

THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

BDO KNOWS: **THE JUMPSTART OUR BUSINESS STARTUPS ACT**



► **SUMMARY**

On April 5, 2012, President Obama signed the Jumpstart Our Business Startups (JOBS) Act into law.¹ The Act was approved by Congress in late March. A primary goal of the JOBS Act is to improve small companies' access to public capital markets. The Act amends a number of provisions of the securities laws to ease the process and costs associated with raising capital from the public.

To encourage private companies to complete initial public offerings (IPOs) of their equity, the Act creates a new category of filers called emerging growth companies (EGCs) which are entitled to certain reporting relief. EGCs are defined as companies with less than \$1 billion of revenue in their most recently completed fiscal year. Companies who first sold their common equity in an initial public offering prior to December 8, 2011 would not be eligible for emerging growth company status. Filers will maintain their emerging growth status for five years following their IPO unless they have annual fiscal revenues that exceed \$1 billion, become a large accelerated filer (have market value of stock held by non-affiliates of at least \$700 million), or issue \$1 billion or more of non-convertible debt in a three-year period.

The emerging growth company status permits reduced disclosures in an IPO registration statement and provides a temporary exemption from certain financial reporting and governance requirements thereafter.

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¹ The complete text of the law is available at: <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf>

This reporting relief allows an EGC to:

- Submit an IPO registration statement with two years of audited financial statements and selected financial data (in lieu of the three years of audited financial statements and five years of selected financial data usually required). In annual reports filed subsequent to the IPO, EGCs are required to include the same number of years of audited financial statements as non-EGCs (i.e., three years unless the company qualifies as a smaller reporting company). Similarly, data for additional years would be added to the selected financial data table at the same time as full financial statements for those years are presented.
- Submit an IPO registration statement confidentially to the SEC. The initial registration statement and subsequent amendments would then be made public no later than three weeks prior to the IPO roadshow.²
- Not provide an auditor's report on the company's internal control over financial reporting (management's report on internal controls is still required).
- Adopt new accounting standards using the effective dates applicable to nonpublic companies (if the standard applies to nonpublic companies)³.
- Disregard certain governance requirements related to executive compensation (i.e., say-on-pay, say-on-frequency and say-on-golden parachute arrangements).
- Comply with smaller reporting company requirements for all other executive compensation disclosures.
- Disregard any future PCAOB rules requiring mandatory audit firm rotation or auditor discussion and analysis. EGCs are also exempt from other PCAOB rules enacted after the effective date of the Act unless the SEC determines such rules to be critical to investor protection.

BDO OBSERVATION

Concerns exist that the reporting relief provided to EGCs, particularly the exemption from the audit of a company's internal controls, will erode investor confidence and protection. Whether the investor community will share these concerns and demand higher risk premiums for investing in EGCs remains to be seen.

Other significant changes to securities laws:

- Eliminate an SEC ban on general solicitation and advertising in Regulation D offerings and 144A offerings if all of the participating investors are accredited investors if the offering is a regulation D offering, or a qualified institutional buyer if it is a 144A offering.
- Require the SEC to adopt rules permitting public offerings of up to \$50 million that are exempt from registration.⁴
- Authorize "crowdfunding" by exempting companies raising \$1 million per year or less from the standard SEC registration process. Certain filing requirements would still apply. The intent is to allow limited-size offerings, principally via the internet, to enable small amounts to be sold to a large number of investors. Participating investors need not be accredited but would be subject to specific purchase limits.
- Raise the number of shareholders of record a nonpublic company is allowed to have before it is required to register with the SEC. The threshold has been increased from 500 to 2,000, as long as there are less than 500 unaccredited investors. Nonpublic banks and bank holding companies would not be subject to the 500 unaccredited investor threshold.
- Allow a nonpublic bank or bank holding company to terminate its SEC registration with a larger number of shareholders of record. Such an entity may terminate its registration when the number of shareholders of record is less than 1,200. The previous requirement was 300. The shareholder threshold for SEC deregistration for all other companies remains at 300.

² The SEC staff has provided guidance for submitting registration statements in this manner, which is available at: <http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm>, and a related FAQ at <http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm>.

³ If an EGC elects to follow the standard to the same extent as a non-EGC, the EGC must notify the SEC of such choice and follow that choice for all standards.

⁴ The process envisioned here appears to be similar to that currently permitted by Regulation A, under which a private company can make a public offering of up to \$5 million of securities and remain a private company.

- Require the SEC to conduct a number of studies, most notably one which reviews the disclosure requirements of Regulation S-K to determine how the registration process can be simplified and costs reduced for emerging growth companies. The SEC is required to complete this study within 180 days.
- Require the Comptroller General to conduct a study on the impact of state securities laws (i.e., Blue Sky laws) on Regulation A offerings.
- Remove specific restrictions placed on brokers and analysts to communicate with potential investors and emerging growth companies even if they are participating in the offering.

BDO OBSERVATIONS:

While a number of the Act's provisions are self-executing, SEC rulemaking is required to implement several others. We expect SEC rulemaking in the coming months to implement the Act and make conforming changes to its rules and regulations. Additionally, we anticipate that interpretive guidance will be needed to address application and transition questions, particularly those related to what issuers should do during the period before the SEC completes this process. For example, in addition to the guidance referred to in footnote 2, the SEC has recently issued FAQs with respect to Title I at <http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm> and the changes in requirements for Exchange Act registration and deregistration at <http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm>. The SEC has also created a portal for providing input related to SEC rulemaking at <http://www.sec.gov/spotlight/jobsactcomments.shtml>. Additionally, 14 law firms have already collaborated to issue a consensus report on the impact of the Act on private offerings during the period prior to SEC rulemaking. See http://www.davispolk.com/files/uploads/CapitalMarkets/General_Solicitation_MultiLaw_Firm_QAs.pdf.

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