DECIDING TO TAKE YOUR COMPANY PUBLIC?

An initial public offering (IPO) is a demanding process and a pivotal point for any company. The two most important questions to ask yourself are: “why are we going public?” and “are we prepared?” Every company is unique and has different reasons and motivations as to why an IPO is the right path. Whether your motivation is to raise capital, improve investor liquidity, or strengthen equity, you must determine if an IPO is the right path for you. It’s crucial to understand the advantages and drawbacks, as well as the alternatives to going public.

ADVANTAGES

- Access to capital markets
- Increased brand awareness
- Stronger position for acquisitions
- Attract quality employees
- Increase ability for future financing

DISADVANTAGES

- Financial Reporting timelines
- Increased exposure and transparency
- Loss of equity ownership
- Increased operating expenses
- Pressure from investors

It would be advisable to assess the alternatives to an IPO, which include obtaining bank loans, private placements, partnerships, reverse mergers, and venture capital financing. After careful consideration of “is an IPO the right path?”, the next step is to determine if you are ready to go public.

ARE YOU PREPARED? – DO YOU HAVE EXPERIENCED INDIVIDUALS ON YOUR TEAM?

Your accounting and financial reporting team, whether internal or outsourced, should have extensive expertise with the reporting requirements of the Securities Exchange Commission (SEC). The reporting requirements of privately held companies can vary significantly from publicly held companies, depending on the nature of the Company’s business and the complexities of the Company’s transactions. Not only should you assess the capacity of your accounting team members, but it also highly recommended to assess other areas/team members including the effectiveness of the Company’s internal controls, members of governance, proficiency in tax law, legal counsel experience, and investor relations. An IPO is no easy feat, so you want to make sure you have the right people helping you through this process.

TIME CONSIDERATIONS

Two years of audited annual financial statements will need to be presented in an IPO, assuming the Company will be filing as an Emerging Growth Company (EGC) or a Smaller Reporting Company (SRC), otherwise, three years of audited financial statements will need to be presented. Audits of financial statements take time so it is important to be cognizant of the fact that the financial statements must meet age requirements, or they go “stale”. Financial statements are considered “stale” if the time between the latest balance sheet presented, and the date of the IPO filing, is more than 134 days. Awareness of this timeline can help avoid any potential delays in the filing.

ACCOUNTING CONSIDERATIONS

If your Company has never been through an audit process it might be advantageous to perform a “Test Run” prior to initiating the IPO process. A “Test Run” will help you determine if the Company can perform a financial close and have an audit complete before the required SEC filing deadlines. Not only will this help to gauge any timeline issues, but it will help locate areas of financial reporting weaknesses or complexities that can potentially cause delays in an IPO process.

Common areas of complex accounting can include, but are not limited to, debt agreements, equity agreements, share-based compensation, revenue recognition, fair value of financial instruments including derivatives, warrant liabilities, and embedded conversion features.

REVIEW DEBT AGREEMENTS

The accounting treatment for debt instruments can be complex, not only due to the terms and features of the agreement itself, but the ability to understand the accounting guidance. Debt instruments can come in a variety of types, each including unique features which can be accounted for differently. Some common types of debt include convertible debt, perpetual debt, share-settled debt, and indexed debt, all of which can include terms that may not be entirely clear on to how to account for in the guidance. One important feature that is often present in debt agreements is embedded derivatives. A contract itself may not be a derivative, but it may contain embedded features that are required to be bifurcated and recognized separately from the contract. Debt instruments should be carefully assessed for any terms that vary the amount or timing of settlement. Typically, you would see embedded derivatives when a contract has conversion terms, redemptions, or certain contingencies.

Just as important as the terms of an agreement, modifications and restructurings are as well, and no less complex. Anytime after issuance of debt, if the company modifies or exchanges with the same lender, an assessment will have to be done to determine whether this change was a troubled debt restructuring, and if not, an extinguishment or modification.

REVIEW EQUITY CONTRACTS

The form of equity interest can vary based on the type of your company, but generally, you will see equity in the form of common shares and preferred shares. Just like debt, equity contracts will vary based on unique terms each contract contains. Common shares tend to be perpetual in nature and include voting and dividend rights, and residual interest in a liquidation. Whereas preferred shares can fall into different categories based on if they are perpetual or redeemable, and if they are convertible or not. In addition, the guidance may require certain types of shares of stock to be recognized as liabilities or, in some cases, assets. Furthermore, SEC registrants may be required to classify certain types of redeemable equity instruments as temporary equity, as it is outside the classification of an asset or liability.

REVIEW YOUR REVENUE RECOGNITION POLICY

Depending on the nature of your company, your revenue recognition policy might not be too complex. Regardless of the complexity of the policy, the SEC heavily weighs their attention in this area. Attention to detail is crucial to reduce the chance of receiving comments from the SEC. Some topics that warrant further consideration are bill and hold agreements, upfront fees, collaboration agreements, reseller arrangements, and presentation of gross vs net. Articulating your company’s revenue policy within the financial statement’s disclosures has become increasingly important. Be sure to understand your contractual performance obligations, determination of the transaction price, if variable consideration exists, how the transaction price is allocated, and when/how is the performance obligation(s) satisfied.

POTENTIAL NEED FOR A VALUATION SPECIALIST

Depending on the financial instruments issued by your company, a valuation specialist may be needed. If after review of your company's debt agreements you have determined derivatives exist, or if you have issued equity contracts, like stock options, warrants, and forward equity contracts, a valuation specialist will most likely be needed. The SEC expects companies to disclose all significant estimates and methodologies used. Using a third-party valuation service will help ease difficulties around these disclosures, as well as the computation of share-based compensation and any potential violations under Section 409A.

RRBB IS HERE TO HELP

In today's ever-changing regulatory environment, it is becoming increasingly difficult for management of public companies to keep up, requiring the need for talented professionals who understand the complex rules associated with regulatory compliance. Whether your company is looking for an outsourced accounting team to help with bookkeeping, preparation of financial statements and SEC documents, or a Public Company Accounting Oversight Board (PCAOB) registered audit firm, RRBB has the capacity to assist you. Over the years, RRBB has assumed many different roles to support various companies in their IPO journey.

ABOUT THE AUTHOR

Stephen McSweeney, CPA, is a Supervisor in the RRBB Assurance and Client Advisory Services Groups. He manages audits and reviews of both publicly and privately held companies and assists companies in their "going public" process. Stephen works with public companies and those going public in a wide range of industries. He received his Bachelor of Science in Accounting in 2016 from Penn State. Stephen is a Certified Public Accountant in New Jersey.

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