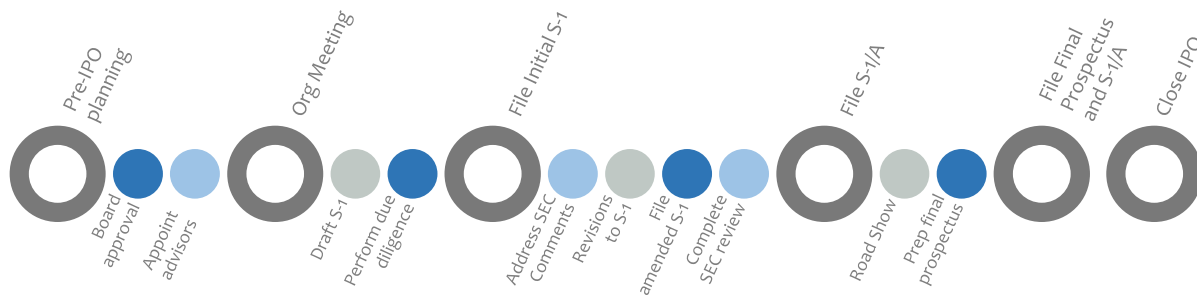


IPO Readiness: Common accounting issues



Executive Summary

- The first step in the IPO process is to select a lead underwriter, legal counsel, and independent auditor
- The Org Meeting establishes the timeline and work-plan for the IPO
- Drafting an S-1 typically takes 3-6 months and could include several rounds of comments from the SEC
- Once the SEC review is complete, the Road Show begins
- Following the Road Show, the final S-1 is filed
- Once the offering is declared effective, the sale of securities to the public may proceed

IPO Process Overview

Companies pursuing an initial public offering (“IPO”) must file their audited financial statements with the SEC in a registration statement on Form S-1 (“S-1”). Once board approval is obtained, the first step in the process is to select a lead underwriter, legal counsel and an independent audit firm. Once the IPO team is in place, the project is initiated with an Organization Meeting (“Org Meeting”). The Org Meeting involves all key parties and establishes a timeline and work-plan for drafting the S-1.

Following the Org Meeting, the drafting of the S-1 begins. Many companies hire an accounting advisor to assist with the rigors of preparing an S-1. Legal and financial due diligence is performed throughout the process to ensure that the filing does not contain inaccurate or misleading information and that nothing material is omitted. Once the initial S-1 is filed, the SEC has 30 days to provide comments. Management and their advisors must respond to each SEC comment in writing. If revisions to the S-1 are necessary, an amended S-1 is prepared and filed. Companies should expect to receive follow up comments on their responses and questions from the SEC on any new information included in amended filings. Once the SEC review is complete, management begins the “Road Show.” Typically a week in duration, the Road Show includes meetings with analysts, brokers and institutional investors to promote the offering.

After the Road Show, the final amendment to the S-1 is filed, which includes the offering price, underwriter’s discount or commission, and the net proceeds to the company. Shortly thereafter, the offering is declared effective and the underwriters may sell the securities to the public. At this point, the Company delivers the registered securities to the underwriters and receives payment for the shares.

Executive Summary (Continued)

- Companies should appoint independent directors and establish an audit committee before the IPO
- The fair value of options granted before an IPO may be challenged by the SEC
- EPS must be presented for all income statement periods
- Preferred Stock and Warrants may require reclassification
- Stock-splits must be reflected retrospectively in the financial statements
- Certain pro forma financial information must be presented
- SOX compliance is not required until the second annual report, however, key internal controls should be implemented early-on

Organizational Considerations

There are a myriad of changes companies must undertake as they begin the IPO process. Major stock markets require that their listed companies have a majority of independent directors on their board. Well in advance of the offering, companies should appoint independent directors and create an audit committee. The audit committee must be comprised of at least one individual who is considered a “financial expert.” In addition, the NYSE and NASDAQ have certain corporate governance standards, including those related to the nomination and compensation of directors.

Accounting and Reporting Considerations

The SEC requires that S-1’s contain audited balance sheets for the two most recent fiscal years and audited statements of income, cash flows, and changes in shareholders’ equity for each of the past three fiscal years with certain exceptions for smaller companies. The Company’s latest interim financial statements must be included if the filing occurs more than 134 days from the end of the fiscal year. Third quarter financial statements are timely through the 45th day after the most recent fiscal year end at which point the audited financial statements must be included for that year.

Stock-based Compensation

The SEC routinely challenges the fair value of stock options granted in the twelve months before an IPO. Companies should carefully evaluate their option pricing and ensure that they have supportable assumptions and methodologies for establishing the fair value of their common stock relative to the eventual IPO price.

Earnings Per Share

Companies must present earnings per share (“EPS”) for each period in the income statement, including a reconciliation of the basic and diluted per-share calculations for income from continuing operations and the impact of any securities that affect EPS such as convertible debt. This calculation can be complex as companies are required to disclose the effect of preferred dividends and dividends in arrears, as well as any securities that could be dilutive to EPS.

Preferred Stock and Warrants

Classification of preferred stock and warrants on the balance sheet is a frequent focal point for the SEC. Certain financial instruments previously mezzanine-classified may require liability classification under the SEC’s rules. For example, mandatorily redeemable securities that did not require liability classification for a private company may require it under SEC rules.

Stock-Splits

Many companies declare a stock-split just prior to the effectiveness of their registration statement. Any such stock-splits should be reflected retrospectively throughout the historical financial statements.

Segment Reporting

The SEC often challenges the determination of segments and the adequacy of segment disclosures, including the aggregation of multiple segments and the basis for the aggregation.

Pro Forma Presentation

Companies are required to present pro forma financial information as though the IPO has already occurred. For example, if preferred stock or debt converts to common stock upon an IPO, the Company must present pro forma balance sheets and statements of stockholders equity to reflect this conversion. Pro forma financial information often involves a significant degree of estimation and can require complex calculations and disclosures.

Sarbanes-Oxley Compliance

Newly public companies are not required to comply with either the management or auditor reporting requirements relating to internal control over financial reporting until their second annual report. However, in the first annual and quarterly filings subsequent to the IPO, the CEO and CFO must certify that the financial statements are accurate, comply with the requirements of the exchange acts, and that the information is fairly presented. Management should implement internal controls early to allow time to assess their effectiveness.



WilliamsMarston LLC

- WilliamsMarston professionals are former Big Four experts with deep industry, operational and technical accounting experience
- We provide actionable insights into the latest technical accounting and financial reporting developments

How we can help

The IPO process can be time consuming and daunting. Many companies find that leveraging an accounting advisor, free from independence restrictions, can be critical to their success. In addition to providing valuable insights and best practices, an accounting advisor can provide experienced resources critical to meeting aggressive and conflicting deadlines.

Pre-IPO Assistance

An accounting advisor can help with planning, project management, drafting of the S-1, audit support, responding to SEC comment letters, and technical accounting advisory.

Post-IPO Assistance

Beyond the IPO, an experienced accounting advisor can assist with on-going financial reporting, training, technical accounting advisory, Sarbanes-Oxley compliance and interim management.

WilliamsMarston advises companies on the accounting and reporting for complex transactions, including IPOs, mergers and acquisitions, and carve-outs. CFO's and controllers rely on WilliamsMarston for tried and tested advice and assistance with their most complex initiatives.

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