

Is an IPO the right answer for your company?

Gauge your readiness

Proper planning is essential for a successful initial public offering (IPO). Even before you start the IPO process, candidly evaluate your company's overall level of readiness. For instance:

- Your organization may need to hire additional internal legal, financial and investor relations professionals with the knowledge and experience to navigate the IPO process and the subsequent demands of being a public company.
- Your company may also need to engage new external advisers, solicit additional independent board members, and possibly amend its legal and capital structure.
- It may be prudent to upgrade accounting and reporting systems as well as internal policies and procedures.

While each of these steps may take a considerable amount of time to complete, failure to address one or more of these items before launching the IPO process could cause significant delays and divert management's attention.

Timing

The actual IPO process itself typically takes four to six months. It involves, among other things:

- Preparing the registration statement to be filed with the Securities and Exchange Commission (SEC)
- Working with the SEC staff to address comments or questions related to the filing
- Articulating the company's performance, strategy and future prospects to potential investors to build excitement around the offering

Unfortunately, even a superbly planned IPO can sometimes falter. Unfavorable market conditions or unresolved SEC staff comments on the registration statement can cause significant delays or force the offering to be suspended.

That said, the probability for success improves when a company is prepared well in advance. Organizations often begin planning the transition to a public company at least a year before commencing the IPO process.

Factors to consider when preparing for an IPO... and beyond

An IPO should not be viewed as a "special project" — a discrete event that can be staffed with surge resources, consultants and contractors.

Instead, your business needs the right people, processes and systems in place that not only will support the company in completing the public offering but in meeting its ongoing responsibilities thereafter.

The following are examples of specific areas to be evaluated well in advance of filing a registration statement with the SEC.

Operational considerations

Performance and growth trends. There is no perfect time to go public. Ideally, an IPO candidate has attained a reasonable size to make it an attractive investment. Perhaps most important, the company must have strong prospects for continuing growth. Once a company has reached the desirable level of performance and growth trends, it must be ready to take advantage of favorable IPO market conditions.

Public image. A public relations (PR) firm may help cultivate a positive public image with investors, analysts and the business press. For instance, a PR firm can distribute news releases and other company information and also coordinate interviews and industry conference appearances.

Liaison officer. A company going public typically designates a liaison officer, or a point person, to coordinate all activities related to the initial offering. This officer will work with investment bankers, auditors and counsel to ensure that deadlines are met and any questions raised are answered by the appropriate parties.

Telling the company's story

Identify and refine key messages. To successfully market the company, management must articulate a thoughtful, compelling value proposition to potential investors. This includes explaining the company's historical performance as well as providing insight into the company's position within its industry, its prospects for future growth and its strategy to grow after the IPO. Expect to spend a significant amount of time developing and refining the company's story and presenting it to potential investors.

Test the waters communications. All issuers are permitted to engage in discussions with certain investors prior to filing the IPO registration statement, to gauge market interest in a possible IPO. This allows companies to evaluate their prospects for success prior to incurring a lot of costs.

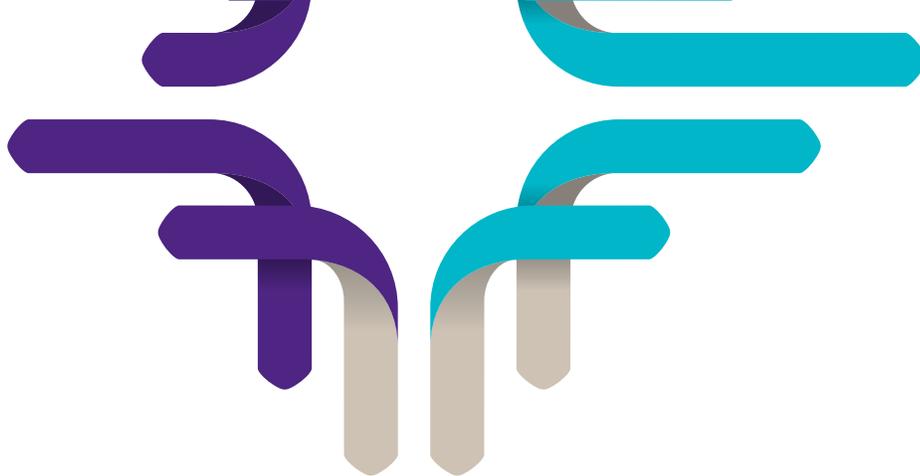
Roadshow. While a company waits for its registration statement to be declared effective by the SEC staff, investment bankers will organize a "roadshow" to build excitement around the offering. This is a critical opportunity for management to explain the company's value proposition to potential investors.

Finance and accounting matters

Audited financial statements. The initial registration statement (and subsequent annual reports, once a company is public) must contain the company's audited financial statements.¹

- It can be complex to identify which financial statements are required if the company came together via a "put-together" transaction or grew via acquisitions, or if the company is being spun off from a larger organization.
- SEC regulations specify the number of years of audited financial statements to be included in the registration statement.
 - Many companies are obliged to file audited balance sheets as of the end of the two most recent fiscal years, and audited statements of income, cash flows and shareholders' equity for each of the three most recent fiscal years. However, smaller reporting companies and emerging growth companies (EGCs) are permitted to file audited statements of income, cash flows and shareholder's equity for only the two most recent fiscal years.

¹ In the registration statement, audited financial statements may also be required for any significant acquired or to be acquired businesses or investments.



- The audits of the company's annual financial statements must be performed by an independent accounting firm that is registered with the Public Company Accounting Oversight Board (PCAOB), and the audits must comply with PCAOB standards. In some cases, auditors might have to re-perform certain aspects of the audit if the audit had been carried out previously under the standards of the American Institute of Certified Public Accountants.
- In its financial statements filed with the SEC — either as part of the initial registration statement or after going public — a company may not use any private company council accounting alternatives or accommodations available to entities that are not a public entity or enterprise as defined under certain U.S. GAAP standards. In addition, the financial statements included in the registration statement must comply with the requirements of Regulation S-X. For example, the SEC requires certain additional financial statement disclosures that are not applicable for nonpublic companies, and it has age requirements after which financial statements for a more recent period are required. To prepare, a company may include full public company disclosures in its financial statements in the year or two prior to filing a registration statement, so that these statements are already available at the time of the IPO and the company has requisite processes in place to gather all the required information for preparing such financial statements within the prescribed timelines on an ongoing basis.

Interim financial statements. In the IPO registration statement, companies may need to include interim financial statements, depending on the timing of the anticipated effective date of the registration statement. After going public, companies must file quarterly financial reports on Form 10-Q. Companies will greatly benefit if they have the right systems, processes and resources to meet this requirement before beginning the IPO process. As a best practice, companies might consider producing quarterly financial reports within prescribed SEC timeframes for a few periods prior to filing a registration statement with the SEC. Note that a company's independent public accountants must review the company's interim financial statements included in Form 10-Q before they are filed with the SEC.

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Financial statements of other entities. A company may be required to include in its SEC filings financial statements of other entities, such as a significant acquired business or equity method investee. In recent years, the SEC staff has encouraged companies to contact them with any pre-filing waiver requests when the company believes that existing rules result in an anomalous conclusion and their proposed alternative presentation or disclosure is reasonable and consistent with investor protection. In addition, financial statements of other entities included in an SEC filing should comply with Regulation S-X and accounting standards applicable to public business entities.

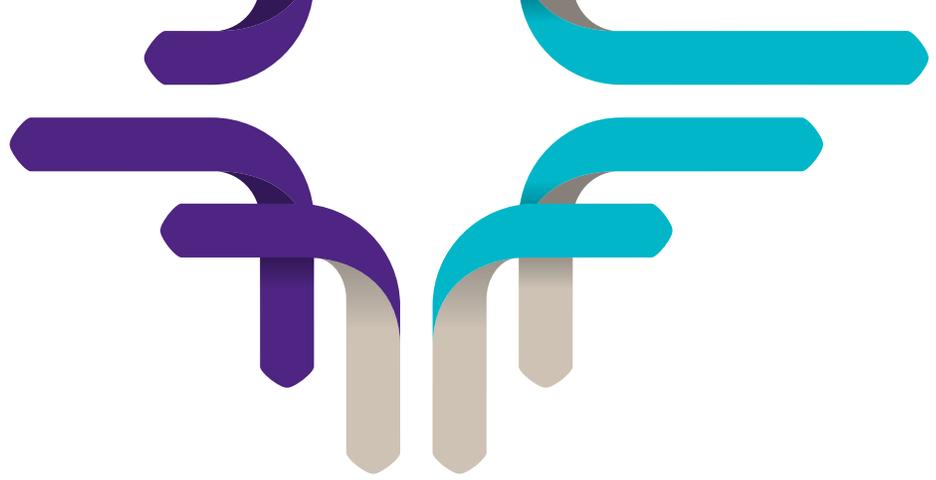
Complex transactions. To prepare for an initial offering, companies review any unusual, complex or significant accounting transactions with their accounting and legal advisers. For example, in a put-together transaction, determining which entity is the accounting acquirer could be complex and require significant judgment. Further, companies often prepare contemporaneous support and documentation for valuations of equity awards granted to officers and employees prior to going public. Companies also review past tax positions and consider resolving any uncertainties with the taxing authorities to minimize possible investor concerns. The SEC staff will almost certainly focus on complex transactions when reviewing the company's registration statement. A company might benefit from "pre-clearing" certain of its accounting and reporting conclusions with the SEC staff before filing an initial registration statement.

Certifications. The CEO and CFO must certify to the completeness and accuracy of both quarterly and annual reports. Pre-IPO, a company should develop internal policies, procedures and controls that provide comfort to these executives so that they can sign the certifications in good faith.

Internal controls. The SEC staff has indicated that it expects existing material weakness(es) to be disclosed in an IPO registration statement. Subsequently, management will be required to assess the effectiveness of the company's internal control over financial reporting in its second annual report after completing its IPO (and on an annual basis thereafter).² As this is a huge undertaking, many companies begin to design, implement and document the company's internal control processes in the year or so before going public.

- Often, companies will engage qualified external consultants to assist with this activity.
- In addition, management may decide to seek assistance of third-party service providers for certain accounting functions, such as valuations of share-based payment awards and other fair value measurements.

² In addition, the independent auditor will be required to attest to the company's internal control over financial reporting effectiveness, unless the company is an EGC or a non-accelerated filer.



Management’s discussion and analysis (MD&A).

The registration statement and all future quarterly and annual reports filed with the SEC will contain MD&A — a narrative describing the company’s performance and liquidity. Writing a comprehensive MD&A is a major step toward operating like a public company. MD&A is a perennial area of focus in SEC staff filing reviews and is the most frequently commented upon area of SEC filings. Therefore, companies may draft an MD&A as part of their quarterly and annual financial statement closing process — pre-IPO — to practice putting together this critical financial analysis.

Compensation discussion and analysis (CD&A).

Many public companies will be required to present a CD&A in the IPO registration statement, as well as in future annual reports or proxy statements.³ The CD&A provides a comprehensive discussion of a company’s compensation policies. For instance, a CD&A must include a robust description — including metrics presented in a number of different compensation tables — around how pay is tied to performance. The CD&A details how performance is defined, and includes a discussion of any peer group benchmarks and compensation consultants employed. Because the CD&A is an area of SEC focus and requires extensive qualitative and quantitative disclosure, it may be beneficial to draft a CD&A well in advance of going public and have it reviewed by legal and compensation experts.

Legal and capital structure considerations

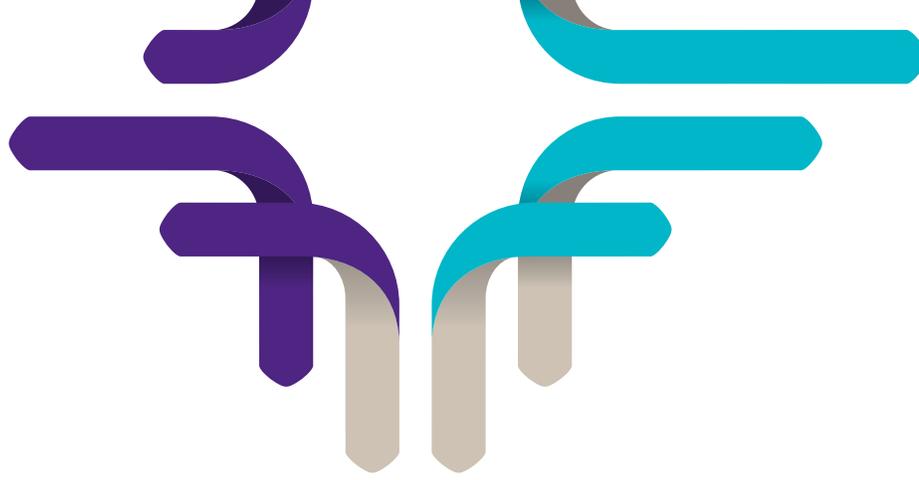
Legal structure. Public companies generally are a C corporation in legal form⁴, or a regular taxable corporation. Companies that are limited liability companies or S corporations generally terminate that status and become a C corporation either before the offering or as a result of the IPO transaction. Companies that are going public as a result of roll-up or put-together transactions — or that have undertaken some form of reorganization in connection with the IPO — will have some additional challenges. Throughout the IPO process, companies and their advisers carefully consider the tax implications of the IPO, including any changes needed to implement a tax-efficient IPO structure.

Capital structure. An IPO may be affected by the number of currently authorized and outstanding shares. If there is a relatively small number of shares authorized and outstanding, the company may wish to enact a stock split; companies may need to amend their corporate charters to authorize the issuance of additional shares. Conversely, if there is a relatively large number of shares authorized and outstanding, the company might wish to consider a reverse stock split. A company may also need to simplify a complex capital structure by redeeming any preferred stock or converting those shares into common stock prior to, or in conjunction with, the IPO.

Restricted stock. Restricted stock can be sold only in compliance with special SEC regulations. If your organization has issued restricted stock, consult with qualified legal counsel to ensure compliance with these regulations in advance of going public.

³ Smaller reporting companies and EGCs are exempt from providing a CD&A.

⁴ There are some exceptions for real estate investment trusts, master limited partnerships and certain asset-backed securities structures.



Corporate governance. In the United States, a company must comply with specific listing standards, depending on which exchange the company plans to list its shares (such as the NYSE or Nasdaq). The individual exchanges mandate requirements around board and audit committee composition, independence, the internal audit function, and having a code of ethics for employees and directors. While SEC rules provide phase-in periods to comply with certain requirements, investors may expect companies to follow best practices in corporate governance at the time of the IPO.

Board composition. Once public, a company's board of directors assumes greater accountability and responsibility. It is therefore important that board members have appropriate credentials and meet independence requirements. When the existing board consists of friends, relatives or colleagues who are not sufficiently qualified or independent, a company may change the board's composition in advance of going public.

Audit committee. A public company must have an audit committee.⁵ The audit committee's primary responsibility is to provide independent review and oversight of the company's financial reporting process, internal controls and independent auditors. All members of the audit committee must be independent. After completion of the IPO, a public company is required to disclose⁶ in its annual report whether it has at least one "audit committee financial expert" serving on its audit committee, the name of the expert and whether the expert is independent of management. If a company does not have an audit committee financial expert, it must disclose this fact and explain why it doesn't.

Other considerations. Prior to going public, a company works with its securities counsel to review and — if necessary — modify the company's articles of incorporation, bylaws and existing shareholder agreements. Legal counsel also reviews for material leases, royalty agreements, acquisition agreements, supplier contracts and other important arrangements, as these may need to be furnished to the SEC — and made publicly available — as part of the IPO registration process.

Follow steps to create a painless transition

During and after the IPO process, your company will take on a number of new fiduciary responsibilities to its public investors and regulators. For some, it can be a difficult transition from private to public company status. However, with proper planning and discipline, an organization can make a relatively painless evolution to a public organization.

For more on IPOs, see [Is going public the right answer?](#), [IPO regulations and reporting requirements](#) and [Navigating the IPO process](#).

⁵ Or, if no such committee exists, the entire board of directors will be designated as the audit committee.

⁶ Audit committee financial expert disclosures are not required in the first annual report for smaller reporting companies.

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