuers may submit draft offering statements to the SEC for non-public review prior to filing.

**Solicitation Materials.** Issuers may solicit interest in a potential offering with the general public before or after the offering statement is filed, if solicitation materials are filed with the SEC.

**Completion or Termination of the Offering.** The final rules require Tier 1 issuers to file a new Form 1-Z within 30 calendar days after completion or termination of the offering. This form would provide summary information on the recently completed offering and update certain issuer information. Tier 2 issuers may provide this information on Form 1-Z or in their annual report on Form 1-K, which is described below.

### Ongoing Reporting Requirements for Tier 2 Issuers

Prior to adoption of the final rules, Regulation A required issuers to file with the SEC every six months to report sales. Under the final rules, Tier 1 issuers are no longer required to file periodic reports. However, Tier 2 issuers are required to file periodic reports on newly created forms as summarized in the following table.

Reporting Requirements	
Annual Reports on Form 1-K	Financial statements prepared on the same basis, and subject to the same requirements for audit standards and auditor independence, as the financial statements required for the offering to be filed within 120-calendar days after the issuer's year-end.
Semiannual Reports on Form 1-SA	<p>Unaudited, condensed financial statements that are not required to be reviewed by an independent accountant filed within 90 days after the end of the first six months of the issuer's fiscal year.</p> <p>There is no requirement for the issuer to specifically disclose that the financial statements have not been subject to a review by an independent accountant.</p>
Current Reports on Form 1-U	Filed within four business days after the occurrence of certain events, similar to Form 8-K reporting requirements (e.g., auditor changes, non-reliance on previous financial statements, departure of certain executive officers, etc.).

**Sarbanes-Oxley Requirements.** Issuers are not required to file as exhibits to their annual and semi-annual reports the certifications mandated by Sections 302 and 906 of the Sarbanes-Oxley Act. Additionally, issuers are not required to include in their annual report a management report on internal control over financial reporting, nor is an audit of internal control over financial reporting required. Audits of Tier 1 and Tier 2 issuers performed under the standards of the PCAOB are not subject to inspection by the PCAOB.

**Termination or Suspension of Ongoing Reporting Requirements.** Tier 2 issuers are permitted to immediately terminate or suspend their ongoing reporting obligations at any time after completing reporting for the fiscal year in which the offering statement was qualified by filing a Form 1-Z, if certain criteria are met, including:

- The issuer has filed all reports required by Regulation A for the shorter of (1) the period since the issuer became subject to such reporting obligation, or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing Form 1-Z;
- The securities of each class to which the offering statement relates are held by fewer than 300 persons (1,200 persons for banks or bank holding companies); and
- Offers or sales made in reliance on a qualified Tier 2 offering statement are not ongoing.

**Disclosure Effectiveness.** The final rules permit issuers to incorporate by reference certain information previously submitted or filed on EDGAR, but they must include a hyperlink to the material. In a change from the proposed rules, the final rules do not limit the availability of incorporation by reference to information previously filed pursuant to Regulation A. The SEC states in its release that it believes this change will help investors receive consistent, required information that previously was provided on EDGAR. Additionally, to avoid unnecessary repetition of disclosure items, the forms required by the final rules encourage issuers to cross-reference items within the form, where applicable.

### KPMG Observation

The objective of encouraging cross-referencing is to eliminate redundancies in different sections of filings. This objective is consistent with the SEC's public comments on its disclosure effectiveness initiative.<sup>7</sup>

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<sup>7</sup> See KPMG's Issues In-Depth, "2014 AICPA National Conference on Current SEC and PCAOB Developments," available at [www.kpmginstitutes.com](http://www.kpmginstitutes.com).