



Preparing for a Successful IPO: What CFOs Need to Know

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Preparing for a Successful IPO: What CFOs Need to Know

An initial public offering (IPO) has long been hailed as a mark of success for up-and-coming companies. An IPO increases access to the capital markets, enhances brand recognition, brings liquidity to investors, and helps the company recruit top talent with attractive equity compensation packages.

And while various laws have encouraged the funding of small businesses and eased securities regulations for newly public companies, the accounting, legal, and regulatory requirements of going public remain rigorous. They will strain any organization that is unprepared for the IPO process.

Focusing on the traditional IPO process for a domestic company, this guide highlights the key accounting and financial reporting requirements and considerations for a company going public.



Conduct a Readiness Assessment

Your IPO readiness assessment will determine your company's preparedness to go public by identifying whether the company meets regulatory, financial, operational, and organizational requirements for a successful IPO.

But this is not just a check-the-box exercise. Your assessment serves as an opportunity to enhance corporate governance, financial management, and operational efficiency while mitigating risks and liabilities.

Using Stout's model as an example, an IPO readiness assessment will include a comprehensive review of multiple areas, discussed below.

ACCOUNTING POLICIES AND ESTIMATES

The assessment includes a review of technical accounting policies and documentation in areas such as revenue recognition, leases, financial instruments, business combinations, and stock-based compensation.

This is to assess compliance with generally accepted accounting principles (GAAP) for public business entities (PBEs) and reasonableness of related accounting estimates.

CLOSE EFFECTIVENESS

The assessment includes a review of the financial reporting close process and other business processes as needed. This is

to provide commentary and recommendations to enhance and speed up the close process to allow the company to meet the demanding reporting deadlines of the SEC. This review will also include an evaluation of the accounting information system.

FINANCIAL STATEMENTS

The assessment includes a review of the company's financial statements and footnotes to assess compliance with GAAP for PBEs and Regulation S-X. The review includes examination of the income tax provision and related disclosures.

GOVERNANCE

The assessment includes a review of the composition of the board of directors. The review will report on the presence of independent directors, gender diversity, and the existence of relevant committees (such as audit, compensation, and governance) in accordance with SEC rules, state laws, and listing requirements.

INTERNAL CONTROLS

The assessment includes a review of the design and implementation of key internal controls over financial reporting, including the adequacy of staffing and appropriate segregation of duties.



Engage Relevant Advisors

As you prepare for an IPO, you will need various advisors to help navigate the complexities of the IPO process. Auditors, legal counsel, valuation advisors, accounting and reporting advisors, and investment bankers will help ensure your company is ready for the IPO and life as a public company post-effectiveness.

AUDITORS

Public companies must have their annual financial statements audited under the standards of the Public Company Accounting Oversight Board (PCAOB). The audit firm selected must be registered with the PCAOB and is also subject to enhanced independence requirements and inspections.

As part of a PCAOB audit, your auditor will evaluate the design and implementation of internal controls as part of their risk assessment for the audit. Although the company is not subject to the provisions of Sarbanes-Oxley (SOX) until after the IPO, any material weaknesses identified need to be disclosed in the Risk Factors section of the registration statement.

UPLIFTING AICPA FINANCIAL STATEMENTS TO PCAOB STANDARDS

Pre-IPO companies often have financial statements that were previously audited under the standards of the American Institute of Certified Public Accountants (AICPA). If the same auditor is retained, the financial statement audits for the historical periods included in the registration statement must be uplifted to PCAOB standards. This may involve additional substantive testing and updated representations from management.

In a confidential submission of a registration statement, typically a dual standards opinion (i.e., both AICPA and PCAOB auditing standards) is issued, with the opinion being updated to only PCAOB standards at the time of the public filing.

LEGAL COUNSEL

Experienced legal counsel with expertise in securities law will help ensure compliance with rules and regulations throughout the IPO process. This includes those related to SEC reporting regulations, fair disclosure, and governance.

Legal counsel is generally the cornerstone of the registration statement process and should be engaged early to ensure your company is adequately prepared for its IPO.

VALUATION ADVISORS

Valuations are used to record various accounting transactions, including grants of stock-based compensation awards, issuance of certain debt and equity instruments, and business combinations, and can involve complex methodologies and significant unobservable inputs. These types of management estimates are typically areas of focus for both auditors and the SEC, and generally require the assistance of a specialist.

COMMON VALUATION AND ACCOUNTING ISSUES DURING THE IPO PROCESS

Common valuation issues for companies going through the IPO process often involve 409A valuations of the company's common stock. Leading up to an IPO, auditors and regulators are keenly focused on "cheap stock" grants awarded to management, which involve equity-based awards that may undervalue the common stock when compared to the IPO price.

Valuation specialists and accounting advisors can assist management with ensuring the progression of their stock price leading up to the IPO is supportable.





ACCOUNTING & REPORTING ADVISORS

Accounting and reporting advisors provide guidance on complex accounting issues that may arise during the IPO process. They help interpret accounting standards and provide recommendations for proper accounting treatment and reporting in accordance with applicable rules and regulations.

In addition, accounting advisors can assist with uplifting the financial statements to GAAP for PBEs and Regulation S-X, preparing financial sections of the registration statement (including Management's Discussion and Analysis [MD&A], summary financial information, capitalization and dilution calculations, and non-GAAP disclosures).

They can also assist with audit readiness, which can help free up bandwidth for management to focus on other important items in the IPO process, such as developing the equity growth narrative and meeting with potential investors.

COMMON ACCOUNTING ISSUES DURING THE IPO PROCESS

- Accounting for complex debt and equity transactions, including presentation of preferred stock
- Stock-based compensation accounting (including cheap stock)
- Earnings per share
- Segment reporting
- Certain tax disclosures and analysis (such as section 382 studies)

INVESTMENT BANKERS

Investment bankers are financial advisors that act as intermediaries between the company and potential investors in the IPO. Companies should engage an investment bank with significant experience with IPO transactions in the industry in which the company operates.

These bankers will help determine the offering size and price range given market conditions and will help management develop their equity story and pitch it to groups of potential investors.

If the investment bank is also acting as an underwriter in the IPO, they will work closely with management to determine the initial offering price, buy the securities from the company, and then sell the securities to investors in their distribution network.

The investment bank that leads the efforts to fully subscribe the offering with orders, and typically underwrites the largest portion of the transaction, is generally referred to as the “lead-left bank” or “lead-left bookrunner.” The nomenclature comes from the position of the lead investment bank’s name on the left side of the prospectus cover.

Uplift Your Financial Statements

Pre-IPO companies often have financial statements that were previously audited under AICPA standards and prepared under GAAP.

But financial statements included in a Securities Act registration statement need to be prepared under GAAP for PBEs and Regulation S-X. In addition to adhering to these enhanced accounting and disclosure standards, the financial statements are also typically put under additional scrutiny in terms of the quality and level of disclosure included in the footnotes.



REPORTING AS AN EMERGING GROWTH COMPANY (EGC) OR A SMALLER REPORTING COMPANY (SRC)

Prior to uplifting the financial statements, companies should work with the legal counsel, accounting advisors, and auditors to determine whether the company will qualify as an EGC and/or a SRC.

EGC

An EGC is not required to present more than two years of audited financial statements and MD&A in a Securities Act registration statement for an initial public offering of equity securities.

An EGC may omit financial information from a registration statement if that information is related to periods that are not reasonably expected to be required at the time the registration statement becomes effective.

An EGC also may elect to defer compliance with new or amended revised financial accounting standards until a company that is not an issuer is required to comply with such standards.

Under the JOBS Act of 2012, an EGC is not required to comply with the requirement to provide an auditor's report on internal controls over financial reporting under section 404(b) of the Sarbanes-Oxley Act for as long as it qualifies as an EGC.

SRC

An SRC is not required to present more than two years of audited financial statements and MD&A, as well as various scaled disclosure requirements under Regulation S-K, such as reduced executive compensation disclosures.

The SRC accommodations apply to the IPO, but also to subsequent Exchange Act filings (e.g., Form 10-K).

The process of uplifting financial statements to GAAP for PBEs and Regulation S-X can be time consuming and complex, and typically requires the assistance of accounting and reporting advisors, as well as close communication with the auditors.

The following are common financial statement areas that require additional documentation and/or enhanced disclosure in an IPO.

CONVERSION FROM LLC TO C-CORP

U.S. securities laws and stock exchanges require domestic registrants to be incorporated in the U.S. As such, U.S. companies that are currently organized as pass-through entities, such as limited liabilities companies (LLPs) or limited liability partnerships (LLPs), will need to convert to a C-Corp prior to their IPO.

This type of change in equity structure will require careful analysis to determine whether the rights of shareholders in each share class have changed, and how the new legal structure should be presented in the financial statements (i.e., either prospectively or retrospectively).

DEBT AND EQUITY SECURITIES

Early-stage companies often raise capital via debt and equity instruments with complex terms and conditions, usually out of necessity. These types of complex financial instruments require careful analysis to determine how they should be presented in the financial statements and to identify any embedded features that might meet the definition of a derivative and require valuation and separate accounting.

Public companies are also required to present contingently redeemable equity securities separately on the balance sheet between liabilities and stockholder's equity, in what is known as "mezzanine" or temporary equity. The determination of which securities should be classified as temporary equity can be complex and typically involve detailed analysis of the terms and conditions of each security issued by the company, including board representation and percentage of ownership of the company.

STOCK-BASED COMPENSATION

Stock-based compensation is a key area of focus for auditors, regulators, and potential investors leading up to an IPO. The analysis of historical stock-based compensation awards should include the accounting for the award itself and the grant date fair value of the award if accounted for under ASC 718.

Certain types of equity-based awards, such as profit interests, can be complex. The specific terms and conditions of the awards, including who the recipient is, and the company's history of settling stock-based awards in cash, will determine whether the award should be accounted for in equity or as a liability.

BUSINESS COMBINATIONS

Business combinations and asset acquisitions are a complex area of accounting for any company, as they typically involve valuation specialists and significant management judgments. Plus, there are additional requirements that need to be considered in an IPO.

Rule 3-05 of Regulation S-X requires companies undergoing an IPO to include in their registration statement audited financial statements of the acquiree and pro forma financial information if certain significance thresholds are met. Additionally, ASC 805 requires certain pro forma revenue and earnings disclosures in the footnotes to the financial statements if material.

EARNINGS PER SHARE (EPS)

Public company GAAP requires the presentation of earnings per share in the financial statements. For profitable companies with more than one share class, convertible instruments, and other potentially dilutive securities, these computations can be very complex. Even the slightest error in EPS can be significant to investors and other financial statement users.

As such, management will want to ensure that EPS calculations are finely tuned and compliant with applicable accounting guidance. The company will also want to continue refining the management forecast process, as being able to produce accurate EPS guidance for analysts is often a very important part of managing the company's stock price.

SEGMENT REPORTING

For each reportable segment, public companies must disclose the assets and certain income statement captions, including the performance measures regularly reviewed by the chief operating decision maker, expenditures on long-lived assets, and various other information.

Although many companies preparing public company financial statements for the first time may believe that they have only one reportable segment, the analysis begins with identifying operating segments and then aggregating them, if applicable. Identifying operating segments continues to be a common area of comments from the SEC staff.

INTERIM FINANCIAL STATEMENTS

In addition to uplifting the annual financial statements, companies must include interim financial statements under Regulation S-X in the registration statement. Although not required, many companies also include an eight-quarter table in the registration statement to illustrate the growth narrative.

The process of preparing quarterized financial information for the first time can be burdensome, especially for companies that previously only issued annual financial statements. Interim financial statements included in an SEC filing also must be reviewed by auditors under PCAOB standards.

Accounting advisors can assist management in getting quarterized financial information prepared and ready for review early in the IPO process so that it does not delay the offering.

PRE-CLEARANCES & WAIVERS

The SEC staff highly encourages companies to pre-clear with the Office of the Chief Accountant any accounting or financial reporting matters for which management, and their auditors, believe the appropriate accounting treatment is unclear.

The SEC staff also has the delegated authority under Rule 3-13 to waive certain SEC reporting requirements in situations where such rules are overly burdensome and the information is not useful to investors (e.g., waiving or limiting the requirements under Rule 3-05 for a significant business combination).

If a company feels that such a waiver is warranted, they should reach out to the SEC staff well in advance of the IPO. The process to pre-clear an accounting issue or obtain a waiver from the SEC staff may take up to a month or more depending on the complexity.

Prepare & File a Registration Statement

Equity securities offered to the public and traded on national stock exchanges need to be registered with the SEC. In a traditional IPO for a domestic company, this process occurs through a registration statement filed on Form S-1. The registration statement includes a prospectus and a significant amount of financial and legal information about the company and the securities being offered.

KEY SECTIONS IN A FORM S-1

- Prospectus Summary (“the box”)
- Risk Factors
- Use of Proceeds
- Capitalization
- Dilution
- Management’s Discussion and Analysis (MD&A)
- Business
- Executive Compensation
- Description of Capital Stock
- Underwriting
- Financial Statements





SECURITIES COUNSEL INVOLVEMENT

Your company's securities counsel will lead the effort of preparing the initial draft of the registration statement, along with input from management and other advisors. The prospectus, including the business section, should align with the company's equity story and other marketing and informational materials that may be used in the IPO process.

ACCOUNTING ADVISOR INVOLVEMENT

Accounting advisors typically assist management with preparation of the financial statements under GAAP for PBEs and Regulation S-X. They will also assist with other areas of the registration statement where financial information is presented, including summary financial data in the box, capitalization, dilution, and MD&A.

Pro forma financial information may be required if there are significant recent business combinations or changes to the capital structure commensurate with the IPO, such as issuance of additional securities, conversion of preferred stock and convertible promissory notes into common stock.

AUDITOR INVOLVEMENT

You should also keep auditors involved in the preparation of the registration statement. Although auditors only opine on the financial statements, they are required by PCAOB auditing standards to read the rest of the offering document and consider whether the financial information presented in it is inconsistent with the audited financial statements.

EGC ACCOMMODATIONS

Under the JOBS Act, EGCs may submit a draft registration statement to the SEC for confidential review, meaning the SEC staff will review it and provide comments before it is made public. The FAST Act of 2015 amended the rules for EGCs to also permit:

- **Omission of certain financial information:** EGCs may omit financial information from a Form S-1 filed (or confidentially submitted) for an IPO if that information relates to periods that are not reasonably expected to be required at the time the registration statement becomes effective.
- **Reduction of the timeframe to make confidential registration statements public:** This provision reduced the required timeframe to make a registration statement public to 15 days before the roadshow.

Finalize Registration Statement & Close Offering

Once a registration statement is filed (or confidentially submitted) to the SEC, the staff will review the registration statement and respond with comments. The SEC staff's initial review of the registration statement typically takes one month. The turnaround time for SEC staff reviews and comments for each subsequent amendment to the S-1 is typically two weeks per amendment.

COMMENT LETTER PROCESS

Comment letters from the SEC staff need to be carefully reviewed by management, legal counsel, accounting advisors, and the company's auditors. Missteps in responding to the SEC staff can cause significant delays.

Anticipate potential follow-up questions or requests from the SEC based on the initial responses provided. Remain responsive and cooperative throughout the iterative process of addressing SEC comments until all concerns are satisfactorily resolved.

Notably, all confidential submissions and correspondence with the SEC will eventually be made available to the public once the Form S-1 is filed publicly.

THE "REDS"

The last amendment to the Form S-1 prior to (or during) the roadshow will include a preliminary prospectus with an offering price range and is often referred to as the "red herring" or the "reds." The nomenclature comes from the red warning label included on the preliminary prospectus cover.

STAYING CURRENT

Financial statements included in the registration statement must be current (i.e., less than 135 days old) before responding to the SEC staff and when requesting effectiveness of the registration statement. If the financial statements are not current, the registration statement will need to be amended to update the financial statements before the company can respond to the SEC staff or request effectiveness.

Balancing the age of financial statements with the timing of the offering and responding to the SEC staff is one of the many challenges of the IPO process.

DECLARATION OF EFFECTIVENESS

When all of the SEC's comments are satisfactorily resolved, they will declare the registration statement effective. Once the registration statement is declared effective, pricing of the IPO is finalized, and the underwriting agreement is signed. It is common for a company to split its stock during this process to achieve a certain price per share at the IPO, which is a complicated and time-consuming endeavor that must be done very quickly to meet appropriate deadlines. An accounting advisor with experience in performing stock-splits and pushing the changes through the S-1 timely is crucial to avoid delays in filings.

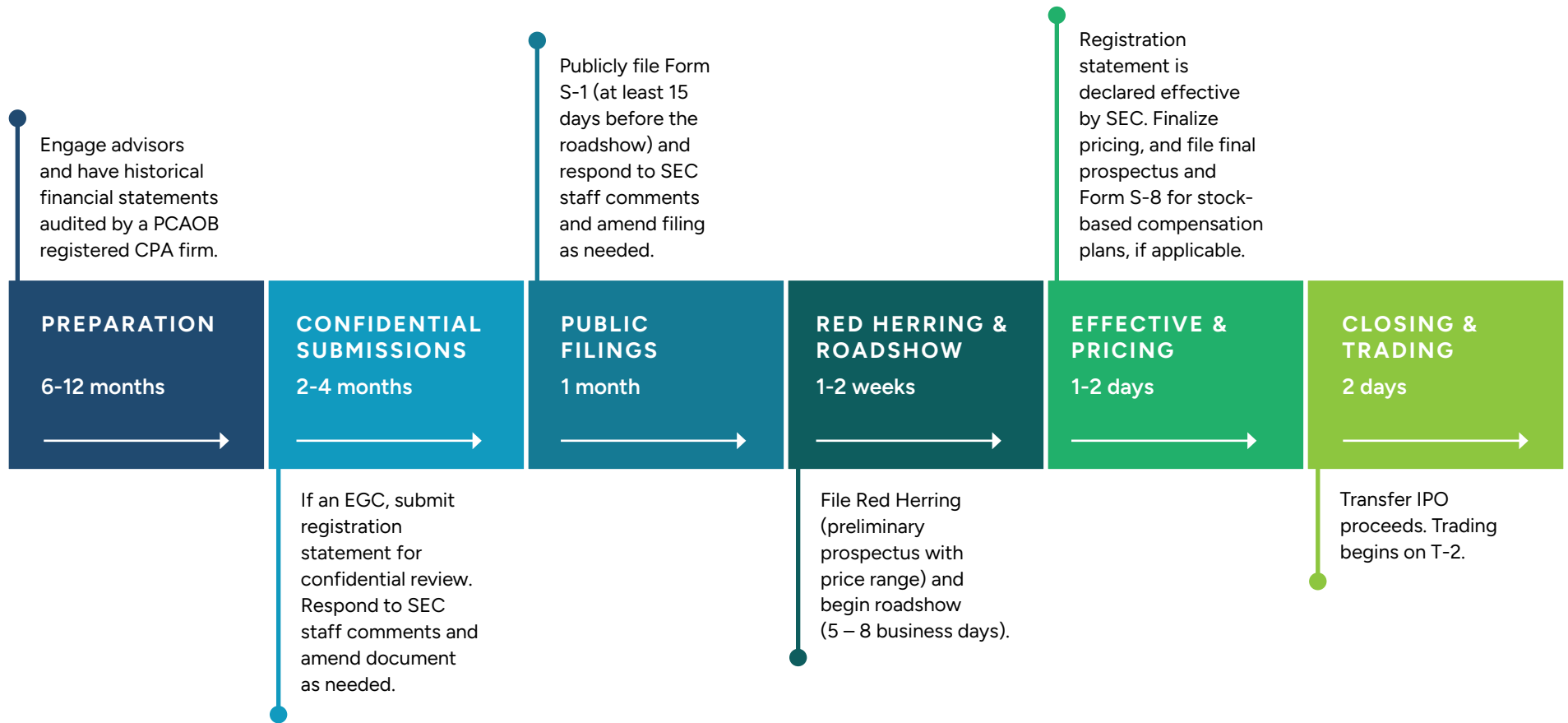
After that, the preliminary prospectus is updated to include the final offering price, and a final prospectus is filed with the SEC. The IPO closes a few days after that when IPO proceeds, net of underwriting commissions, are transferred to the company.



Final Thoughts

While the IPO process can be a time-consuming and expensive endeavor, it can provide opportunities for the company to grow through access to capital, enhanced brand recognition, and increased talent pools. Third-party advisors who have the technical knowledge of rules and regulations can help guide your company through the process to ensure success.

IPO Timeline



About Our Services

With more than 100 public company readiness engagements completed, Stout professionals assist companies through the entire life cycle of becoming a publicly traded company and remaining compliant once it is publicly traded. Whether this transformation happens through an initial public offering, reverse merger, or another path, proper planning and a comprehensive understanding of the process before and after going public is critical to a company's success.

We help clients achieve their public reporting objectives through collaboration with all parties involved. Our services include:

- Initial and interim readiness assessments
- Accounting policy development and technical accounting for complex transactions
- Preparation of registration statements and comment letter responses
- Internal controls over financial reporting
- Accounting and finance operations
- Quarterly close and reporting assessments and process implementation
- Interim and fractional CFOs and Controllers
- Project planning and management
- Audit preparation and support

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About Stout

Stout is a global advisory firm specializing in corporate finance, accounting and transaction advisory, valuation, financial disputes, claims, and investigations. We serve a range of clients, from public corporations to privately held companies in numerous industries. Our clients and their advisors rely on our premier expertise, deep industry knowledge, and unparalleled responsiveness on complex matters.

Stout Services

INVESTMENT BANKING & RESTRUCTURING

Stout's investment banking team specializes in providing mergers and acquisitions advice, private capital raising, and other financial advisory services.

TRANSACTION ADVISORY

Stout leverages its considerable deal experience to assist clients in making sound business decisions to successfully complete their critical transactions.

VALUATION ADVISORY

Stout provides expertise across a broad spectrum of industries in the valuation of business enterprises, complex securities, intellectual property, real estate, and personal property.

ACCOUNTING & REPORTING ADVISORY

Stout delivers a practical, hands-on approach to a wide range of complex accounting topics, such as business combinations, revenue recognition, and more.

DISPUTES, CLAIMS, & INVESTIGATIONS

Stout provides expert testimony and consulting, as well as investigative, claims, and compliance services for financial-related matters.

SPECIALTY & INDUSTRY SERVICES

Stout offers specialized services focused on helping companies optimize operations, reduce risk, make informed decisions, and enhance value.

PRESS INQUIRIES

Please contact Sarah Leas at sleas@stout.com for additional information.

Access our Media Kit at <https://www.stout.com/en/about/media-kit>.

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