REACHING THE PINNACLE | Guide

Going public and living as a public company

May 2024

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INTRODUCTION

The risks companies face continually evolve. Whether the risk relates to interest rates, inflation, human capital, transition to a lower carbon economy, or a threat not yet anticipated, assessing and responding is critical. Companies might want or need to raise capital in response to these risks – for example, to increase liquidity in the face of economic challenges or to take advantage of strategic acquisitions or other market opportunities. Companies wanting to raise capital might consider going public through an initial public offering (IPO). Taking your company public will significantly change your organization. Before you make the decision, be sure you know what's involved in going public – as well as the benefits and risks of doing so. To help you make that decision, we offer this guide. And if the decision is to proceed, this guide can help you plan the transition, execute the IPO, and meet the obligations of a public company.

The road from a private company to a publicly traded one is long, with tasks to accomplish, procedures to follow, and decisions to be made at every turn. We provide a realistic view of what it's like to go through the complex IPO process and practical advice for assembling the team, hiring advisers, registering with the Securities and Exchange Commission (SEC), maintaining investor relations, and taking the many additional actions the company will be required to execute.

In addition to addressing how to get past the hurdles to becoming a public company, we discuss accommodations that make the process of becoming a public company simpler for some, including emerging growth companies (EGCs).

The information here will help to prevent surprises, deepen your knowledge of the transition, and increase your understanding of the part you will play in the demanding process.

We are grateful to Luse Gorman (including John Gorman, Kip Weissman, Scott Brown, Zachary Davis, Babette Schwartz, and Keeler Fina) for its contribution in reviewing this guide.

We hope you find this guide helpful, and we welcome feedback.

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DECIDING WHETHER TO GO PUBLIC

Before exploring the details of how to take a private company public, company owners or executives must consider the basics: Why do they want to do it? What do they expect to attain in both the short run and the long run from going public, and what do they expect the tangible and intangible costs to be? Which option for going public is likely to best fit their particular situation, and when is the right time to pursue it?

WHY GO PUBLIC?

Private companies choose to go public[1] for a variety of reasons. Depending on the structure of a company, the decision to go public is made by a company's owners or the board and management team or a combination of the two. Determining an individual company's optimal capital structure, including the cost of that capital and whether capital should be raised publicly or privately, is complex.

Some companies go public to obtain additional exposure in their marketplace, others may have existing agreements with equity holders that require the entity to register shares with the SEC, and still others may want to create a liquid currency to facilitate acquisitions or raise capital to fund organic growth.

Whatever the reason, going public gives companies access to capital that likely costs less than that in the debt or equity markets otherwise available to them in the private marketplace. Companies that choose to go public and list on an exchange in the United States have access to the largest capital markets in the world. This liquidity is the driving force behind the access to capital at a lower cost than that in the private marketplace.

A liquid market for a company's capital has many advantages. For example, after a company has registered a transaction with the SEC, subsequent registrations are more streamlined, with less time and effort expended on raising capital, because the company has already prepared and has available the information a registration statement requires. Moreover, in the future the company might be allowed to use a short-form registration statement, such as Form S-3,[2] or the company might qualify as a well-known seasoned issuer (WKSI),[3] which allows almost immediate access to the capital markets.

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[1] In this publication, the act of "going public" refers to the process of a private company registering an IPO of securities with the SEC

[2] Form S-3 is a short-form registration statement that can be used by companies that have timely reported under the *Securities Exchange Act of 1934* for 12 months or more and that satisfy certain other requirements depending on the types of securities being offered. Benefits of using this form are that 1) previously filed financial statements and other required disclosures can be incorporated by reference from other SEC filings, such as the Form 10-K, into the Form S-3, 2) SEC reports subsequently filed can be incorporated by reference, and 3) the form can be used as a shelf registration statement whereby securities may be offered to investors on a delayed or continuous basis for a period of three years.

[3] A WKSI is defined by Rule 405 of Regulation C under the *Securities Act of 1933* as an issuer that, among other eligibility requirements, has been current and timely in its Exchange Act reports for at least a year and either has at least $700 million in public float or has issued $1 billion in nonconvertible securities in registered offerings in the most recent three years. WKSIs may use Form S-3 (or Form F-3 for foreign private issuers [FPIs]) as an automatic shelf registration statement, which is effective immediately upon its filing with the SEC and without being reviewed by the SEC's Division of Corporation Finance. See instruction I.D. of Form S-3.

Other advantages include the ability to attract employees with compensation arrangements that include equity shares with a liquid market and the potential to be a more attractive buyer in a business combination if shares are included in the purchase price of the acquired business.[4]

Companies seeking to raise capital should include in their analysis the alternatives to going public, such as private placements that are exempt from SEC registration, revolving credit facilities from a financial institution, and divestitures.

Alternatives to going public

Capital-raising alternatives to going public often are a result of exemptions from registration provided in the securities laws. An offering is exempt from registration with the SEC under the *Securities Act of 1933* (Securities Act) because either the transaction or the securities themselves are exempt from registration. An exempt offering might also be referred to as a private placement or unregistered offering. Exempt securities offerings also include municipal securities offerings and exempt public offerings. Private placements are done by both private and public companies as well as hedge and other funds. Exempt offerings are generally at a stated price and to a targeted group of potential investors. In the recent past, an increasing number of companies that might have raised capital through a registered offering have instead raised capital privately through private equity or venture capital investors. However, such investors typically seek a "liquidity event" within five to seven years following funding, which can include an initial public offering.

Examples of exempt transactions include:

- Private placements, including offerings under Regulation D Rule 506, Rule 144A, and Section 4(a)(2) of the Securities Act
- Small issues of securities, including Regulation A offerings and offerings under Rule 504 of Regulation D (Section 3(b))
- Regulation CF transactions (crowdfunding) (Section 4(a)(6))
- Private resales of securities (Section 4(a)(7))
- Intrastate offerings (Section 3(a)(11)), Rule 147 and Rule 147A
- The SEC provides an overview of the various offering exemptions and related rules here: https://www.sec.gov/smallbusiness/exemptofferings/exemptofferingschart

CROWE PRACTICE TIP

When assessing whether an exemption applies to a securities transaction under state and federal securities laws, consult with appropriate securities counsel, as the rules are voluminous and can be complex.

[4] Refer to the "Merger transactions" section within this chapter for more information on business combination transactions.

WHAT ARE THE OPTIONS FOR GOING PUBLIC?

Initial public offering

The most common method for a private company to become a public one is issuing common stock to new investors in an IPO. A traditional IPO is a transaction in which a private company issues new equity shares that will be listed on an exchange (alternatively, the shares might be traded in over-the-counter [OTC] markets) and that the general public is able to buy and sell. Sometimes a follow-on, or secondary, offering is consummated subsequent to the primary offering, often by filing a separate registration statement on Form S-1 (or a Form S-3, if available) in order to raise additional capital or register the resale to the public of shares previously issued by the company in a private placement.

The bulk of this publication discusses the traditional IPO process, with a focus on the primary offering of equity securities. However, there are other ways of becoming a public company, and in this section, we describe a few of those other methods.

Merger transactions

Some companies go public via a merger transaction registered on Form S-4 such that one private company issues shares in a registered exchange offering for another private company's shares. Alternatively, some companies go public via a traditional IPO and later enter into a merger transaction with another company. In such cases, the merger transaction might require a separate registration in addition to the IPO registration.

Registered debt exchange transactions

One method of going public by issuing public debt is through a registered debt exchange offer on Form S-4, a mechanism often referred to as an "A/B exchange offer" or an "Exxon capital exchange offer," after the first SEC no-action letter approving the procedure.[5] This transaction occurs when an entity issues new registered debt securities in exchange for identical debt securities that previously had been issued in a private placement. The registered debt securities become securities that can be traded freely and are not subject to restrictions of the private placement. Specific legal and form requirements for such transactions should be discussed with SEC counsel.[6]

Exchange Act registration

In some cases, companies "go public" because they are legally required to register with the SEC when they no longer qualify for an exemption under the securities laws. A common example is when a company's ownership grows to the point that the number of nonaccredited equity shareholders exceeds 500, SEC registration generally is required under Section 12(g) of the *Securities Exchange Act of 1934* (Exchange Act).

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[5] Exxon Capital Holdings Corp., SEC No-Action Letter, 1988 SEC No-Act. Lexis 682 (May 13, 1988).

[6] Section 12(g) of the Exchange Act provides the scope of issuers that must register securities as well as some exemptions from registration. The scope includes issuers that engage in interstate commerce. Issuers that do not meet the scope of Section 12(g) and are not required to register include those that have total assets of $10 million or less and a class of equity securities held by fewer than 2,000 people or fewer than 500 nonaccredited investors. For bank and savings and loan holding companies, the investor threshold is limited to 2,000 people, as the nonaccredited investor threshold does not apply.

Direct listings

Direct listings offer an alternative to the traditional "underwritten" IPO. In a direct listing, there is no underwriter, and no new shares are sold to the public. The company's outstanding shares are listed directly on an exchange, which offers liquidity for shares held by existing shareholders. The company's shares are registered on a *Securities Act* registration statement (for example, Form S-1). The registration statement includes the same financial statement and disclosure requirements, and it is subject to the same SEC filing and review process as a traditional IPO.

Special purpose acquisition companies (SPACs), reverse recapitalizations, and reverse mergers

Other methods for going public include merging with a SPAC, a reverse recapitalization, or a reverse merger. SPACs typically raise cash through a separate IPO, and the stated use of the cash proceeds from the IPO is to acquire a private operating company. After the SPAC merger, the private operating company becomes a public company. Many of the considerations for reverse recapitalizations typically apply to SPAC mergers; however, each SPAC transaction is unique and can result in various governance and financial reporting complexities.

CROWE PRACTICE TIP

In January 2024, the SEC finalized new rules that are designed to enhance investor protections and align the requirements for SPACs with those of a traditional IPO in three areas: disclosure, use of projections, and issuer obligations.

Often a reverse recapitalization occurs when a public (listed and registered) shell company acquires all of the stock of a private company in exchange for a majority of the shares of the shell company. It is common for the newly merged company to take on the name of the private company and for the historical financial statements of the registered entity to become those of the private company as predecessor of the registrant, to the extent the private company had operations. The new shareholders typically elect directors, who appoint officers of the company.

A reverse merger (or reverse acquisition) is similar to a reverse recapitalization but usually occurs with a domestic registrant that is not a shell company.[7] A reverse merger is also defined in the master glossary of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) as "[a]n acquisition in which the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes based on the guidance in [ASC] 805-10-55-11 through 55-15. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition."

A reverse merger (or reverse acquisition) is accounted for under ASC 805-40 as a business combination if the accounting acquiree meets the definition of a "business." A reverse recapitalization transaction is accounted for similarly to a reverse merger (or reverse acquisition), but it does not qualify as a business combination as it is outside the scope of FASB ASC Topic 805. No step-up in basis (that is, no goodwill or new intangible assets) is recorded in a recapitalization transaction.

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[7] Refer to ASC 805-40-25-1.

Each type of transaction is often paired with a follow-on offering because, unless the merged entity has sufficient cash available, the reverse recapitalization or reverse merger does not raise cash. The entity is likely to need the follow-on offering in order to recoup some of the costs of becoming a public company and to afford the ongoing costs of being a public company.

According to the requirements of Form 8-K, within four business days after completing the transaction, a company engaging in a reverse recapitalization must file all information that would be in a Form 10 for the combined company.[8] The Form 8-K, effectively an IPO prospectus given that it must include Form 10 disclosures, includes audited financial statements, management's discussion and analysis (MD&A), pro forma financial information, a detailed company description, and executive compensation disclosures.[9]

For a reverse merger (or reverse acquisition), given that purchase accounting must be applied to the transaction, the initial Form 8-K is due within four business days, but the financial statements and pro forma financial information can be filed by amendment to the Form 8-K no later than 71 calendar days after the date of the initial Form 8-K filing that reported the transaction.[10]

Refer to Topic 12 of Corp Fin's Financial Reporting Manual for more guidance on reverse mergers (or reverse acquisitions) and reverse recapitalizations, and see Corp Fin's disclosure guidance on reverse mergers, "Topic No. 1: Staff Observations in the Review of Forms 8-K Filed to Report Reverse Mergers and Similar Transactions."

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[8] Refer to Items 2.01(f) and 9.01(c) of Form 8-K.

[9] Refer to Item 2.01(f) of Form 8-K and to Form 10.

[10] Refer to Item 9.01(a) and (b) of Form 8-K.

WHEN IS THE RIGHT TIME TO GO PUBLIC?

Whether the owners, the board of directors, or both are responsible for deciding whether to take their company public, they should answer a series of questions to understand whether the timing is right:

- Does the company have the right professional expertise and infrastructure to take a company public? Infrastructure is not limited to staffing; it also includes IT systems, management structure, the board of directors, and internal control environment.
- Does the company meet the criteria of underwriters and the market?
- Does the valuation existing at the time of the proposed offering make sense given the owners' and management's understanding of the business?
- Is the company prepared to make disclosures at the level required for a public company?[11]
- Is the company prepared to meet the ongoing obligations of a public company?[12]
- Are the company's insiders willing to relinquish some level of control[13] and answer to public stockholders?
- Can the company meet stock exchange listing requirements?
- Is an IPO the best way to achieve the company's objectives?
- Does the company have access to key advisers, such as underwriters, SEC counsel, and an independent audit firm registered with the Public Company Accounting Oversight Board (PCAOB)?

CROWE PRACTICE TIP

If going public in order to acquire another business or businesses, consider 1) whether the infrastructure is in place both to go public and to absorb the acquisition(s) and 2) the limitations on the size of businesses that can be acquired before the infrastructure is no longer sufficient.

WHAT ARE SOME OF THE COSTS OF GOING PUBLIC?

The decision to go public must take into account not only the time, complexity, and expense of the transition itself but also the costs the company continues to incur after it has become public.

Cost of greater scrutiny

Scrutiny by investors, analysts, the press, and the general public is constant for public companies. Management is responsible for carefully evaluating their actions related to earnings trends and business strategies, disclosure matters, and investor relations as those actions can affect the company's reputation. This is important since the company's reputation can have an impact on the company's stock price and market value.

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[11] See the disclosure requirements discussed in the "Initial filing process," Chapter 3.

[12] See the ongoing reporting requirements of a public company and other SEC regulations discussed in Chapter 4.

[13] If the company's insiders do not want to relinquish control, external advisers including the company's underwriters and SEC counsel can assist in understanding the potential to pursue alternative IPO structures (such as umbrella partnership corporation [Up-C] structures) so that owners can retain voting control.

Attention to share price

In effect, the act of going public introduces a new measure of the company's performance – the share price. Management should understand that shareholders often have expectations of higher share prices as part of their investment strategy.

Public companies face pressure to maintain short-term earnings growth – which creates a temptation to maintain share prices by sacrificing long-term profitability and growth for short-term earnings. The financial markets usually react adversely to reports of reduced earnings, especially when the news comes as a surprise to analysts and investors.

There is no easy solution to this need to, on one hand, please shareholders seeking continuous growth in short-term earnings and, on the other hand, make decisions based on long-term strategies for increasing profitability. However, it is helpful for a public company to have a sound business strategy that is balanced appropriately between short- and long-term goals. Management should clearly communicate this strategy to shareholders and the financial community so that they are aware of the reasons for any short-term earnings volatility and its relationship with the company's long-term focus.

Approach to disclosure matters

Needing to provide a widespread group of investors with material information is a dramatic change for a company that has been privately owned. The audience often changes from a boardroom containing a small group of owners and employees to potentially thousands of investors and analysts on earnings calls or at annual meetings. The pressure of responsibility to a larger group pervades virtually all aspects of business activities – from drawing up new employment contracts to planning mergers to considering research and development projects. Management must be concerned not only with achieving the goals for the company but also with how shareholders and the investment community at large can see the means to achieve those goals. These types of management decisions have an impact on the company's reputation.

Disclosures keep investors aware of trends and circumstances. Public companies are required to make timely disclosures of information material to investment decisions, whether the information is favorable or detrimental to the company's image. This goes beyond financial data to include information about company developments such as new products, recent acquisitions, and important management changes. Investors are also increasingly focused on sustainability reporting, and a company planning to go public should consider the nature and extent of sustainability reporting investors might want or will be required for an SEC registrant (for example, climate-related disclosures).

The obligation to keep investors informed of corporate developments is fulfilled through annual, quarterly, and current reports; proxy statements; and shareholders' meetings. A public company generally must disclose promptly any significant events or developments, whether positive or negative, concerning the company. The company should exercise particular care to prevent material information from being leaked, intentionally or inadvertently, before public disclosure is made.

In communicating material information to investors, the company should consider how all public statements comply with Regulation Fair Disclosure (Regulation FD) and the SEC's social media guidance. Specifically, Regulation FD aims to give all investors the ability to gain access to material information at the same time, and it requires the distribution of material information in a manner reasonably designed to convey it to the general public broadly and nonexclusively. A brief summary of Regulation FD is available on the SEC's website: "Regulation FD provides that when an issuer discloses material nonpublic information to certain individuals or entities – generally, securities market professionals, such as stock analysts, or holders of the issuer's securities who may well trade on the basis of the information – the issuer must make public disclosure of that information."

In an April 2, 2013, news release, the SEC clarified that companies may use social media outlets, such as Facebook and Twitter, to announce key information in compliance with Regulation FD. To comply with Regulation FD, a company must alert its investors which social media will be used to disseminate such information.

Investor relations

In addition to informing investors about earnings trends, business strategies, and other material events, management usually makes a conscious effort to maintain the company's positive image in the financial community and market interest in its shares.

To maintain market interest in the company's securities, management's efforts should be directed not only to existing investors in the company – the shareholders – but also to potential investors and the market as a whole. Securities analysts play a significant role in the financial community. They often work in the research departments of brokerage houses and investment banking firms. Thus their assessments of the company influence the investment advice provided to the investor clients of these institutions. Securities analysts examine annual reports and other published information, often discussing the company's operations, plans, and prospects with company management during public quarterly earnings conference calls in order to gain further insight.

A company's management should welcome such discussions and even initiate them. Many cities have local societies or groups of securities analysts who meet regularly to hear presentations by public companies' management teams. These forums provide an opportunity for management to promote the company, discuss information about the company and its plans, and respond to analysts' questions, in each case consistent with the requirements of Regulation FD.

Financial costs

The financial cost of becoming a public company – and also of living as one after the IPO – varies by company but is usually significant. Following are some of the financial costs, most of which continue to be a factor after the transition:

- Engaging external SEC counsel and independent PCAOB-registered auditors with IPO and SEC experience.
- Recruiting or training qualified in-house personnel (accountants and attorneys) to serve as SEC-filing and disclosure experts and to assist in navigating the IPO process and filing with the SEC once the company is public.
- Producing quarterly and annual filings that meet SEC rules and filing deadlines which typically require private companies to accelerate their historical quarterly close timeline (see the "SEC periodic filing deadlines" table).
- Preparing financial information in a structured data (XBRL) format.
- Filing documents with the SEC via the EDGAR system.
- Preparing and distributing annual reports and proxy statements for annual meetings.
- Paying listing and exchange fees and transfer agent costs.
- Complying with the exchange requirements of the Nasdaq or New York Stock Exchange (NYSE): establishing an internal audit function within one year of the listing date on the NYSE, independent directors to make up the majority of the board on both exchanges, an audit committee composed entirely of independent directors on both exchanges, and a recovery policy for erroneously awarded compensation on both exchanges.
- Acquiring or developing adequate IT systems to provide timely information to management and investors and to support reporting requirements of the exchange and the SEC.
- Purchasing directors' and officers' insurance policies to cover additional legal exposure
- Recruiting or training qualified in-house personnel to navigate the internal control over financial reporting (ICFR) readiness process and training existing personnel to be mindful of internal control effectiveness so that management will be in a position to report on ICFR after filing the first Form 10-K.[14] Management will also be required to conclude on the effectiveness of Disclosure Controls and Procedures[15] in each periodic report (for example, Form 10-K, Form 10-Q).

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[14] See Instruction 1 to Item 308 of Regulation S-K.
[15] See Item 307 of Regulation S-K.

SEC periodic filing deadlines[16]

Category of filer	Form 10-K	Form 10-Q
Large accelerated filers ($700 million or more in public float[17])	60 days from fiscal year-end	40 days from fiscal quarter-end
Accelerated filers, includes some smaller reporting companies (SRCs) ($75 million up to $700 million in public float and $100 million or more in revenue)	75 days from fiscal year-end	40 days from fiscal quarter-end
Nonaccelerated filers, includes some SRCs[18] (less than $75 million in public float or less than $100 million in revenue)	90 days from fiscal year-end	45 days from fiscal quarter-end

For many companies, the total cost is a small price to pay for the advantages of going public. However, for some small companies in particular, the total cost of going public might not justify the benefits of completing a successful IPO.

[16] See “SEC reporting obligations,” in Chapter 4, including the “Reporting obligations by filer status” table, for more discussion of SEC periodic reporting obligations (such as the financial statement requirements in annual and quarterly periodic forms).

[17] Public float is defined in Corp Fin’s Financial Reporting Manual as the aggregate worldwide market value of an entity’s voting and nonvoting common equity held by nonaffiliates. The calculation for public float is defined in Item 10(f) of Regulation S-K.

[18] See the “Filer status assessment” table, Chapter 4, for the qualifications of an SRC.

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PLANNING TO GO PUBLIC

Once the decision has been made to become a public company, the planning process must begin and certain key elements of the company's situation are addressed, including the following:

- Assessing corporate governance such as board composition and structure
- Engaging experts, such as SEC counsel and a PCAOB-registered audit firm, including evaluating auditor independence using SEC independence rules
- Evaluating the financial reporting process
- Considering SEC disclosures
- Evaluating IT systems
- Selecting a stock exchange so that processes can be put in place to comply with that exchange
- Considering the timing of compliance with Section 404 of the *Sarbanes-Oxley Act of 2002* (SOX)

CROWE PRACTICE TIP

In order to organize the IPO team of company personnel and external advisers to prepare for a smooth IPO process, it is important to develop an IPO preparedness plan and timeline.

An IPO preparedness plan would normally include many or all of the tasks summarized within this chapter. Timelines vary by company and often are influenced by the company's underwriters.

PRE-IPO TASKS

During the planning stage, management identifies high-risk areas related to the offering from a financial reporting and legal perspective.

Areas identified as high risk should be analyzed and discussed with the underwriters, SEC counsel, and the independent auditor, as appropriate, and the rationale for all the conclusions reached should be documented.

Management should see that an ethical tone is incorporated into the company's planning and risk assessment efforts and that the ethical tone is emphasized from the top down to all levels of employees. Management must have the right people in place so that the appropriate amount of time and skilled resources can be dedicated to the IPO planning process, including risk assessment.

CROWE PRACTICE TIP

In an August 2023 statement, SEC Chief Accountant Paul Munter outlined the SEC's view on management's obligations to perform an iterative and robust risk assessment process.

Corporate governance

The quality of the company's corporate governance structure is important for management to consider. Benefits of good corporate governance include better risk management and confident stakeholders. Therefore, establishing a strong corporate governance program can help the company attract new investors when the IPO is launched.

Corporate governance includes the structure of the board of directors, such as the number of independent directors and the audit committee. Both of the national exchanges – NYSE and Nasdaq – require that the majority of the board members must be independent directors.[19] The listing requirements of the exchanges[20] address the role, authority, and qualifications of the board and committees of board directors beyond that discussed in this section.[21] Many other considerations for establishing good corporate governance exist that attempt to align the interests of the company and its stakeholders.

Diversity

Composition of the board is an important decision for a public company. The SEC has in the past cited academic research supporting the benefits of diversity of thought and skills as well as research indicating diverse boards "allocate more effort to monitoring, have better financial reporting quality, and are more likely to hold management accountable after poor performance." Moreover, investors are increasingly interested in how an entity considers diversity policies when selecting board members.

SEC rules[22] require disclosure of "the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director," and how a company's board (or nominating committee) implements policies that consider diversity in identifying director nominees. The SEC's interpretive guidance[23] states companies should:

- Discuss how any self-identified diversity characteristics, if the individual who self-identifies the characteristics consents to such disclosure, were considered in determining the experience, qualifications, attributes or skills of an individual for board membership
- Describe how the board considers self-identified diversity attributes of nominees, including any other qualifications the company's diversity policy covers

The audit committee

Typically, the board of directors establishes the audit committee through a formal resolution. The audit committee's role is specified in a written charter,[24] which should provide the committee with sufficient flexibility to perform its duties and responsibilities as determined by the board. At a minimum, the charter should include a discussion of the audit committee's structure, membership, activities, and reporting requirements. Following are some common structural considerations.

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[19] Refer to NYSE Listed Company Manual Section 303A.01 and Nasdaq Listing Rule 5605(b)(1).

[20] The NYSE Listed Company Manual is available at https://www.nyse.com/listings/resources, and the Nasdaq listing rules can be found at https://listingcenter.nasdaq.com/rulebook/nasdaq/rules

[21] Refer to NYSE Listed Company Manual 303A and Nasdaq Listing Rule 5605.

[22] Refer to Item 401 and Item 407 of Regulation S-K.

[23] Refer to Regulation S-K Compliance & Disclosure Interpretations, Questions 116.11 and 133.13.

[24] Refer to NYSE Listed Company Manual Section 303A.07(b) and Nasdaq Listing Rule IM 5605-3.

Audit committee size

Although the size of the audit committee should be determined by a company's specific needs and the listing requirements of the exchange, three to five members is a typical size. A minimum of three audit committee members is required by both the NYSE and the Nasdaq.[25] The exchanges also require that all audit committee members of listed companies are independent directors.[26] There is a heightened standard of independence for audit committee members under SEC Rule 10A-3 and the listing standards of the exchanges.

Audit committee members

The audit committee members should be selected by the board of directors. When selecting audit committee members, the board should consider an individual's capacity to serve productively as an audit committee member including their:

- Broad business experience
- Financial literacy and the ability to understand financial statements
- Knowledge of the company's operations
- Familiarity with SEC rules and regulations, accounting principles generally accepted within the United States (U.S. GAAP), and PCAOB standards
- Commitment and available time
- Independence

A company is not required by the SEC to have a financial expert (as defined in Item 407(d)(5) of Regulation S-K) sit on the committee, but it is required to disclose whether a financial expert serves on the audit committee (see same Item 407(d)(5) of Regulation S-K). The exchanges require at least one member of the audit committee to have a certain level of financial sophistication or expertise as defined by the separate exchange rules.[27] Due to the long-term nature of the audit committee's activities, membership continuity is also a consideration. Reappointments and membership terms that end in different years help to achieve continuity because they prevent all experienced members from being replaced at one time.

Audit committee meetings

The number of meetings the audit committee schedules depends on the scope of its responsibilities. Generally, quarterly meetings are held to review the Forms 10-Q and 10-K before they are issued, and additional meetings are held where other governance matters (for example, external and internal audit planning and reporting) are covered. Many audit committees request that the CFO, director of internal audit, and independent auditors attend sessions of their committee meetings. The audit committee also typically reviews the company's earnings press release before issuance.

CROWE PRACTICE TIP

A best practice for audit committees is to set aside portions of meetings for private sessions with the independent auditors and for private sessions with the internal auditors to discuss identified risks and accounting and reporting matters without the influence of management's presence.

[25] Refer to NYSE Listed Company Manual Section 303A.07(a) and Nasdaq Listing Rule 5605(c)(2).
[26] Refer to NYSE Listed Company Manual Section 303A.07(a) and Nasdaq Listing Rule 5605(c)(2).
[27] Refer to NYSE Listed Company Manual Section 303A.07(a) and Nasdaq Listing Rule 5605(c)(2)(A).

Audit committee activities

As all board committees should do, the audit committee should prepare minutes for all of its meetings to document the committee's activities and recommendations. The minutes should be circulated to the company's board of directors to keep the board apprised. At least annually, the audit committee should prepare a formal report for the board of directors that summarizes the past year's activities, conclusions and recommendations, and the coming year's agenda.

The overall duties of an audit committee should be tailored specifically for the objectives, needs, and circumstances of the company the committee is designed to serve. The most common duties include providing the following:

- Selection, retention and, if needed, termination of the independent auditors
- Oversight of the company's:
  - Internal control
  - Internal audit function, including review and approval of internal audit's remit
  - Financial reporting process, including monitoring and evaluating the adoption of new accounting standards
- Review of the external audit plan
- Self-evaluation of the audit committee's qualifications and effectiveness

The board and audit committee should use a "Goldilocks" approach in delineating the roles of the committee – all required roles must be covered, but care should be taken to not burden the committee with tasks that are more properly handled by other committees or the board as a whole.

SEC perspective on audit committees

The SEC has regularly commented on the importance of audit committee oversight of the financial reporting process. In various statements, SEC Chief Accountant Paul Munter has:

- Emphasized the vital role audit committees play in oversight of the financial reporting process, including internal controls over financial reporting, and the external auditor
- Encouraged audit committees to assess whether the scope of their assigned responsibilities is appropriate, attainable, and aligned with the skills of their members and to not overlook the importance of their core oversight responsibilities
- Stressed the importance of audit committee involvement in materiality evaluations
- Cautioned audit committees to remain vigiliant to auditor independence
- Provided questions audit committees might ask the lead auditor about the use of other auditors
- Outlined the importance of a comprehensive risk assessment, which is within the purview of the audit committee's oversight role

Audit committees should carefully consider how these statements should be incorporated into their governance actions.

Oversight of the company's internal control

The audit committee's oversight of internal control generally involves reviewing the internal control evaluations performed by management, the internal auditors, and the independent auditors plus the methods they followed to make such evaluations. One of the audit committee's primary internal control concerns relates to those who oversee financial reporting. Audit committees usually plan specific discussions with senior corporate management and meet with internal and independent auditors concerning any comments the auditors might have about control improvements and any significant deficiencies or material weaknesses that have been identified.

Review of the internal audit function

An effective review of internal audit activities covers planned audit work, the results of completed work, and management's implementation of the internal audit department's recommendations. The review of the internal audit plan is a significant task for audit committees and requires more oversight than the external audit plan does.

Internal audit plans should address the following activities:

- Internal audit activities, which include all areas or topics that are considered by internal audit's plan and risk assessment
- An assessment of the risks in the organization, usually those aligned to internal audit activities
- A testing plan to obtain the desired level of comfort based on the results of the risk assessment and the principal activities and initiatives in the organization
- Whether and how the internal audit function will support management's assessment of ICFR beginning with the entity's second Form 10-K[28]
- The audit department budget
- A high-level schedule of activities for the year

The audit committee's review also focuses on the company's individual needs. For example, if a new IT system has been installed, internal audit work on the system's effectiveness, security, and other controls might assume a higher priority.

The capacity of internal auditors to fulfill their responsibilities is measured by the degree to which they are competent, which includes their proficiency and training, and whether they are independent of the activities they audit. In addition to the internal audit department's reporting relationships to top management, the interaction between the department and the audit committee can support the desired level of independence. Meetings with internal auditors and a defined reporting relationship, whereby significant internal audit findings are provided to the audit committee in written reports, can provide the internal auditors with direct access to the board of directors.

Audit committees also must monitor the status of open issues identified by internal auditors – those not resolved by management to the satisfaction of the internal auditors – paying particular attention to items that are past their planned completion date or at risk of missing the target date.

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[28] See footnote 14.

Selection and retention of the independent auditors

Typically, audit committees are responsible for recommending to the board of directors and the shareholders, an independent auditing firm to audit and report on the financial statements issued by the company.

Re-engaging a firm of independent auditors and selecting a new firm are decidedly different activities. When re-engaging the current auditor, the quality of the firm's services are evaluated firsthand. When hiring a new firm, information about its experience and service quality must be obtained from other sources. Nevertheless, the basic considerations discussed elsewhere in this chapter (see "Selecting the right advisers and experts") apply to both situations. In addition to selecting and retaining auditors, the audit committee determines the compensation paid to the auditors for their annual audit and quarterly review services.

The committee also considers matters that affect auditor independence under PCAOB and SEC rules, such as the evaluation of nonaudit services performed by the auditor and any of the auditor's affiliates, financial relationships (such as ownership interests and lending relationships) of the auditors with the issuer, and employment of prior audit firm staff by the issuer and its affiliates (a one-year cooling off period applies to certain former employees of the auditing firm engaged by an audit client in a financial reporting oversight role). Independence requirements should be evaluated for both the current period audit and all periods presented in an SEC filing.

Any nonaudit services performed by the auditor or any of the auditor's affiliates (including network firms and other affiliates) with respect to the entity or any of its affiliates should be assessed for compliance with independence rules. The risk of violating an SEC independence rule is greater because the SEC and PCAOB independence rules for public company audits are more stringent than those for private company audits. Examples of prohibited nonaudit services include bookkeeping, internal audit outsourcing, valuation services, actuarial services, and financial information system design and implementation.

In addition to more stringent rules surrounding nonaudit services and other relationships between the auditor and company, SEC and PCAOB independence rules include other requirements such as partner rotation, independence communication requirements, and audit committee preapproval of audit and nonaudit services.

Independence matters also have to be considered for affiliates of SEC registrants and not solely for the registrant itself. Common affiliates are subsidiaries and parent companies. Refer to Article 2 of Regulation S-X for the SEC rules on the qualification of auditors.

Resource for audit committees

In March 2021, the Center for Audit Quality (CAQ), in conjunction with the Audit Committee Collaboration, updated its "External Auditor Assessment Tool: A Reference for U.S. Audit Committees" to help audit committees evaluate the appointment, oversight, and compensation of external auditors. It includes sample questions in three areas:

- The auditor's quality of services and sufficiency of resources
- The auditor's quality of communication and interaction
- The auditor's independence, objectivity, and professional skepticism

A sample form and rating scale are included and can be used to collect input from company personnel about the external auditor.

CROWE PRACTICE TIP

When planning to undertake an IPO, begin considering matters that affect auditor independence under SEC and PCAOB rules. Do not postpone consideration of such matters until the year of the IPO because determining your current auditor is not independent likely will have a significant impact on any IPO timeline. Because of the more stringent SEC and PCAOB independence rules for public companies, carefully consider the independent auditor's nonaudit services (such as drafting financial statements and delivering tax provision assistance services) to the company and the company's affiliates worldwide, as well as other independence-related matters.

CROWE PRACTICE TIP

In October 2020, the SEC adopted amendments to auditor independence rules, including reducing the lookback period evaluation for prior-year relationships and services and updating independence rules for affiliates of the entity.

CROWE PRACTICE TIP

In February 2024, SEC Chief Accountant Paul Munter reminded audit committees of their key role in prioritizing and promoting audit quality. Munter's statement provides example data points audit committees can consider when evaluating audit quality and working to support the auditor's independence and ability to exercise professional skepticism.

Review of the external audit plan

Many audit committees hold meetings before the audit commences to discuss the audit plan with the independent auditors. The review of the annual audit plan with the independent auditors is the committee's opportunity to satisfy itself that the audit will meet the needs of the company's board of directors and shareholders. Although the audit must be based on the auditors' professional judgment, at this point the audit committee can learn the basis for the auditors' judgment and the extent of planned audit work.

Topics the audit committee typically discusses with the independent auditors include the following:

- The independent auditors' responsibilities under PCAOB standards (both auditing and independence standards)
- The general outline of the extent and timing of the auditors' proposed coverage of locations, such as departments, branches, divisions, and subsidiaries
- The general nature of the audit procedures to be performed, including coverage of various risks, transactions, and balance sheet and income statement accounts
- The extent of any planned reliance on the work of internal auditors and the anticipated effect of this reliance on the audit
- Any significant accounting and auditing issues that the auditors can foresee
- The impact on the financial statements of any new or proposed changes in accounting principles or regulatory requirements
- Significant reporting deadlines

Oversight of the company's financial reporting process

Oversight of the financial reporting process is an important obligation of the committee and is linked directly to an SEC-required disclosure in annual proxy statements. Item 407(d)(3) of Regulation S-K requires the audit committee to state, in the registrant's annual proxy statement that discloses a shareholder meeting at which directors are to be elected, whether the committee has completed the following tasks:

- Reviewed and discussed the audited financial statements with management
- Discussed with the independent auditors the matters required to be discussed by the PCAOB and the SEC
- Received the written disclosures and the letter from the independent auditors required by the PCAOB regarding the independent auditor's communications with the audit committee concerning independence, and discussed with the independent auditors their independence
- Based on the previously mentioned discussions, recommended that the audited financial statements be included in the company's annual report on Form 10-K filed with the SEC

One key element of the financial reporting oversight role that assists the audit committee with making the aforementioned SEC-required disclosure is meeting with the independent auditors to discuss audit results. The PCAOB's AS 1301 requires the auditor to communicate audit results and other matters with the audit committee on a timely basis and prior to the issuance of the audit report, including:

Appointment and retention; audit strategy

- Any significant issues that were discussed with management in connection with the appointment or retention of the auditor
- The terms of the engagement, including providing an engagement letter to the audit committee annually
- Whether the audit committee is aware of any violations or possible violations of laws and regulations, or other matters relevant to the audit
- An overview of the overall audit strategy, including the timing of the audit and significant risks identified during the auditor's risk assessment procedures
- Other strategy matters, when applicable, such as the use of the company's internal auditors, need to use specialists, use of other auditors, and how the auditor determined it can serve as the principal auditor

Accounting policies and practices, estimates, and significant unusual transactions

- Significant accounting policies and practices, including the nature and impact of the initial selection of and changes in significant accounting policies or their application, and the effect on the financial statements of significant policies in controversial or emerging areas
- Critical accounting policies and practices – defined as those policies and practices that are most important to a company's financial condition and results and that require management's most difficult, subjective, or complex judgments – including why those policies are considered critical and how current or anticipated events might affect them
- Critical accounting estimates, including a description of the process used by management to develop the estimate, significant assumptions that have a high degree of subjectivity, and any significant changes to the process used by management to develop the estimates or significant assumptions
- Significant unusual transactions – defined as those outside the normal course of business or that otherwise appear to be unusual due to their size, timing, or nature – and how management accounts for them

Auditor's evaluation of quality of financial reporting

- Evaluation of qualitative aspects of significant accounting policies and practices, and situations when the auditor has identified bias in management's judgments
- Auditor's assessment of critical accounting policies and practices, including management's disclosures, and basis for auditor's conclusions about the reasonableness of critical accounting estimates
- Auditor's understanding of the business purpose, or lack thereof, of significant unusual transactions
- Auditor's evaluation of financial statement presentation and disclosures
- Situations where the auditor has identified a concern regarding pending application of new accounting policies that are not yet effective
- Alternative accounting treatments related to material items that have been discussed with management, including ramifications of such alternatives and treatments preferred by the auditor

Other matters

- The auditors' responsibilities for other information in documents containing audited financial statements, any procedures performed related to the information, and the results of the procedures
- Any difficult or contentious matters for which the auditor consulted outside the engagement team and that are relevant to audit committee oversight of the financial reporting process
- When the auditor is aware that management has consulted with other accountants about significant audit or accounting matters and has identified a concern, the auditor's views about such consultation
- When applicable, the auditor's evaluation of the company's ability to continue as a going concern, as described further in AS 2415, "Consideration of an Entity's Ability to Continue as a Going Concern," and related conclusion about the matter
- A schedule of uncorrected misstatements related to accounts and disclosures, how they were determined to be immaterial, and if they could potentially cause future period financial statements to be materially misstated
- Any corrected misstatements, unless clearly trivial, that were detected by audit procedures
- Any disagreements with management, whether or not satisfactorily resolved, that could be significant to the company's financial statement or auditor's report
- Any significant difficulties encountered during the audit, such as significant delays by management or unwillingness to provide information needed by the auditor
- Observations on internal control over financial reporting, including any identified significant deficiencies and material weaknesses
- Other material written communications between the auditor and audit committee
- Other matters significant to the oversight of the company's financial reporting process

Self-evaluation of the audit committee's qualifications and effectiveness

Audit committees' annual self-evaluations assess the effectiveness of the committee and include evaluations of how well the audit committee members understand the company's financial reporting process, ICFR structure, and internal audit department. The assessment should also consider how well the audit committee members communicate with the independent auditors and how well they understand the role of the auditors. In addition, the evaluation should help the committee members understand the effectiveness of the committee's structure, including its size, membership, and communication in their own meetings as well as meetings with other board members and management.

CROWE PRACTICE TIP

Audit committees should strive for continuous improvement and ask two fundamental questions: 1) What makes a high-quality audit committee? 2) How can an audit committee achieve excellence?

Selecting the right advisers and experts

It is critical to select a team of advisers and experts that will assist in the registration process. They can assist management with navigating portions of the IPO process, particularly with complex tasks.

Underwriters and their counsel

One of the most critical advisory positions is that of the underwriter. The lead underwriter is responsible for marketing and selling the company's stock to investors, providing comments on the registration statement and prospectus, organizing and leading the road show, and assisting management with determining the price per share for the IPO and the number of shares to sell. As part of the effort to limit the underwriter's legal liability, the underwriter also performs a due diligence investigation with respect to the company issuing stock and its registration statement. In performing due diligence, the underwriter requests that the independent auditors provide a comfort letter on certain financial information contained in the registration statement.

An underwriter typically engages counsel to serve on the underwriter's behalf by assisting with securities law compliance and due diligence obligations. Although not highly visible to all parties throughout the process, the underwriter's counsel often provides comments on the registration statement as a whole and interacts with management and the independent auditors on matters relating to the comfort letter.

When selecting an underwriter, management is advised to consider the following factors:

- The underwriter's knowledge and understanding of the company's business and ability to articulate that knowledge as part of the registration statement and prospectus review process
- The underwriter's knowledge of and experience in the industry in which the company operates
- The depth of the underwriter's bench
- The underwriter's experience with interacting with regulatory agencies
- The underwriter's reputation in the marketplace, including in the financial community and with regulatory agencies
- The underwriter's track record of effective communication with management and other experts during the IPO process
- The ability to respect how involved the company wants the underwriter to be in the registration process
- The underwriter's fees
- Potential conflicts of interest

The cost of an underwriter is determined by the value of the brand that the underwriter brings to the transaction as well as the number of services the underwriter will have to perform in order to market and transact the IPO. For example, if the private company already has brand recognition in the marketplace, it might need the underwriter to perform less marketing work than is typical in an IPO. However, if the underwriter also has a strong brand, its value will be incorporated into the underwriter's fee.

CROWE PRACTICE TIP

Underwriters typically request a comfort letter from the auditors to demonstrate that the underwriters have performed a reasonable investigation of matters in the registration statement, which enables the underwriter to have a due diligence defense to the underwriter's statutory liability under Section 11 of the Securities Act of 1933*. Comfort letters are essentially agreed-upon procedure engagements done for underwriters of securities offerings.*

External SEC counsel

External SEC counsel is another important adviser and expert that will help a company execute the IPO process. Among the SEC counsel's responsibilities are guiding management through drafting the registration statement and prospectus, submitting confidential treatment requests (CTRs) to the SEC, coordinating the SEC filing review, communicating with the SEC staff on behalf of the company, and gathering various legal contracts that are often filed as exhibits to the registration statement (such as stock incentive plans, employee stock purchase agreements, the certificate of incorporation, and a legal opinion on the validity of the shares being registered).

Factors management is advised to consider when selecting an SEC counsel include the following:

- The company's experience and relationship with counsel's law firm
- Counsel's experience with the company's capital transaction history or similar capital structure
- Counsel's experience with the SEC related to registration statements, periodic filings, and other filings
- Counsel's reputation and credibility in the marketplace
- Counsel's track record for effective communication with management and other experts during the IPO process
- Ability to respect how involved the company wants counsel to be in the registration process
- Counsel's fees

Fees will be based on the value that the law firm adds to the engagement. For example, if the law firm needs to issue an opinion on or conduct a review of complicated transactions in conjunction with the IPO registration process, fees will be higher than if transactions are uncomplicated and counsel needs to provide only SEC compliance services. When additional services increase the complexity of counsel's work, fees go up.

Independent auditors

Completing the list of the most critical advisers and experts in an IPO process is the PCAOB-registered independent audit firm. The primary objective of the independent auditors is to perform an audit of the historical financial statements and provide a comfort letter on financial information disclosed in the registration statement, as requested by the underwriter. It is of utmost importance for company executives and the board of directors to understand how the audit firm plans to ensure that the audit firm is compliant with SEC and PCAOB independence and PCAOB auditing standards with respect to the IPO audit engagement.

Among the factors pertinent to the selection of an independent audit firm are:

- The audit firm's knowledge and experience in the industry
- An evaluation of the audit firm's independence
- Consideration of rotation of both the audit partner and the engagement quality review partner assigned to the engagement (following SEC independence rules that require that both partners rotate every five years and that all audit periods included in a filing are subject to the rotation requirements)

- The firm's quality control procedures
- The nature of other services the firm offers
- Company management's ability to interact and communicate effectively with the firm

Other experts

Depending on the company's industry and financial situation, it might engage additional experts, such as valuation experts and tax experts. A valuation expert might be needed to value stock compensation issued a short period of time before the IPO date (typically within two years), intangible assets such as goodwill and customer intangibles for impairment analysis testing, or a business acquisition. It is critical that management understands the valuation methodology used, takes responsibility for the input to the valuations, and agrees with the measurements of the valuation experts when those measures will be included in the company's financial statements and disclosures.

A tax expert might be needed to provide a tax opinion if the tax consequences of the transaction contemplated in the offering are material to an investor and the company discloses a representation of the tax consequences in the registration statement.[29]

Financial statement requirements

The financial statements included in registration statements and periodic filings must conform to SEC requirements, including having an audit performed by a firm registered with the PCAOB. As noted in "The JOBS Act" section in Chapter 3, the initial registration statement of domestic EGCs must include a minimum of two years of audited financial statements in conformity with U.S. GAAP, and domestic companies that are not either an EGC or an SRC must include three years of audited financial statements in conformity with U.S. GAAP. See "Appendix B: Foreign private issuers" for the financial statement requirements of certain foreign entities.

Financial statements for interim periods might also be required, depending on the timing of the registration statement. See the "Financial statement requirements for initial registration statements" table, Chapter 3, for more information about annual and interim financial statement requirements in an IPO registration statement.

To protect the company's reputation, it is critical that management provides accurate financial reporting as part of the IPO process. Questions arising about the accuracy of financial statements and disclosures can cause regulators and investors to question the competency and ability of management to disclose accurate financial information on a consistent basis. Ultimately, a restatement could affect market interest and demand for shares. Furthermore, errors in the registration statement can create financial risk for the company because if the stock price were to depreciate as a result of the restatement of the erroneous financial statements, investors could claim that they had relied on bad data. Errors also can create additional risk for the company's executives under the SEC's erroneously awarded compensation rules,[30] which in the event of an accounting restatement require the recovery of erroneously awarded incentive-based compensation.

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[29] Refer to Item 601(b)(8) of Regulation S-K.

[30] Refer to SEC final rules "Listing Standards for Recovery of Erroneously Awarded Compensation."

Additional SEC disclosure requirements

Companies making the transition from private to public status must understand SEC-specific disclosure requirements that are incremental to U.S. GAAP as issued by the FASB. Details about common disclosures required by newly public companies are included in the "Initial filing process" section of Chapter 3.

IT system requirements

IT systems should be in place and functioning prior to an IPO. The systems should be sufficient to enable the company to obtain, analyze, consolidate, and report financial information on all of its reporting entities well in advance of scheduled earnings releases. Management also should assess any additional systems used in evaluating the financial performance of the company, which may include systems used for budgeting and forecasting.

A critical component of IT system requirements is compliance with SOX 404. Companies are not required to comply with SOX 404(a)[31] immediately upon the effective date of an IPO, but compliance is required shortly afterward. See "Internal control over financial reporting," Chapter 4, for key considerations in a SOX 404 compliance program including "IT systems under SOX 404."

CROWE PRACTICE TIP

Weak ICFR increases financial reporting risk in the registration statement. Although management is not required to provide an assessment of internal control in the initial registration statement, if there is a lack of sound ICFR, that risk should be addressed prior to going public.

Exchange listing versus OTC markets

As an alternative to listing securities on an exchange (NYSE or Nasdaq), companies should consider the possibility of their securities trading in OTC markets. Before committing to an exchange, management should seriously consider the differences between exchange listing and OTC trading:

- Marketability, liquidity, and collateral value are generally considered enhanced by a stock exchange listing because market values are readily determinable, transactions can be consummated quickly, and trade volume is high. Access to liquidity for a company can be further improved once a listed company becomes part of an index traded on an exchange. Generally, market values in OTC markets are less liquid, which can lead to difficulties with the valuation of securities traded in such markets.
- The specific market where a company's shares are traded might influence investors, analysts, creditors, and other stakeholders. It could be important to stakeholders or required by certain investors that a company's shares are listed and traded on an exchange rather than traded in an OTC market.
- The NYSE and Nasdaq offer a suite of ancillary services, including some related to corporate governance practices and reporting, to assist companies traded on the respective exchanges.
- The major exchanges impose reporting and disclosure rules as well as governance requirements, and in order to be listed on those exchanges, a company must be registered with the SEC. OTC markets do not impose reporting, disclosure, or governance rules to the same extent as the exchanges, but OTC markets have several tiers of traded companies, with different reporting and disclosure requirements applicable to each tier. In addition, trading on an OTC market does

[31] SOX 404(a) includes the requirement for management, in its second annual report on Form 10-K, to assess ICFR as of the end of its most recent fiscal year and to state whether it is effective.

not require SEC registration unless the company no longer qualifies for exemption from registration (for example, a nonbank trading OTC company grows such that unaccredited shareholders exceed 500 and total assets exceed $10 million).

- Companies must, of course, meet qualification requirements for listing on a national exchange. The NYSE requires 1,100,000 of publicly held shares and 400 round lot holders, and either 1) a certain level of aggregate pretax earnings over the most recent three years (or two years for EGCs) or 2) global market capitalization of at least $200 million.[32] Similarly, the Nasdaq Global Select Market has minimum requirements for pretax earnings in the aggregate for the prior three fiscal years and a minimum of $45 million in market value.[33] The Nasdaq Global Market and the Nasdaq Capital Market have lower minimum requirements – for example, at least $20 million and $15 million, respectively, in market value.[34] A direct listing (that is, when the company lists on an exchange but does not raise capital) on either the NYSE or the Nasdaq can have different requirements. Companies listed on an exchange are subject to a lengthy list of additional provisions, as outlined in the NYSE Listed Company Manual and the Nasdaq listing rules.
- Exchange listings have initial and ongoing costs.

Internal audit

The capacity of the company's internal audit department to fulfill its responsibilities can be assessed by considering the following factors:

- Scope of the internal auditors' authority as presented in the internal audit department's charter or other document describing its duties
- Qualifications and experience level of the staff, as evidenced by hiring and training policies
- Reporting relationships between the director of internal audit and the company's executive management and the board of directors (including the audit committee)

Internal audit departments frequently assist management with testing ICFR for purposes of management's assessment of such controls. The degree to which internal auditors are independent of the activities they audit is a recognized measure of their capability to fulfill their responsibilities. In addition to the department's reporting relationships to top management, the nature of the interaction between the department and the audit committee can support the desired level of independence.

To reduce the company's inherent risk, internal auditors should have direct access to the board of directors, including the audit committee. To maintain this access, internal auditors should have regular meetings and a defined reporting relationship with the audit committee and should provide the audit committee with written reports that discuss findings. As an alternative to an internal audit department, management can engage an outside audit firm (other than the firm selected as the independent auditor) to perform internal audit activities, which would be subject to similar qualifications and protocols applicable to an in-house internal audit department. Company management would need to oversee and actively manage such an outsourcing arrangement. See more on internal audit activities, including reporting to the audit committee in the section, "The audit committee," particularly the subsection, "Review of the internal audit function."

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[32] Refer to NYSE Listed Company Manual Section 102.01C.
[33] Refer to Nasdaq Listing Rule 5315(f)(2).
[34] Refer to Nasdaq Listing Rules 5405 and 5505.

Pre-IPO tax considerations

Taxes are another important consideration for a company that is planning to go public. If any change to the capital structure of a company is necessary for going public, there could be consequences related to income tax. For example, when an IPO is consummated and additional shares of the company are sold to new shareholders, an ownership change under Internal Revenue Code (IRC) Section 382 can occur. This change can limit the use of net operating losses (NOLs) and might cause the loss of them altogether.

CROWE PRACTICE TIP

We recommend that tax professionals with specialized knowledge in federal tax planning strategies help a company before any IPO with developing a plan for realizing the benefits related to the NOLs.

Furthermore, if the private company is converting from an S corporation to a C corporation, deferred income taxes likely will need to be recorded. If converting from an S corporation, company executives or owners should consider whether pro forma taxes and earnings per share should be disclosed on the face of the historical financial statements to reflect the change in capital structure.

Also, S-corp owners should seriously consider the timing of any distributions to shareholders given that distributions declared prior to the IPO would be paid solely to the S-corp owners, and those declared subsequent to the IPO would be paid to old and new shareholders of the company. If distributions are declared prior to the IPO, but not reflected in the latest balance sheet, owners should consider whether such distributions are to be presented as a pro forma on the face of the historical financial statements.

See Section 3400 of the Division of Corporation Finance's Financial Reporting Manual (Corp Fin's Financial Reporting Manual) and "Pro forma financial information," Chapter 3, for more information about these pro forma considerations.

The employee compensation agreements of the private company should be reviewed for tax consequences. Specifically, any change-in-control agreements should be assessed for excess parachute payments under the golden parachute rules in IRC Section 280G.

CROWE PRACTICE TIP

The determination of the application of the IRC Section 162(m) compensation limit is complicated, so we recommend that a tax professional assist with this analysis and that of all material employment agreements.

Also, once the company is public, if compensation to a covered executive exceeds $1 million under IRC Section 162(m), the compensation above $1 million is not tax-deductible. Special rules apply to equity compensation granted prior to going public. All employment agreements and compensation plans should be reviewed for compliance with the IRC.

The company is responsible for calculating the income tax provision quarterly, including all deferred taxes and the effective tax rate, and disclosing that information on Forms 10-Q and 10-K. In addition, public companies are required to assess the effectiveness of ICFR, which includes tax amounts and disclosures (see "Internal control over financial reporting," Chapter 4).

Companies that do not have qualified in-house tax expertise to calculate these amounts and develop the related disclosures must engage a qualified professional to perform these services on behalf of management. SEC and PCAOB auditor independence standards prohibit the external auditor from performing these services on behalf of management for all periods included in the financial statements.

THE SEC REGISTRATION PROCESS AND BEING A PUBLIC COMPANY

For planning purposes, executives should develop a timeline that accounts for the remaining phases of an IPO, the registration process, and existence as a public company immediately after the IPO. The registration process involves filing the registration statement with the SEC (such that the filing ultimately is declared effective by the SEC) as well as conducting the road show and interacting with investors until the IPO is completed. In this section, we highlight the timing of important events from the perspective of an EGC. See "Registering with the SEC," Chapter 3, for a discussion of elements of the registration process.

Phase 0 – before the IPO launch

Before kicking off the IPO, the company must produce financial statements in accordance with GAAP and SEC rules, and its independent auditor must perform a PCAOB audit of the financial statements that will be included in the initial confidential submission – if filing under the Jumpstart Our Business Startups Act of 2012 (JOBS Act) – to the SEC. Importantly, the company also should have a plan in place for the use of proceeds. These tasks could take anywhere from a few months to a year, depending on the complexity of the registrant and the level of sophistication applied to the financial statements when the company was private. Timing of this phase also depends on when the company wants to market its shares to the public.

It is important to develop a draft transaction timeline during this stage. Among other things, the company should consider the financial statement updating requirements of Rule 3-12 of Regulation S-X and how financial statement updating requirements might affect the offering timeline.

CROWE PRACTICE TIP

To develop a timeline during the planning stage, obtain commitments from the company's personnel and advisers to conform to the timeline and help to make the IPO process as smooth as possible. Guidelines for matters to include in a timeline have been provided in this section. There is variability in IPO timelines, given that each company has unique circumstances affecting their offering process. No single timeline can be applied to all IPOs.

Phase 1 – the IPO launch

The launch phase encompasses drafting the registration statement, due diligence performed by underwriters, and the initial confidential submission to the SEC. Phase 1 (and a portion of phase 2) encompasses the pre-filing period, also known as the "quiet period." Before the registration statement is filed, management should seek advice from its legal counsel about all external communications, in order to avoid making a prohibited offer before the registration statement is made public (often referred to as "gun jumping").

Section 5 of the Securities Act prohibits securities offerings during the quiet period. According to the SEC's interpretation, an offer includes "the publication of information and statements, and publicity efforts, generally, made in advance of a proposed financing, although not couched in terms of an express offer," and these activities "may in fact contribute to conditioning the public mind or arousing public interest in the issuer or in the securities of an issuer in a manner which raises a serious question whether the publicity is not in fact part of the selling effort."[35]

[35] Refer to "Publication of Information Prior to or After the Effective Date of a Registration Statement," SEC Release No. 33-3844.

During this phase, the company hosts a formal kick-off meeting with its third-party professionals, often called an "all hands meeting." Subsequently, the underwriter begins performing financial, business, accounting, and legal due diligence. The underwriter performs due diligence in order to understand the company better and conclude whether it wants to underwrite the shares to be sold. If it decides not to, the transaction would not proceed and the company would need to engage a different underwriter. Also at this stage, the company, its legal counsel, the underwriter, and the underwriter's counsel review the underwriting agreement and related documents to ensure consensus and understanding of the transaction details.

In addition, all parties begin participating in drafting sessions for the Form S-1 and the related offering document. At this time, the underwriter uses the company's historical financial information to model financial forecasts for the company and develop financial forecasts and projected pricing of the company's shares.

After the financial forecasts and projections have been developed, the underwriters seek internal approval for taking the offering to market. This phase comes to a close when the company submits its confidential registration statement to the SEC.

Phase 2 – the SEC review

Phase 2 begins with the initial review by the SEC of the confidential submission and ends with pricing of the transaction, at which point the company and the underwriter enter into the underwriting agreement. While the SEC is performing the initial review, which typically takes up to 28 calendar days or 20 business days, company executives and their advisers prepare the road show presentation. After receiving the first round of comments from the SEC, the executives and their advisers typically spend up to two weeks responding to the comments.

During this phase, an EGC also might engage in what is called "testing-the-waters" (TTW) premarketing. TTW can be applied during the "quiet period" to allow communication with qualified institutional buyers (QIBs) and institutional accredited investors, as defined by the SEC, prior to or following the date a registration statement is publicly filed. TTW is distinct from a traditional road show and does not trigger the 15-day filing requirement described later.[36]

This phase includes the "waiting period," which begins late in phase 2 or on the date the company first publicly files the registration statement with the SEC. This period ends when the SEC declares the registration statement effective, in phase 3. Section 5(c) of the Securities Act allows offers of securities during the waiting period, after the registration statement is filed. The offers made during this time are subject to the prospectus requirements and offer limitations of the Securities Act. SEC legal counsel should be heavily involved in assisting the company with all communications and offers during this time.

[36] See "Generally Applicable Questions on Title I of the JOBS Act" for more guidance on TTW and other Title I JOBS Act matters at "Jumpstart Our Business Startups Act Frequently Asked Questions" on the SEC website.

When company executives are ready to release the registration statement to the public, they publicly file the Form S-1 amendment with the SEC and issue a press release. The registration statement must be filed publicly at least 15 days prior to launching the road show or its requested effective date if no road show is planned.[37]

When the registration statement has been filed publicly, management finalizes and rehearses the road show presentation. The company should expect to receive another round of comments from the SEC during this period. Company executives and their advisers need to submit a response and, most likely, file an amended Form S-1 with the SEC to address the SEC's comments and update financial information.

Phase 2 ends when company executives and their advisers finalize the underwriting agreement and legal opinions and when the independent auditor completes its comfort letter procedures. The underwriting agreement is finalized once it includes the valuation of shares and estimated price range. The company's SEC legal counsel often provides a legal opinion, which is filed as an exhibit to the registration statement, supporting the validity of the shares issued in accordance with the underwriting agreement. The underwriter's legal counsel also provides a legal opinion, and the independent accountants provide the comfort letter to the underwriters. The underwriting agreement is expected once the registration statement is declared effective by the SEC.

The comfort letter includes agreed-upon procedures performed by the independent accountants, who agree that certain financial information included in the registration statement (such as disclosures in MD&A) conform to the company's books and records or the audited annual or reviewed interim financial statements. Agreed-upon procedures do not represent an audit of the amounts, merely a verification that certain amounts correspond to the company's books and records or the financial statements. It is important to include sufficient time in the comfort letter plan for management to provide books and records support for each item requiring comfort, which can be a significant and time-consuming process.

The final comfort letter is given to the underwriters once the registration statement and prospectus are final – typically on the day of pricing, because final pricing includes the last numbers dropped into the filing.

[37] See Securities Act Section 6(e).

Phase 3 – going to market

Phase 3 includes marketing the company's shares, pricing the shares, and issuing the shares to the public. Printing and distribution of the preliminary prospectus and the road show are usually part of this phase. Pricing is finalized, and the SEC declares the registration statement effective – after all SEC comments have been resolved and material disclosure related to the share price has been updated throughout the filing. See a discussion of the SEC comment letter process in "Interaction with the SEC during an IPO," Chapter 3.

After the registration statement is effective, the company enters the "post-effective period." At this point, underwriters may sell only securities that are subject to the effective registration statement. See Section 5(a) of the Securities Act.

Finally, the transaction typically closes at "T+2" – that is, two days after "T," the trade date.

Phase 4 – being a public company

It will immediately be clear to the management of a newly public company that its reporting obligations are vastly different from those of a private company. Existing as a public company involves meeting numerous new and ongoing responsibilities, including: continual interaction with investors; compliance with SEC annual, quarterly, and current reporting requirements; compliance with SOX 404; and compliance with additional regulations. See "SEC reporting obligations" and "Other SEC regulations" in Chapter 4.

CROWE PRACTICE TIP

Companies, auditors, and underwriters should meet to determine the procedures to be completed in connection with a comfort letter. Auditors may not be able to "comfort" all items initially requested by underwriters depending on the guidance in AS 6101. The expected procedures are outlined in a draft comfort letter, which provides the underwriters and auditors the opportunity to discuss any changes prior to the final executed letter.

3. REGISTERING WITH THE SEC

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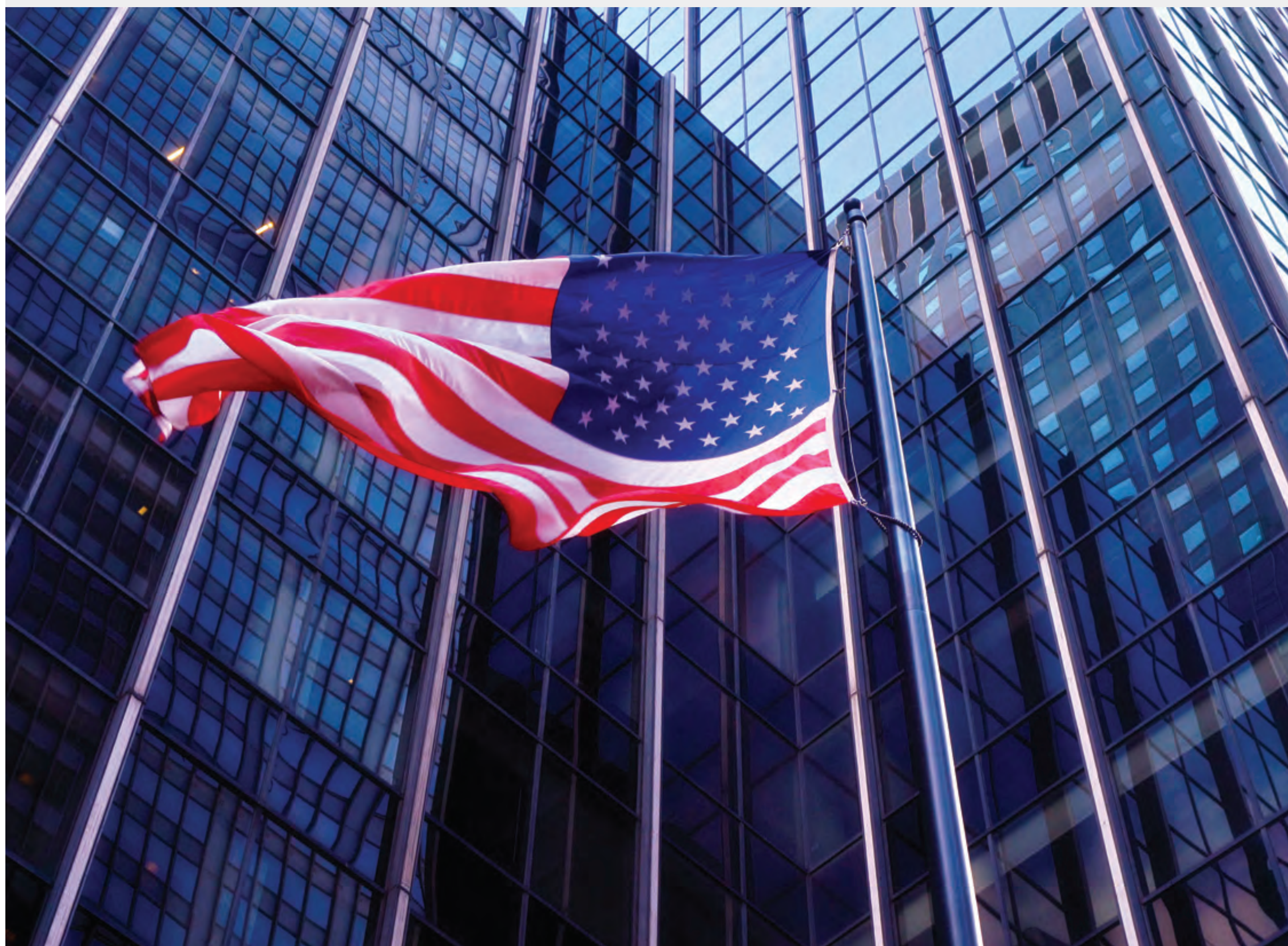

REGISTERING WITH THE SEC

There are many aspects to registering an IPO with the SEC – from eligibility for EGC status to the accounting pre-clearance and disclosure waiver processes to finally executing the complex filing review process and satisfying the financial statement requirements. The accounting and reporting disclosures that stem from SEC guidance and FASB guidance specifically for public companies must be heeded.

THE JOBS ACT AND FAST ACT

The JOBS Act expanded the number of companies that could qualify for certain SEC reporting and disclosure accommodations for private companies interested in becoming publicly traded companies. The JOBS Act – which applies to domestic and foreign entities alike – was intended to improve smaller companies' access to public capital markets, and therefore a number of disclosure accommodations were granted to companies that qualify as EGCs. If an entity meets the EGC qualifications, it is typically beneficial to apply the disclosure accommodations when drafting a registration statement to save time and money in the registration process.

The *Fixing America's Surface Transportation Act* (FAST Act), signed into law in December 2015, provided additional accommodations to EGCs, including shortening the number of days (from 21 to 15) for publicly filing documents prior to the issuer "road show" and establishing a "grace period" for an EGC that ceases to qualify as an EGC during the registration process. The FAST Act also allows EGCs to omit historical (annual or interim) financial information for periods otherwise required by Regulation S-X if the company reasonably believes the omitted information will not be required in the final registration statement.

Emerging growth company qualifications

Title I of the JOBS Act created a new category of issuer – an EGC, or an issuer with less than $1.235 billion in total revenue (indexed for inflation by the SEC every five years) that has not previously sold common stock pursuant to an effective registration statement on or before Dec. 8, 2011. The issuer continues to be an EGC until the earliest of the following: it reaches the fifth anniversary of its IPO, its revenue reaches or exceeds $1.235 billion, it becomes a large accelerated filer (defined by the SEC as having a public float of $700 million or more), or it has issued more than $1 billion in nonconvertible debt over the previous three years.[38] Except for the last item (nonconvertible debt), the issuer loses EGC status as of the end of the fiscal year in which the disqualifying event occurs.

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[38] For additional guidance related to eligibility as an EGC, refer to Section 10100 of Corp Fin's Financial Reporting Manual.

JOBS Act accommodations

As a result of the JOBS Act, EGCs are permitted to:

- Prepare an IPO registration statement with only two years (instead of three) of audited financial statements, unless the registrant 1) is a foreign private issuer (FPI) that is filing as a first-time adopter of International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB); or 2) is retrospectively applying an accounting policy or a restatement or reclassifying items in the financial statements reported in conformity with IFRS as issued by the IASB
- Comply with the SEC's detailed executive compensation disclosures on the same basis as an SRC (this is a scaled-down disclosure alternative)
- Adopt any new or updated accounting standards using the same time frame that applies to private companies
- Defer compliance with internal control auditor attestation requirements of SOX 404(b) until the company is no longer an EGC (After an issuer loses EGC status, it will still not be subject to internal control attestation requirements if it meets the definition of nonaccelerated filer.)
- Not hold nonbinding stockholder advisory votes on executive compensation or golden parachute arrangements

Corp Fin has issued several announcements and frequently asked questions (FAQs) about the JOBS Act, which are posted on the SEC's website. The FAQs address a wide range of issues, including the revenue numbers to use when determining whether the EGC revenue test is met and whether a company can take advantage of EGC status if it was once an Exchange Act reporting company but is not currently required to file Exchange Act reports.

Confidential draft submission

The JOBS Act added a provision to the Securities Act that states that an EGC may submit to the SEC a draft registration statement for confidential nonpublic review. Corp Fin's FAQ, "Confidential Submission Process for Emerging Growth Companies" (Confidential Submission FAQ), provides guidance on the confidential submission process.

Subsequently, the SEC revised the guidance so that beginning on July 10, 2017, all companies (including foreign and domestic, EGCs, and non-EGCs) are permitted to submit draft registration statements relating to IPOs for review on a nonpublic or confidential basis. This replaced the previous requirement that the company needed to qualify as an EGC or anFPI. Submitting a draft registration statement commences the SEC staff's review of an IPO filing before the company announces to the public that it is pursuing an IPO.

Although Section 6(e) of the Securities Act does not specify what a draft registration statement must include, the SEC staff expects draft registration statements to be substantially complete when submitted the first time. As discussed in question 7 of the Confidential Submission FAQ, "substantially complete" includes a signed audit report of the registered public accounting firm covering the fiscal years presented in the registration statement and exhibits. However, if the company reasonably

CROWE PRACTICE TIP

The confidential submission process should not be mistaken for a process by which a private company can submit a document to the SEC staff and have them evaluate the quality of such document. Draft registration statements that are initially confidential submissions must be publicly filed at least 15 days before the road show. Therefore, the quality of a draft registration statement should be the same as any document that a company is ready to make available to shareholders and the public.

A consent from the registered independent accountant is not required for the confidential submission. Additionally, the confidential draft registration statement does not need to include signatures from the directors and officers, and no fees are required at the time of submission. If the initial draft registration statement is not substantially complete, SEC staff contacts the company to inform it that the Corp Fin review is deferred until a substantially complete submission is made. Expect an initial comment letter from Corp Fin staff within 30 days of the initial submission of a confidential draft registration statement that is substantially complete when submitted.

believes that interim or annual financial statements will not be required at the time of the contemplated offering (for EGCs) or at the time of publicly filing the registration statement (for non-EGCs), those financial statements are not required to be presented in the draft registration statement.

For additional EGC disclosure and compliance guidance, see Topic 10 of Corp Fin's Financial Reporting Manual.

INTERACTION WITH THE SEC DURING AN IPO

The SEC is organized into multiple divisions and offices, each focused on its own goals, with the overall goal of facilitating the execution of the SEC's mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The primary division a company interacts with when registering an IPO under the Securities Act is Corp Fin. Corp Fin is composed of staff whose primary responsibility is to perform reviews of Securities Act and Exchange Act registration statements and periodic filings.

When registering an IPO, a company might also interact with the SEC's Office of the Chief Accountant (OCA). OCA is the principal adviser to the SEC on accounting and auditing matters and is managed by the SEC's chief accountant. OCA is responsible for establishing and enforcing accounting and audit policy for companies regulated by the SEC.

Furthermore, there are chief accounting offices in the Divisions of Corporation Finance (CF-OCA), Investment Management (IM-OCA), and Enforcement (ENF-OCA). CF-OCA is responsible for interpretations and policies related to financial reporting and disclosure of registrants under the Securities Act and the Exchange Act. IM-OCA reviews financial reporting documents and answers interpretive questions on accounting and financial reporting issues submitted by investment companies as defined by the *Investment Company Act of 1940*. ENF-OCA investigates possible violations of securities laws with respect to accounting, auditing, and financial issues.

Filing review process in the Division of Corporation Finance

Corp Fin is organized into nine review offices that are responsible for different industries. Each review office has a chief who is responsible for daily management of the group's reviews of its assigned registrants. When a registration statement is filed, usually a minimum of two accountants and two attorneys from the review office to which the industry is assigned review the registration statement. The Corp Fin staff generally takes up to 20 business days or 28 calendar days to email an initial comment letter on the initial registration statement and sends follow-up letters within 10 business days following the date that responses are submitted.

CROWE PRACTICE TIP

Before drafting a response to correspondence from the SEC, take note of which office is sending the letter and understand the objective of that office. We also recommend consulting with the independent auditor and SEC counsel prior to responding to any such correspondence.

The number of comments and letters companies receive from the staff depends on the quality of the document initially filed with the SEC, the number of significant legal and accounting issues related to the transaction and the entity, and the quality of responses sent to the SEC. It is not uncommon to receive several pages of comments in the first letter and for there to be a few rounds of comments before the matters are resolved. As information is added to subsequent registration statement amendments, the staff might raise new comment topics.

Comment and response letters are publicly available following the public filing of the registration statement. If the company wants to maintain confidentiality of a portion of a response letter, the company may request confidential treatment. See Corp Fin Disclosure Guidance Topic No. 7, "Confidential Treatment Applications Submitted Pursuant to Rules 406 and 24b-2," and consult with external SEC counsel before filing a CTR.

How to work effectively with Corporation Finance staff

During the registration statement process, Corp Fin staff communicates with external SEC counsel unless otherwise requested. The staff should be notified of the preferred point of contact for correspondence if it is other than SEC counsel. An ongoing dialogue with the SEC should begin no later than when the initial comment letter is received. In many cases, however, this dialogue should begin when the first submission is made to the SEC, whether it is submitted confidentially or filed publicly.

During the initial conversation, management should discuss the timing of the offering with the staff so that the staff can be as accommodating as possible to the company's timeline. The company and its advisers should be aware that the staff generally follows the timelines set forth in the preceding section, "Filing review process in the Division of Corporation Finance."

Comments issued by Corp Fin staff usually request one of two things: 1) revision to a disclosure or 2) clarification of a disclosure. A request to revise disclosure in the registration statement process is typically a request to amend the registration statement and change the disclosure. If management does not believe a revision or amendment is warranted, it should include an analysis and conclusion as to why no revision is necessary in a response to the staff's comment.

Furthermore, a comment requesting clarification of a disclosure is not a comment requesting an amendment to the filing. Rather, the staff is merely asking the company's management to supply additional facts related to the disclosure, or lack of disclosure, in the registration statement to the staff to clarify the company's view on an issue because management is likely to be in the best position to identify and evaluate facts related to particular issues. It would be prudent when responding to comments asking for clarification for management to consider whether the disclosure could be improved in light of the staff's comment, but management should keep in mind that a revised disclosure might not be necessary.

If the company does not understand a comment, it can ask for clarification by calling the SEC staff member whose phone number appears at the bottom of the letter alongside his or her name. In crafting a response, the company should keep in mind that it will be required to file all correspondence on the SEC's Electronic Data Gathering, Analysis, and Retrieval system (EDGAR), and eventually it will be released to the public. The SEC encourages registrants to seek the advice of counsel and their auditors, as applicable, when responding to SEC comment letters.

For additional information about Corp Fin's filing review process, see the overview available on the SEC's website.

Pre-clearance process with the SEC's Office of the Chief Accountant

If a company that is going public has entered into a transaction for which there is no clear accounting guidance, its management should consider consulting, or "pre-clearing," the accounting with the SEC's OCA – which is responsible for accounting and audit policy and interpretations – prior to accounting for the transaction in a filing with the SEC. When seeking to consult with OCA on a U.S. GAAP or IFRS-IASB accounting issue, pre-clearance letters may be sent via email to OCA.[39] OCA then assigns a team of accountants to consult on the issue and invites individuals from Corp Fin, including accountants from CF-OCA and AD office staff, to review the issue. Individuals assigned to review the registration statement (once it has been filed) may not participate in the pre-clearance consultation, but they have access to the materials produced as a result of the consultation process, including conclusions reached by OCA. (See "Form of Delivery and Content of Correspondence for OCA Consultations" on the SEC's website.)

If a material U.S. GAAP or IFRS-IASB accounting issue is not pre-cleared with OCA prior to registration, it is at the discretion of the Corp Fin review team to determine whether to consult with OCA on a particular accounting matter during the registration statement review process. In those limited situations in which the company wants OCA to be consulted on a topic after a filing review has commenced but before the review team engages OCA, the request can be made to the review team, which will then engage OCA.

Independence and audit consultations are topics handled by OCA and follow generally the same process that accounting consultations do, but, depending on the subject matter, individuals from Corp Fin might not be involved.

Waiver process with Corporation Finance's Office of the Chief Accountant

In the Division of Corporation Finance, CF-OCA is responsible for interpreting SEC rules and regulations with respect to filings under the Securities Act and the Exchange Act. Therefore, companies should consult with CF-OCA when seeking to do the following:

- Pre-clear an SEC-specific disclosure, such as a disclosure required by the registration statement form under the Securities Act
- Request an SEC disclosure accommodation
- Request a waiver for certain SEC-required financial statements or other disclosures under the Securities Act or the Exchange Act

As discussed in Topic 2 of the Financial Reporting Manual, under Rule 3-13 of Regulation S-X, the staff may permit the omission of one or more financial statements otherwise required under Regulation S-X or the substitution of appropriate comparable statements.

CF-OCA can be contacted by submitting a waiver request. The Corp Fin area of the SEC website contains further instructions on contacting CF-OCA for advice.

CROWE PRACTICE TIP

When considering whether a waiver request is reasonable, consider if exclusion of the required disclosure from the filing would harm an investor's ability to make an investment decision – that is, if the required disclosure is material information.

[39] Email them to the OCA at OCARequest@sec.gov.

INITIAL FILING PROCESS

Identify the registrant

The first question to answer for a potential SEC registration is, who is the registrant? In many cases, the answer to this question is straightforward and requires minimal analysis. But in other situations this question can produce a more complicated analysis.

Regulation S-X sets forth the financial statement requirements for registration statements under the Securities Act and the Exchange Act, and Article 3 of that regulation requires the filing of consolidated balance sheets and statements of income and cash flows for the registrant and its predecessors. Under Regulation S-X, the registrant is defined as the issuer of the securities for which a registration statement is filed.[40] A predecessor is defined by Rule 405 of Regulation C under the Securities Act as an acquired entity, the major portion of which (in terms of the business and assets acquired) was acquired by another entity. Therefore, usually the issuer of the securities is the registrant, and the financial statements for it and any predecessors are required in a registration statement.

When a transaction is being registered or consummated in conjunction with a securities offering, the substance of the transaction can make identifying the registrant complex. For example, when a new holding company is formed to own the operating company, and the holding company issues shares in an IPO and is therefore the registrant, the historical financial statements included in the registration statement are not those of the holding company (the issuer). Instead, the historical financial statements are those of the operating company.

This is due to the concept of predecessor financial statements. Section 1170 of Corp Fin's Financial Reporting Manual notes that a predecessor must be identified when an issuer succeeds to substantially all of the business of another entity and the issuer's own operations (in other words, the issuer's operations before succession) appear insignificant relative to the acquired business.

Assessment of the filing category

Because companies that qualify for SRC or EGC status might want to consider certain disclosure accommodations and scaled disclosure options available to them, determining whether a company qualifies as an SRC or an EGC should be done prior to drafting the registration statement. When a company that is filing an initial registration statement under the Securities Act assesses its status as an SRC, its estimated public float should be calculated within 30 days of the filing date (with a less than $250 million threshold to qualify). If the issuer has no public float (for example, if only debt securities are to be registered), the issuer must have annual revenues of less than $100 million in its most recent audited annual financial statements included in the initial registration statement to qualify as an SRC. Alternatively, the issuer could qualify as an SRC if it has less than $100 million in revenue and public float of less than $700 million. A registrant that determines it falls within the thresholds can elect

CROWE PRACTICE TIP

Carefully consider the facts and circumstances surrounding any transactions contemplated in conjunction with the securities offering. In such situations, solicit input from the independent auditor when identifying the registrant and its predecessor and when identifying the financial statements required for filing a registration statement.

CROWE PRACTICE TIP

A common IPO structure for pass-through entities (partnerships or LLCs) that gives rise to predecessor financial statement questions is an umbrella partnership corporation (Up-C). Typically, an Up-C structure involves creating a new C-corporation (the public registrant), which will hold an equity interest in the existing partnership when the IPO is completed. The financial statements of the existing partnership typically represent the predecessor of the registrant in this structure.

[40] See Rule 1-02(t) of Regulation S-X.

to take advantage of scaled disclosures available to SRCs. An SRC is not required to use scaled disclosures and may elect scaled disclosures on an ala carte basis (that is, it may elect to follow scaled disclosure for one item requirement but may elect not to follow scaled disclosure for another item).

Some of the scaled disclosure options available to SRCs are discussed in the remainder of this chapter as well as in "Filer status," Chapter 4. Also refer to Topic 5 of Corp Fin's Financial Reporting Manual, Article 8 of Regulation S-X, and the SEC's small entity compliance guide. EGC qualifications and certain accommodations are described earlier in this chapter, under "The JOBS Act and FAST Act."

Financial statement requirements

Article 3 of Regulation S-X requires that non-EGC and non-SRC companies file consolidated audited balance sheets for two years as well as statements of income and comprehensive income, changes in stockholders' equity, and cash flows for three years. An EGC or SRC is granted an accommodation to file audited statements of income and comprehensive income, changes in stockholders' equity, and cash flows for only two years in addition to the two-year balance sheet.

Regarding the dates of the financial statements, audited annual financial statements need not be updated to include the most recently completed fiscal year if all of the following criteria are met:

- They are not available yet.
- The registration statement is declared effective within 45 calendar days of the most recently completed fiscal year.
- Unaudited interim financial statements are filed as of an interim date that is no more than 134 calendar days before the registration statement becomes effective (in other words, the interim financial information is filed as of the end of the third fiscal quarter for the most recently completed fiscal year).[41]

Registrants that qualify as SRCs are granted an accommodation for the age of financial statements in an initial registration statement that allows them to forgo updating audited annual financial statements to include the most recently completed fiscal year if the statements are not available and the registration statement is declared effective within 90 days of fiscal year-end. In this situation, unaudited interim financial statements as of the third fiscal quarter-end would be required. These statements could be as old as 179 days when the registration statement is declared effective as long as the SRC 1) expects to report income from continuing operations attributable to the registrant before taxes in the most recent fiscal year and 2) reports income from continuing operations attributable to the registrant before taxes in at least one of the two audited fiscal years presented.[42]

[41] See the "Rule for Initial Filers" under Section 1200 of Corp Fin's Financial Reporting Manual and Rule 3-01 of Regulation S-X.

[42] See Rule 8-08 of Regulation S-X.

For reference, this table shows, by category of filer, the financial statement and age requirements for **initial registration statements**.

Financial statement requirements for initial registration statements

Category of filer	Audited annual financial statement requirements	Unaudited interim financial statement requirements (to the extent age requirements are met)[43]	Effective date deadline for filing audited financial statements for most recently completed fiscal year	Age requirements
Non-EGC; non-SRC	Audited balance sheets for **two years**[44]; audited statements of income, comprehensive income,[45] changes in stockholders' equity,[46] and cash flows[47] for **three years**	Interim-period-end balance sheet within 135 days of effectiveness; most recent interim period from FYE[48] to balance sheet date and corresponding PY[49] interim period income, comprehensive income, and cash flow statements; and most recent interim period from FYE to balance sheet date changes in stockholders' equity statement[50]	Within 45 days of the FYE[51]	Interim or audited annual financial statements must be as of a date within 135 days of the effective date
EGC	Audited balance sheets, statements of income, comprehensive income, changes in stockholders' equity, and cash flow statements for **two years**	Same as above	Non-SRC EGC – same as non-SRC above SRC EGC – same as SRC below	Non-SRC EGC – same as non-SRC above SRC EGC – same as SRC below
SRC	Same as EGC	Same as above	90-day rule: Within 90 days of FYE, subject to the income reporting conditions described on the previous page[52]	Interim or audited annual financial statements as of a date within 135 days of the effective date, with the exception of the 90-day rule noted in the previous column

[43] Interim financial statements included in registration statements are as of the end of a fiscal quarter and can be three, six, or nine months to date, depending on the age requirements as specified by Rules 3-01(e) and 3-02(b) of Regulation S-X. The required periods for which interim financial statements are to be provided in registration statements are not the same as those included in Form 10-Q. See the introductory language of Rule 10-01(c) of Regulation S-X.

[44] Rule 3-01(a) of Regulation S-X.

[45] Rule 3-02(a) of Regulation S-X and ASC 220-10-45-1 through 45-1B.

[46] Rule 3-04 of Regulation S-X.

[47] Rule 3-02(a) of Regulation S-X.

[48] FYE means fiscal year-end.

[49] PY means prior year.

[50] A reconciliation of stockholders' equity beginning and ending balances is required for each period that a statement of comprehensive income is presented. See Rule 3-04 of Regulation S-X.

[51] Rule 3-12(d) of Regulation S-X.

[52] Rule 8-08 of Regulation S-X.

Updated financial information

There is an explicit requirement noted in Rules 3-12(c) (for non-SRCs) and 8-08 (for SRCs) of Regulation S-X that when a filing is made near the end of a fiscal year and audited financial statements are not yet included in the filing, the audited financial statements should be included in the filing if they become available prior to the effective date. If management has more updated financial information (which may or may not be audited) available than is explicitly required by the rules before the registration statement is effective, management should disclose that information to potential investors in the registration statement.

For updated financial information to be considered available, management should be comfortable that the information is complete and accurate. In Section 1220 of Corp Fin's Financial Reporting Manual, the SEC staff notes that availability is determined based on facts and circumstances, and financial statements become available no later than when a set of GAAP financial statements are issued. Financial statements are issued, as defined in ASC 855-10-S99-2, when they are widely distributed to all shareholders and other users or filed with the SEC.

AUDITOR'S REPORT

Form AP

To provide investors with more information about participants in the audit, PCAOB rules require auditors to file Form AP, "Auditor Reporting of Certain Audit Participants," with the PCAOB for each issuer audit. Information to be disclosed includes:

- Engagement partner name
- Names, locations, and extent of participation of other accounting firms that took part in the audit and whose work constituted 5% or more of the total audit hours
- Number and aggregate extent of participation of all other accounting firms that took part in the audit whose individual participation was less than 5% of the total audit hours

The standard deadline for Form AP is 35 days after the date the auditor's report is first included in an SEC-filed document. However, for initial public offerings, the Form AP filing deadline is 10 days after the auditor's report is first included in an SEC-filed document.

Critical audit matters

PCAOB auditing standard 3101 (AS 3101) requires auditors to include in the auditor's report a discussion of critical audit matters. A critical audit matter (CAM) is any matter arising from the audit of a company's financial statements that was communicated or required to be communicated to the audit committee and that 1) relates to accounts or disclosures that are material to the financial statements and 2) involves especially challenging, subjective, or complex auditor judgment. CAM requirements were born from the communications among auditors, the audit committee, and company management about complex matters that were happening as part of the audit. CAMs are a way of bringing third-party investors into that communication and sharing those important items, making communication among all parties more transparent.

CAMs are required for audits of financial statements of all issuers except EGCs. The standard also requires the auditor's report to include disclosure of auditor tenure – that is, the year in which the auditor began serving consecutively as the company's auditor.

OTHER REQUIRED FINANCIAL INFORMATION

Other financial statements and information

Other financial statements and information are required when certain tests of significance are triggered for specific transactions. The most commonly required financial statements, other than the consolidated financials of the registrant and its predecessor, are those for 1) significant completed or probable acquisitions, pursuant to Rule 3-05 of Regulation S-X; 2) significant equity-method investments, pursuant to Rule 3-09 of Regulation S-X; and 3) the parent company only, pursuant to Rule 12-04 by operation of Rule 5-04(c) of Regulation S-X.

Significant business acquisitions

Financial statements

Financial statements of an acquired business, or a probable business acquisition, typically should be filed with the SEC in a registration statement if any of the significance test calculations exceed 50% or if the registration statement is declared effective 75 days or more after a significant acquisition exceeding 20% significance is consummated. In the following discussion, the annual financial statements for significant acquisitions should be audited. These financial statements may be audited under American Institute of Certified Public Accountants (AICPA) standards if the acquired entity is not an issuer as defined by the SEC in Section 3 of the Exchange Act.

Pro forma financial information

The SEC requires that specific pro forma financial information be provided in registration statements when certain transactions are consummated and when certain significance thresholds are met. SEC-required pro forma financial information for significant business acquisitions differs from the disclosure of supplemental pro forma information required by ASC 805 in terms of the threshold for disclosure and the disclosure location. For example, SEC pro forma financial information is required when certain numerical significance thresholds are met and the information is provided outside of the annual financial statements. In contrast, supplemental pro forma information under ASC 805 is required when it is material and is included in the footnotes to the financial statements.

In order to determine whether pro forma financial information is required, one must first evaluate whether a transaction has occurred that would require disclosing such information. Transactions such as a significant business combination, a disposition of a significant portion of a business, an acquisition of one or more real estate operations, a roll-up transaction,[53] or a business that was previously part of another entity (such as a carved-out business) might require pro forma disclosure. See Article 11 of Regulation S-X to evaluate whether such a transaction has occurred and whether a business combination or disposition transaction is significant.

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[53] As defined by Item 901(c) of Regulation S-K, a roll-up transaction is one involving partnerships in which investors will receive new securities or securities in another entity.

Once it is determined that a transaction requiring pro forma financial information has occurred, the pro forma financial information must follow certain guidelines prescribed by Article 11 of Regulation S-X. Specifically, an introductory paragraph, a pro forma condensed balance sheet, pro forma condensed statements of income, and accompanying explanatory notes should be included. Columnar format is preferred for the financial statements.

Calculating significance of an acquired business

If a business (as defined in Rule 11-01(d) of Regulation S-X) is acquired, significance testing should be performed to determine whether Rule 3-05 financial statements are required to be filed. After compliance with the Final Rule, the three significance tests in Rule 1-02(w) of Regulation S-X are:

- **Investment test:** Fair value of purchase consideration as a percent of the registrant's aggregate worldwide market value for a specified period of time
- **Asset test:** The registrant's share of assets in the subsidiary as a percent of the registrant's total consolidated assets as of the most recent fiscal year-end
- **Income test:** For the most recent fiscal year, the lower of a) the registrant's share of pretax income of the acquired business as a percent of the registrant's pretax incomes; or b) the registrant's share of annual revenue of the acquired business as a percent of registrant's annual revenue

If any of the three significance tests exceed 20%, financial statements of the acquired business must be included in the registrant's filing. For example, if significance exceeds 20% but is less than 40%, only the most recent fiscal year and subsequent interim period financial statements of the acquired or to-be-acquired business are required to be included in the registrant's filing. Presentation of the comparative interim period is not required. The two most recent fiscal years and the subsequent and comparative interim periods are required if significance exceeds 40%.

Preparing pro forma financial information

The pro forma income statement should be completed assuming the transaction was consummated at the beginning of the fiscal year presented and should include "transaction accounting adjustments" – that is, adjustments to reflect the application of the required accounting for the transaction – and may include footnote discussion of "management adjustments" to depict expected synergies or dis-synergies of the transaction when certain criteria are met. Additionally, some pro forma presentations (for example, carve-outs) require "autonomous entity adjustments" that show the adjustments needed to present the results of operations as if the issuer was a separate, stand-alone entity. The pro forma balance sheet should be completed assuming the transaction was consummated as of the most recent balance sheet date presented, and it should include transaction accounting adjustments and autonomous entity adjustments, if applicable.

Significant equity-method investment financial statements

For significant equity-method investments of a registrant, financial statements of the investee should be included in the registrant's filing for the periods when significance is calculated in excess of 20% using the investment or income tests as defined in Rules 3-09 and 1-02(w) of Regulation S-X for any period presented in the registrant's filing. The equity-method investee's annual financial statements should be included in the registrant's filing for the same number of years required of the registrant, but the required financial statements only need to be audited for the years when significance exceeds the threshold. Interim financial statements are not required, but summarized income statement information for significant equity-method investees should be disclosed for interim periods, pursuant to Rule 10-01(b)(1). Generally, the annual financial statements may be audited under AICPA standards for certain non-issuer investees.[54]

See Section 2400 of Corp Fin's Financial Reporting Manual for additional guidance on financial statement requirements for significant equity-method investments.

Parent-company-only financial information

Parent-company-only condensed financial information is not subject to the same significance testing as the previously discussed financial statements. Parent company financials are required when restricted net assets (those net assets that may not be transferred to the parent by subsidiaries without the consent of a third party) of consolidated subsidiaries exceed 25% of consolidated net assets as of the end of the most recently completed fiscal year. The objective of this financial information is to show the financial condition and operations of the parent company (the registrant) as a stand-alone entity when there are restrictions on the amount of net assets the subsidiaries may transfer to the parent company. This information can be material to an investment decision when the dividends paid by the registrant to shareholders are affected by the restrictions placed on the subsidiaries transferring funds to the registrant. See Section 2810 of the Corp Fin Financial Reporting Manual for additional information on the required condensed financial information of the registrant or parent company.

SEC accounting and disclosure matters

Companies registering with the SEC must analyze a number of accounting matters. For some matters, the SEC has issued its own guidance for public companies, and typically private companies do not consider this guidance unless they are planning to go public and register with the SEC. In addition, SEC staff tends to commonly consider and comment on particular concerns during registration statement reviews. The following is an explanation of a few accounting-related matters companies should consider carefully prior to submitting a registration statement to the SEC.

[54] See Section 4110.5 of Corp Fin's Financial Reporting Manual for specific requirements when an auditor's report of a nonissuer whose financial statements are filed to satisfy Rule 3-09 of Regulation S-X needs to comply with PCAOB standards or when an audit firm auditing the Rule 3-09 financial statements needs to be registered with the PCAOB.

Materiality considerations

A general principle of SEC rules and regulations addressed in Rule 4-01 of Regulation S-X indicates that SEC filings should include, at a minimum, the required financial statement disclosure, and as appropriate, further material information should be included to avoid making the financial statements misleading. When evaluating whether certain disclosures are required, materiality should be assessed. Immaterial items are not required to be disclosed in SEC filings, according to Rule 4-02 of Regulation S-X and in conformity with U.S. GAAP (ASC 105-10-05-6).

In 1999 the SEC issued Staff Accounting Bulletin (SAB) 99 on the subject of materiality (now included in ASC 250-10-S99). In the press release, the SEC reminded management not to make intentional immaterial errors in order to manage earnings and to be cognizant of its legal responsibility to keep books and records that accurately and fairly reflect transactions and the dispositions of assets. The SEC also reminded auditors of their obligations to inform management and, in some cases, audit committees about illegal acts.

The SAB addressed the following concerns, among others:

- The SAB lists some of the circumstances in which small misstatements could be material. Further, the SAB states that the very practice of managing earnings might be a material fact to disclose, because most investors would consider it significant.
- The SAB states that the use of a numerical threshold, such as 5% of an item, is only a preliminary assumption or initial step. Further consideration is needed to determine if a reasonable user of the financial statements would consider the matter important. The SEC notes that courts have required considering the “total mix” of available information, and that the FASB has rejected a formula approach to materiality in favor of judgment based on all of the circumstances.
- Assessing significance needs to be done on both a gross and a net basis. Thus a misstatement, even if offset by other misstatements, could need to be corrected.
- Because the Securities Act and the Exchange Act require books and records to be accurate in reasonable detail, the SAB lists some factors to consider for determining whether an immaterial misstatement is a violation of these laws. An intentional immaterial misstatement might be an illegal act, requiring the auditor to communicate that matter to the audit committee, even if it is immaterial when netted with other misstatements.

Error corrections and restatements

The financial statements are made publicly available in the initial public filing with the SEC, and any material error corrections that might arise from the SEC review would require that the financial statements be labeled “restated” in an amended filing before the SEC declares the registration statement effective. In an IPO, the restatement label and related disclosures can be removed when an additional full fiscal year of financial information is added in an amendment to the filing.

Management also must continue to consider the disclosure requirements for error corrections and restatements found in ASC 250-10-50. Consistent with the SEC’s guidance, ASC 250-10-50 does not require restatement disclosures to be repeated in subsequent periods. However, when management of the private company

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In a March 2022 statement, SEC Chief Accountant Paul Munter reminded stakeholders that materiality should be based on the total mix of information from a reasonable investor’s perspective, and he reminded them of how the SEC staff views materiality. For example, the staff believes that “as the quantitative magnitude of the error increases, it becomes increasingly difficult for qualitative factors to overcome the quantitative significance of the error.”

restates previously issued financial statements (even if the financial statements were not issued publicly but were issued only to certain creditors or other parties), management should notify users of the previously issued financial statements. As with all disclosures, materiality should be assessed to determine whether the error correction must be disclosed publicly.

In 2006, the SEC issued SAB 108, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements," which is now included in ASC 250-10-S99. SAB 108 describes two approaches for assessing material errors that commonly were used in practice: the rollover approach and the iron curtain approach. The rule requires registrants to use the dual approach (both approaches) to evaluate misstatements.

The rollover approach (income statement approach) focuses on the impact of the misstatement to the current year's income statement. This approach is weak because it allows immaterial misstatements to accumulate each year, and correcting the cumulative amount in a given year could result in a material error in the income statement.

The iron curtain approach (balance sheet approach) views the correction of any adjustments from prior years to be a correct adjustment for the current year. The primary weakness of this approach is that it can result in a situation in which a misstatement in the current-year income statement is not evaluated as an error.

In applying the dual approach that is required by the SEC, registrants must quantify the impact of correcting all prior-year misstatements on the current-year financial statements. By using both the rollover and iron curtain approaches, they must correct the current-year financial statements if either approach results in a material misstatement. In addition, if an error is identified in the current year, a separate analysis of the financial statements of prior years should be performed to determine whether prior-year financial statements were materially misstated. If such an error is identified, prior-year financial statements should be restated in accordance with ASC 250-10.

In addition, under PCAOB AS 2201 the restatement of previously issued financial statements to correct a material error is considered an indicator of a material weakness. Accordingly the impact an error has on ICFR should be considered.

After the IPO and listing on an exchange, the issuer will be subject to the SEC's final rule "Listing Standards for Recovery of Erroneously Awarded Compensation."[55] When there is an accounting restatement, which includes "Big R"[56] or "little r"[57] error corrections, the final rule requires an analysis of whether there was any incentive compensation that executives would not have received had the financial statements included the accounting error(s). If so, the issuer is required to recover, or "claw back," the compensation from the executives. Incentive compensation is any compensation that is based wholly or in part on a financial measure. The issuer's clawback policy must be filed in its annual report on Form 10-K. If an accounting restatement occurs that requires recovery, the issuer must disclose various matters including the

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Those charged with governance might want to consider whether the issuer's current or future compensation philosophy will include incentive compensation that would be covered by the clawback rule.

[55] See "Listing Standards for Recovery of Erroneously Awarded Compensation," published in the Federal Register on Nov. 28, 2022.

[56] "Big R" restatements correct errors that are material to previously issued financial statements.

[57] Restatements that correct errors that are not material to previously issued financial statements but would result in a material misstatement if 1) the errors were left uncorrected in the current report or 2) the error correction was recognized in the current period are called "little r" restatements.

aggregate dollar amount of erroneously award compensation and how that amount was calculated, the aggregate amount that has not been recovered as of the end of the fiscal year, and the estimates and methodology used to determine erroneously awarded compensation tied to share price or TSR.

Goodwill impairment

Generally, the disclosures related to a goodwill impairment analysis include those required by ASC 350-20-50 and critical accounting estimates required in MD&A, pursuant to Item 303 of Regulation S-K. Item 303(b)(3) requires issuers to provide qualitative and quantitative information to understand the estimation uncertainty and the impact a criterial accounting estimate has had or is reasonably likely to have on financial condition or results of operations. The objective of goodwill disclosures in critical accounting estimates is to provide information that allows an investor to assess the probability of a future material impairment charge. Section 9510 of the Corp Fin's Financial Reporting Manual provides recommended disclosures when there is a reporting unit with material goodwill and at risk of failing step one of the impairment test.

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Companies that previously applied private company council (PCC) alternatives for goodwill and intangibles, which are not allowed in IPO financial statements, will have changes to their historical accounting, including the need to reassess goodwill impairment triggering events throughout the historical financial statement periods.

Share-based compensation in IPOs

Sometimes companies contemplating an IPO grant stock options or stock awards to key employees before the company goes public. ASC 718, "Compensation – Stock Compensation," and SAB Topic 14, "Share-Based Payment," address accounting requirements for private companies going public, as well as the ongoing financial reporting and disclosure requirements after the IPO. Determining the fair value of such awards before the offering date is inherently subjective because the underlying shares are not actively traded. The AICPA's Accounting and Valuation Guide (AICPA Guide), "Valuation of Privately-Held-Company Equity Securities Issued as Compensation," provides guidance and best practices for valuing private company securities.

When such equity securities are issued shortly before the IPO (less than 12 months) and the IPO price significantly exceeds the fair value of equity securities (or the fair value of equity securities used as an input to a stock-option valuation model) issued before the IPO, the SEC staff will frequently challenge the pre-IPO fair value. Management should be able to support its significant judgments and key assumptions used to estimate the fair value. The AICPA Guide recommends obtaining a contemporaneous valuation from an independent specialist to determine the fair value of securities issued as compensation.

Estimates used to determine share-based compensation are often considered critical for companies going public. In particular, estimating the fair value of the underlying shares can be highly complex and subjective because the shares are not publicly traded. The staff has included suggested disclosures in Section 9520, "Share-Based Compensation in IPOs," of the Financial Reporting Manual. Companies should discuss material assumptions, methodology and judgments used, and the extent of complexity and subjectivity in the estimate. The company should also disclose that estimates of fair value will not be necessary once the underlying shares are traded publicly.

After an IPO, a registrant might be in possession of material nonpublic information and should consider the staff's interpretive guidance[58] on "spring-loaded" share-based compensation.

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[58] See SAB 120.

Complex financial instruments

The decision to go public can result in a number of changes to a company's historical accounting for financial instruments. For example, SEC registrants with redeemable financial instruments must apply Rule 5-02.27 of Regulation S-X (codified within ASC 480-10-S99). Under Rule 5-02.27, an SEC registrant must present outside of permanent equity (that is, as temporary equity) any financial instruments that are redeemable at the option of the holder or upon the occurrence of an event not solely in the issuer's control (for example, a preferred share that is redeemable upon a change-in-control event that is outside the issuer's control). Instruments classified as temporary equity that are currently redeemable must be measured at their maximum redemption amount or, if the maximum redemption amount is contingent on an index or variable (for example, the fair value of the instrument), based on the conditions existing at the balance sheet date. If a company has not historically applied the guidance in ASC 480-10-S99, it may need to change its balance sheet classification of redeemable financial instruments as it prepares to go public.

Under the *Employee Retirement Income Security Act* (ERISA), employer securities that are held by participants in an employee stock ownership plan (ESOP) and that are not readily tradable[59] on an established market must include a put option. The ESOP put option is a right to demand that the sponsor redeem shares of employer stock held by the participant. If conditions exist when holders of equity securities may demand cash in exchange for their shares (regardless of probability), the sponsor, if an SEC registrant, is required by ASC 480-10-S99-4 to record the maximum possible cash outlay outside of permanent equity (as temporary equity on the balance sheet). For a company registering with the SEC, Rule 5-02 would apply to ESOP shares until there is no right of the holder to put back the shares received or to be received. The ESOP share put right typically terminates when the underlying shares are listed on the NYSE or Nasdaq or traded on certain foreign exchanges. In this case, companies registering with the SEC would classify their ESOP shares outside of permanent equity until the put terminates.

An IPO can also affect historical conclusions about whether an instrument, or a feature embedded therein, meets the definition of a derivative instrument. For example, a warrant to acquire common shares of a nonpublic company that requires gross settlement (that is, cash for shares) generally would not be considered a derivative instrument because it does not result in "net settlement." If that company went public, however, the warrant might now be considered a derivative because the publicly traded shares into which the warrant are exercised would likely be considered readily convertible to cash. Similar changes in conclusions could occur for features embedded in a financial instrument – for example, a conversion option embedded within preferred stock or a debt instrument.

In situations when derivative conclusions may be affected, companies may need to update their previous accounting analyses to consider whether the instrument or embedded feature qualifies for an exception to the derivative literature. For example, an instrument that might otherwise be treated as derivative upon a company's IPO might qualify for the "indexed to own equity" scope exception. Companies will need to document their considerations as to whether any exceptions to derivative accounting apply.

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[59] For companies going through an IPO, this is the case even if they have OTC-traded securities, because those securities are not included in the definition of readily tradable securities on an established market. See Section 409(h) of the IRC. Readily tradable on an established market is defined by the term "publicly traded" in Treas. Reg. 54.4975–7(b)(1)(iv).

Entities preparing to go public should also review their fair value policies, procedures, and disclosures as the SEC staff frequently comments on such matters. For example, companies should ensure models used to measure the fair value of financial instruments appropriately reflect the impact of any embedded features that could affect valuation. The SEC staff also frequently requests registrants to enhance their disclosures on fair value to include further quantitative information, including information about unobservable inputs used in fair value measurements.

Selected staff accounting bulletins

Staff accounting bulletins (SABs) are accounting interpretations and policies followed by the Division of Corporation Finance and the Office of the Chief Accountant. SABs should be considered by registrants in preparing their financial statements included in IPO registration statements and subsequent periodic filings. Some of the more commonly applicable SABs are discussed here; however, this is not a complete list of SABs that may apply to a specific registrant's financial statements.

SAB Topic 5.A, "Expenses of Offering." Specific incremental costs that are directly attributable to a proposed or actual securities offering may be properly deferred and netted against the offering proceeds (paid in capital), but costs related to an aborted offering should be expensed and not deferred. The SEC defines a short postponement as a period up to 90 days and notes that such a period does not represent an aborted offering. Management salaries and other general and administrative expenses may not be allocated to the cost.

SAB Topic 4.C., "Changes in Capital Structure." When a stock dividend, stock split or reverse stock split occurs after the latest balance sheet date, but before the financial statements are issued, or before the effective date of a registration statement, the SEC staff has indicated such transactions require retroactive effect in the balance sheet, and appropriate footnote disclosure.

SAB Topic 4.E., "Receivables From Sale of Stock." Under Rule 5-02 of Regulation S-X, receivables from the sale of capital stock are reported as deductions from stockholders' equity, and not as assets. In this SAB, the staff indicated the receivable from the sale of stock may be reported as an asset if paid in cash before the financial statements are issued, and the payment date is disclosed in the financial statements.

SAB Topic 5.T., "Accounting for Liabilities Paid by Principal Stockholder(s)." When a company's principal stockholder transfers shares to a plaintiff to settle litigation against the company, the settlement should be recognized as an expense in the company's financial statements with an offsetting credit to paid in capital. Similar accounting is required for other transactions where the principal stockholder pays an expense for the company, unless the action is caused by a relationship or obligation completely unrelated to their position as a stockholder and clearly does not benefit the company.

Impact of recently issued accounting standards

SAB Topic 11.M (also known as SAB 74) requires SEC registrants to disclose, if material, the impact that recently issued accounting standard(s) is (are) expected to have on a registrant's financial statements when adopted. SAB 74 disclosures can be particularly helpful to investors and users in understanding the impact of these accounting standards when adopted.

SAB 74 disclosures are expected to increase in specificity as the registrant gets closer to an adoption date. Registrants should disclose the impact of adoption, once it is known. In a 2016 announcement, the staff stated that if a registrant does not know or cannot reasonably estimate the impact that adoption of an accounting standard is expected to have on the financial statements, then in addition to making a statement to that effect, the registrant should consider additional qualitative financial statement disclosures to help the reader assess the significance of the impact that the standard will have on the registrant's financial statements when adopted.

The additional disclosures to be considered include:

- A description of the effect of the accounting policies that the registrant expects to apply, if determined
- A comparison to the registrant's current accounting policies
- A description of the status of the registrant's process to implement the new standard
- The significant implementation matters yet to be addressed

The FASB codified this SEC staff announcement in ASC 250-10-S99-6.

U.S. GAAP disclosure for public companies

As a company evaluates new disclosures that will be required once it becomes a public company, management should consider the public company adoption dates for new accounting standards as well as U.S. GAAP disclosure requirements that are specific to public entities (including SEC reporting companies) and incremental to disclosures for private entities.

Public company adoption dates

Private companies are usually permitted an additional year, and sometimes longer, to adopt new or revised accounting standards compared to public companies. Public company adoption dates apply to financial statements included in IPO registration statements, unless the private company qualifies as an EGC, and elects to use the private company adoption date accommodation for new or revised standards. Many EGCs have taken advantage of this accommodation in recent years for a number of major accounting standards, including revenue recognition, leases, and credit losses.

Accounting standards can provide transition guidance to varying subsets of companies, so knowing the definitions used by FASB in its guidance is important, particularly for non-EGCs because they are not permitted to use private company adoption dates. Generally, the more recent FASB standards use the definition of a public business entity (PBE), which is a broader definition of public company than used in previous standards. However, both PBEs and earlier definitions include SEC filers and companies in the process of registering securities with the SEC.

Some standards have delayed effective dates for PBEs that are not SEC filers. This is an important distinction for other entities that are not otherwise SEC filers, but whose financial statements (for example, due to Rule 3-05 or Rule 3-09 requirements) are included in a submission by another SEC filer. They are considered PBEs but not SEC filers.

CROWE PRACTICE TIP

Management of a private company wanting to go public should carefully consider public company transition periods for recently issued accounting standards and accounting alternatives available only to private companies (such as the standards issued by the Private Company Council that are not available to public companies, including EGCs).[60]

Segment disclosures

Segment disclosures are required for public entities, pursuant to ASC 280-10. The general objective of such disclosures is to provide investors with the disaggregated operating results that management evaluates in order to assess performance and allocate resources throughout the company. The required segment disclosures are specified in ASC 280-10-50 and include, among others, a measure of profit or loss and total assets for each reportable segment. The measures might differ from what is reported in the consolidated financial statements but 1) should be consistent with the measure reported to the chief operating decision-maker for purposes of making decisions about allocating resources to and assessing performance of the segment and 2) should be reconciled to the consolidated financial statements as required by the standard. ASU 2023-07 requires new incremental segment disclosures and is effective for fiscal years beginning after Dec. 15, 2023, and interim periods within fiscal years beginning after Dec. 15, 2024.

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When evaluating the reasonableness of segment disclosures, ask whether an investor has sufficient disaggregated disclosure (consistent with the objectives of ASC 280-10) available to understand the company's performance relative to its business activities and to assess the prospects of its cash-generating ability or cash requirements at the operating-segment level.

Earnings per share

Earnings per share presentation and disclosure requirements apply to public entities. Computation and presentation of earnings per share (EPS) might be new for some private companies. Depending on complexity of the company's existing capital structure and any new securities issued, the EPS computation can be complicated, and applicable EPS guidance (ASC 260-10) requires careful consideration. Earnings per share must be disclosed on the face of the income statement for public entities (including SEC reporting companies), pursuant to ASC 260-10. Basic and diluted earnings per share should be disclosed on the face of the income statement, and a reconciliation of the numerator and denominators for each per-share calculation should be disclosed in the notes.

Additional disclosures or pro forma presentations may be required in certain situations, such as distributions to owners or promoters or other changes in capitalization at or prior to IPO closing, or distribution of offering proceeds in excess of earnings. (Refer to Financial Reporting Manual 3420, 3430 and 7340 for additional details.)

[60] The staff's view that EGCs are public entities and are not able to use the private company alternatives in SEC filings was discussed at the SEC Regulations Committee meeting on Sept. 25, 2013.

Other incremental public company financial statement disclosures

Under various FASB ASC topics and SEC rules, public company financial statements, including financial statements in an IPO registration statement, require more disclosures than private companies. Here are a few examples:

- Income taxes, such as a quantitative reconciliation of income tax expense at the statutory rate to the amount reported for income tax expense from continuing operations (Rule 4-08(h) of Regulation S-X); additional disaggregated information in the rate reconciliation as well as for income taxes paid required by ASU 2023-09, effective for PBEs for annual periods beginning after Dec. 15, 2024
- Fair value disclosures, including a narrative description of the sensitivity of level 3 fair value measurements to changes in unobservable inputs
- Business combinations, such as supplemental pro forma disclosures in the footnotes
- Defined benefit pension plans and postretirement plans, such as a tabular reconciliation of beginning and ending balances of the benefit plan obligation, showing applicable individual components (for example, service costs, interest costs, contributions, benefits paid, and actuarial gains and losses)
- Disclosure of related party transactions required on the face of the applicable financial statement (Rule 4-08(k) of Regulation S-X)
- Presentation of the number of common shares issued and outstanding on the face of the balance sheet (Rule 5-02 of Regulation S-X)

Other disclosure matters for SEC registrants

In addition to incremental financial statement requirements and disclosures applicable to SEC registrants, management should be aware of other disclosure requirements that apply to information included in the registration statement that is outside the financial statements. Some examples include MD&A, non-GAAP financial measures, capitalization and dilution tables, risk factors, cybersecurity, climate-related disclosures, and the prospectus summary.

Management’s discussion and analysis

Many private companies are not required to provide a robust discussion of their financial results in their annual report. Thus, MD&A is often a disclosure that requires a significant amount of time and effort to compose for companies going public. The purpose of MD&A is to explain the company’s results of operations and financial condition through the eyes of management in order to help investors determine whether past performance is indicative of future performance. It can be written at the segment level if management believes that is the appropriate level to facilitate an understanding of the company’s financial situation. See Item 303 of Regulation S-K for MD&A disclosure requirements.

The discussion should be specific and cover the annual and interim periods presented in the financial statements. For an EGC or an SRC in the initial registration statement, it can be limited to two years if the financial statements cover only two years.

Emerging risks, including those mentioned in the introduction, might represent a trend or uncertainty for the registrant. MD&A requires disclosure of known trends and uncertainties affecting revenues or income, including the relationship between revenues and costs (for example, labor costs and materials). One often overlooked MD&A disclosure requirement is the narrative discussion of the extent to which changes in revenue are attributable to changes in price or volume of goods or services sold.[61] This disclosure, which should address increases or decreases in revenue as applicable, coupled with additional analysis, could be critical to understanding an entity's performance. For example, if revenue has increased for the most recent two years due to price increases, it likely would be material for an investor to know such a fact, as well as whether management reasonably expects the price increases to be a trend that will continue into the future. Similarly, if volume is the main reason for an increase in revenue, it could be material to an investor to understand whether the company reasonably expects to continue to increase volume in the future by entering into additional geographic locations or by increasing the production of goods. Furthermore, if the company has a metric or other key indicator for the purposes of understanding price or volume changes in goods sold, management should consider disclosing that metric and discussing recent trends in the metric.

Item 303 of Regulation S-K also requires disclosures focused on material short- and long-term liquidity needs. Disclosures should address cash requirements from known contractual and other obligations and include a discussion of known trends or uncertainties affecting the registrant's liquidity or capital resources. For example, disclosures should identify internal and external sources of liquidity and any actions taken to remedy an identified liquidity deficiency. The disclosures also should address the registrant's material cash requirements (for example, commitments for capital expenditures), sources of funding, and why there are material cash requirements. Disclosures also should include significant changes in equity, debt, or off balance sheet financing. See Item 303(b)(1) of Regulation S-K.

CROWE PRACTICE TIP

Critical accounting estimate disclosures should supplement, not duplicate, the company's accounting policies or other disclosures in the notes to the financial statements.

Item 303(b)(3) of Regulation S-K requires disclosure of critical accounting estimates, which are estimates that have significant estimation uncertainty and materially affect the registrant's financial statements. Critical accounting estimates disclosure should provide investors with enough quantitative and qualitative information, when material and reasonably available, to understand why estimation uncertainty exists and how the estimate has affected the registrant over time, including how much each estimate has changed during the reporting period and the sensitivity of the reported amounts to the calculation's methods, assumptions, and estimates.

When developing MD&A, preparers should give detailed consideration to all the required disclosures. Investors and the SEC spend a considerable amount of time reviewing and assessing MD&A because it is management's story of the company's financial performance. The SEC encourages the disclosure of forward-looking information in MD&A to provide investors a fuller picture of the organization and its future. If forward-looking information is disclosed, care should be taken to ensure that all material assumptions and any related uncertainties are fully disclosed.

[61] See Item 303(b)(2)(ii) and (iii) of Regulation S-K.

Non-GAAP financial measures

Public companies frequently use non-GAAP financial measures to supplement discussion of their historical or future financial performance, financial position, or cash flows. These measures start with GAAP but are not calculated in accordance with GAAP. A common example is EBITDA, which starts with GAAP earnings and then adds back interest, income taxes, depreciation and amortization. As a general rule, the SEC staff does not encourage the use of non-GAAP information, nor does the SEC expressly prohibit it. Further, the SEC staff does not require companies to include non-GAAP information in SEC filings even when used by management outside of their SEC filing. However, the staff does expect that the story management tells investors outside of SEC filings is consistent with the disclosure in SEC filings and other public information.

The SEC adopted rules to address the use of non-GAAP financial measures by public companies. Regulation G applies to any public disclosure of a non-GAAP financial measure. Item 10(e) of Regulation S-K adds more requirements for disclosures in registration statements and other SEC filings, and certain aspects of Item 10(e) apply to earnings releases furnished under Item 2.02 of Form 8-K.

A non-GAAP financial measure, which has the same meaning in Regulation G and Item 10(e) of Regulation S-K, is defined as:

> *"[A] numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:*
>
> *(i) Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or*
>
> *(ii) Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented."*

Under Regulation G, a public company that discloses a non-GAAP financial measure must present the most directly comparable GAAP measure, and quantitatively reconcile the individual difference(s) between the non-GAAP and GAAP measures. Regulation G also prohibits using a non-GAAP financial measure that contains a material misstatement or omission.

Under Item 10(e)(1)(i) of Regulation S-K, for non-GAAP financial measures disclosed in SEC filings or earnings releases furnished under Form 8-K, the company must also:

- Present, with equal or greater prominence, the most directly comparable GAAP financial measure
- Provide a quantitative reconciliation of the difference(s) between the non-GAAP and GAAP financial measures
- Provide a statement about why management believes that non-GAAP financial measure is useful for investors
- To the extent material, explain additional purposes, if any, for which management uses the non-GAAP financial measure

Item 10(e)(1)(ii) of Regulation S-K identifies certain prohibitions in the use of non-GAAP measures in SEC filings that should be considered.

CROWE PRACTICE TIP

The primary consideration in evaluating the quality of non-GAAP disclosures is verifying that such disclosures are not misleading given that the measures on which they are based represent a departure from GAAP. It is important to verify that the measures provide useful information to investors – and to confirm that statements and disclosures are consistent across all publicly available information, including earnings calls, presentations, and SEC filings.

In various staff interpretations and public speeches, the SEC has provided examples of some pitfalls to avoid when disclosing non-GAAP measures. For example, the staff has observed the use of potentially misleading non-GAAP financial measures, such as:

- A performance measure that excludes normal, recurring, cash operating expenses necessary to operate a registrant's business
- Inconsistencies in the calculation of a non-GAAP measure from period to period
- Inconsistencies in the treatment of gains and losses that are similar in nature (that is, adding back nonrecurring losses and not deducting nonrecurring gains, or "cherry-picking")
- Non-GAAP measures that use "individually tailored" accounting principles (such as a non-GAAP policy to accelerate revenue recognition when it should be deferred under GAAP or changes an item from accrual to cash or from gross to net)
- Presenting a non-GAAP measure with a label that does not reflect the nature of the non-GAAP measure (such as labeling a non-GAAP measure the same as a GAAP line item or subtotal even though it is calculated differently or labeling a non-GAAP measure "pro forma" that is not calculated consistent with pro forma requiments in Article 11 of Regulation S-X)
- Non-GAAP performance measures that look like liquidity measures and are presented on a per-share basis
- Presenting the non-GAAP measure more prominently than the comparable GAAP measure
- Presenting a non-GAAP income statement, alone or as part of the required non-GAAP reconciliation, that is comprised of non-GAAP measures and includes all or most of the line items and subtotals found in a GAAP income statement

The staff believes no amount of disclosure can remedy a misleading non-GAAP measure. Additional guidance on this topic is available in Corp Fin's "Compliance and Disclosure Interpretations – Non-GAAP Financial Measures," and Topic 8 of Corp Fin's Financial Reporting Manual, as well as the SEC's "Conditions for Use of Non-GAAP Financial Measures" (SEC Release No. 33-8176).

Capitalization table

Many domestic registrants are asked by the underwriter of the offering to prepare a capitalization table, and in that case they look at the disclosure requirements in Form 20-F for FPIs by analogy. Item 3.B of Form 20-F by operation of Item 4(a) of Form F-1 requires an FPI to disclose a capitalization table. The capitalization table includes capitalization as of a date no earlier than 60 days prior to the date of the document that shows capitalization on an actual basis and, if applicable, an as-adjusted basis to reflect the sale of new securities being issued and the intended application of the net proceeds from those securities.

Regarding timing, the staff will not object if the capitalization table of an FPI is presented as of the same date as the most recent balance sheet required in its registration statement as noted in Section 6270 of Corp Fin's Financial Reporting Manual. Domestic registrants analogize this guidance when developing their tables. Generally, it is reasonable for a domestic registrant to include a capitalization table as of the same date as the balance sheet date, but underwriters might request more updated information.

CROWE PRACTICE TIP

Generally, the capitalization table reflects the offering on an as-adjusted basis using the midpoint of the IPO price range when shares are being registered for a firm-commitment underwritten offering. In addition, given that there is no specific disclosure rule for domestic registrants and that guidance is limited, the primary consideration in evaluating the quality of the capitalization table disclosure is verifying that such disclosure is not misleading.

The SEC provides guidance for domestic registrants regarding the pro forma amounts in the capitalization table. When developing pro forma financial information, it is prohibited to assume offering proceeds in the capitalization table and in other pro forma presentations, except in limited circumstances that are described in Section 3320 of Corp Fin's Financial Reporting Manual. Many offerings fall under the exception of a firm-commitment underwritten offering or another exception, and in those cases it is acceptable to assume offering proceeds in the capitalization table for pro forma purposes.

Dilution table

When a company uses Form S-1 in an IPO, the company is required to disclose dilution (the excess of the offering price over the net tangible book value per share) to investors in the offering. This disclosure must be made in instances in which common shares are being registered, and there is substantial disparity between the public offering price and the price paid by existing owners for shares in transactions during the past five years or for shares they have the right to acquire.

The required disclosures include the following:

- A comparison of the proposed IPO price per share and the price paid by existing owners
- The net tangible book value per share before and after the IPO
- The increase in net tangible book value per share attributable to the cash payments made by investors in the offering
- The amount of immediate dilution from the IPO price that will be absorbed by investors in the offering

CROWE PRACTICE TIP

The dilution table usually reflects the offering price using the midpoint of the IPO price range when registering shares for a firm-commitment underwritten offering. In addition, it might be necessary to present net tangible value per share on a pro forma basis, depending on the transactions reflected in the pro forma financial statements elsewhere in the registration statement. The dilution amount should best reflect the difference in the net tangible book value and the offering price that is absorbed by investors in the offering immediately after the IPO occurs.

Risk factors

Under Item 105 of Regulation S-K, registrants (other than SRCs) must disclose under the caption "Risk Factors" material factors that make investing in the registrant or its offering speculative or risky. Risk factors should be described in a logical order, organized under relevant headings. This section is often divided into subsections such as risks related to the issuer's business, risks related to the industry in which the issuer operates, risks related to economic or other macro events, and risks related to the common stock of the issuer. Risk factors should be specific to the registrant and should not be general risks that could apply to any company. They should be concise and organized logically. A summary of risk factors of no more than two pages is required in the forepart of the prospectus if the risk factor section exceeds 15 pages. The registrant should explain how each risk factor affects the registrant. The SEC staff might question risk factors that are stated too broadly. The staff also might question the completeness and consistency of these disclosures compared to other information in the registration statement or otherwise publicly available.

Emerging areas of risk such as those mentioned in the introduction and how they might affect the issuer might need to be addressed in Risk Factors or other sections of the prospectus.

Cybersecurity

Cybersecurity threats have become more frequent as more companies rely on networked systems and internet usage has increased and might result in risk factor, MD&A, or other disclosures in the company's IPO filings. Once the IPO occurs, additional cybersecurity disclosures are required, which are discussed in the Forms section of Chapter 4.

Climate-related disclosures

In March 2024, the SEC finalized new climate-related disclosure rules. In IPO registration statements for fiscal years beginning in 2027 or later, new registrants will be required to include information about the entity's climate-related governance, strategy, risks, and targets (Item 1500 of Regulation S-K). The financial statement notes (Article 14 of Regulation S-X) will also require information, subject to quantitative thresholds, about the impact of any severe weather events or natural conditions on the company and, if material, how carbon offsets are used to meet the company's climate-related goals. Additional disclosure considerations, which are discussed in the Forms section of Chapter 4, apply once the IPO occurs.

CROWE PRACTICE TIP

Court challenges might affect compliance dates, and entities subject to the final rules should monitor litigation developments.

Quantitative and qualitative disclosures about market risk

Item 305 of Regulation S-K requires quantitative and qualitative information about market risk (for example, interest rates, foreign exchange rates, and commodity prices) using hypothetical changes in market rates or prices that are expected to reflect reasonably possible near-term changes. The company must present information separately for trading instruments and nontrading instruments using one of three alternatives (tabular, sensitivity, or value at risk). SRCs are not required to provide market risk disclosures.

Related party transactions

Item 404(a) of Regulation S-K requires disclosure of related party transactions exceeding $120,000 since the beginning of the latest fiscal year, or proposed for the current year, and in which the related person had or will have a direct or indirect material interest. (The initial registration statement on Form S-1 required this disclosure for the two prior fiscal years. See Instructions to Item 404.) The registrant should describe the nature of the transaction and its dollar amount, and disclose how the person is related to the registrant and their involvement in the transaction. Financial Reporting Manual Section 9610 indicates that, for certain relationships and transactions with related parties, these disclosures may need to be supplemented with additional discussion in the MD&A. Disclosure should be provided when an investor might not be able to understand the registrant's reported results of operations without a clear explanation of these arrangements and relationships.

Prospectus summary

Under Item 503 of Regulation S-K, registrants are required to provide a summary when the length or complexity of the prospectus makes a summary useful. The summary should provide a brief explanation of the key aspects of the offering, and it should be in plain English. The prospectus summary may also include summary business or financial information, which, if provided, must also be in plain English. The SEC staff may question registrants when this disclosure is not properly balanced between positive and negative information.

4. LIVING AS A PUBLIC COMPANY

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LIVING AS A PUBLIC COMPANY

Having climbed the technically complex route of an IPO and SEC registration, the newly public company must become accustomed to a new sort of life as an SEC reporting company.

CROWE PRACTICE TIP

Part of living as a public company is continually evaluating emerging risks, new regulations, messages from regulators, and new accounting standards. Public companies have an obligation to monitor these and other developments for evolving stakeholder expectations and to ensure investors receive accurate, transparent, and complete disclosures.

SEC REPORTING OBLIGATIONS

Once a company has an effective Securities Act registration statement, the newly public company is immediately subject to the Exchange Act periodic reporting requirements. The significant reporting requirements under the Exchange Act include annual, quarterly, and current reporting requirements that are often determined by the filing category of the registrant. Certain other requirements under the Exchange Act will not be applicable until the company's securities are registered under the Exchange Act. Such registration is typically required by underwriters and might also be triggered by the number of public stockholders or other requirements.

The importance of compliance with the periodic reporting requirements cannot be overemphasized. The periodic reports represent a primary form of communication with shareholders and the financial community in general. Poorly prepared, incomplete, or late reports might adversely affect relations with investors and the public. It could preclude future use of certain simplified registration forms and in some cases might even lead to SEC enforcement actions.

Filer status

CROWE PRACTICE TIP

SRC status, which provides certain disclosure accommodations, uses both the public float calculation and revenues from the previous fiscal year.

Once an IPO is completed and a company becomes an SEC reporting company, management will be required to assess its filing category under the Exchange Act annually. A registrant's filing status affects, among other matters, the filing due dates for periodic reports and whether the company's annual internal control report needs to be audited.

Because the filing status is assessed at the end of each fiscal year, any change in status will first affect the Form 10-K filed as of its fiscal year-end. As part of the assessment, management should determine the company's public float as of the company's most recent **second** fiscal quarter-end (for example, a calendar year-end company will perform the public float test as of June 30).

Filer status assessment

The following table summarizes the public float and revenue thresholds for entry into the respective filing status.

<table>
<tr><th colspan="4">Public float and revenue thresholds for entering filing status</th></tr>
<tr><th>Initial public float</th><th>Initial annual revenue</th><th>Filing status*</th><th>ICFR audit required?**</th></tr>
<tr><td>Less than $75 million</td><td>N/A</td><td rowspan="2">Nonaccelerated filer and SRC</td><td>No</td></tr>
<tr><td>$75 million to $700 million</td><td>Less than $100 million</td><td>No</td></tr>
<tr><td>$75 million to $250 million</td><td>$100 million or more</td><td>Accelerated filer and SRC</td><td>Yes</td></tr>
<tr><td>$250 million to $700 million</td><td>$100 million or more</td><td>Accelerated filer (not SRC)</td><td>Yes</td></tr>
<tr><td>More than $700 million</td><td>N/A</td><td>Large accelerated filer</td><td>Yes</td></tr>
</table>

* Stepping down a filing status is based on lower thresholds than stepping up a filing status. Specifically, a large accelerated filer becomes an accelerated filer when its public float decreases to less than $560 million. An accelerated filer becomes a nonaccelerated filer when its public float decreases to less than $60 million. A nonaccelerated filer is not subject to the ICFR audit requirement, irrespective of its annual revenue. Further, an accelerated filer may retain its accelerated filer status (because its public float is $60 million or higher) but no longer be subject to the ICFR audit requirement when its revenue decreases to less than $100 million, if also SRC, or to less than $80 million, if not SRC.

** EGCs are not subject to ICFR audit requirements. The criteria for qualifying as an EGC are defined in Chapter 3.

Reporting obligations by filer status

This table shows the principal reporting obligations for each category of filer on Forms 10-K and 10-Q. The next section, "Forms," elaborates on the reporting obligations noted in the table.

Filing status*	Filing deadlines	Periods presented in Form 10-K	Periods presented in Form 10-Q	Management's annual assessment of ICFR effectiveness	Disclosure controls and procedures (DCPs) and SOX 302 certifications
Large accelerated filer (LAF) (also non-SRC)	Form 10-K: 60 days Form 10-Q: 40 days	Annual FS 3 years; except balance sheet 2 years	Balance sheet: Most recent quarter end and prior fiscal year-end Statements of income and comprehensive income: YTD and prior year comparable period; QTD and prior year comparable period Cash flow statements: YTD and prior year comparable period Statements of shareholders' equity: Same as income statements	Required in second Form 10-K	Required in all Form 10-Ks and Form 10-Qs
Accelerated filer (AF) (not SRC)	Form 10-K: 75 days Form 10-Q: 40 days	Same as LAF	Same as above	Same as above	Same as above
Accelerated filer (and SRC)	Same as AF (not SRC)	Annual FS 2 years	Same as above	Same as above	Same as above
Nonaccelerated filer (also SRC)	Form 10-K: 90 days Form 10-Q: 45 days	Annual FS 2 years	Same as above	Same as above	Same as above

* An EGC will not be required to include, in its first annual report on Form 10-K, audited financial statements or selected financial data for any period prior to the earliest audited period presented in connection with its IPO (see question 30 of the SEC's "Generally Applicable Questions on Title I of the JOBS Act").

Forms

The primary forms on which domestic SEC registrants file their financial statements and comply with periodic reporting requirements on an annual and quarterly basis are Forms 10-K and 10-Q, respectively. In addition, registrants are required to make current reporting disclosures on Form 8-K upon the occurrence of certain specified events. Once a company has registered a securities offering under the Securities Act, the first periodic report is due for periods ending after the date of the last balance sheet included in the registration statement.[62]

Form 10-K

Form 10-K is the primary report used to update annually much of the information contained in the original registration statement. The form includes annual financial statements, MD&A, cybersecurity governance disclosure,[63] climate-related disclosures (after the compliance date applicable to the company), and a description of business. For non-SRCs, the form also includes risk factors.

Form 10-K deadlines are summarized in the table "Reporting obligations by filer status" earlier in this section. Some of the information required in Form 10-K also is required in other SEC filings, most commonly the annual shareholders' report prescribed by the SEC's proxy requirements. Information that has been included in a previous SEC filing or will be included in a future proxy statement filing may be incorporated by reference in the Form 10-K by referring to the previously filed document or the future proxy statement filing. For example, management may incorporate certain disclosures required in Part III of Form 10-K by reference to the future proxy statement filing that includes such disclosures, provided the proxy statement is filed within 120 days of the fiscal year-end. Part III of Form 10-K requires, among other items, disclosure of executive compensation and, for non-SRCs and non-EGCs, disclosure of the ratio of CEO pay to that of the median employee. All disclosure requirements and instructions for the form can be found in Form 10-K.

Exhibits pursuant to Item 15(b) of Form 10-K, such as the company's certificate of incorporation or stock incentive plans, are another example of information that often is filed separately and is incorporated by reference into the Form 10-K. See the exhibit table in Item 601 of Regulation S-K for specific applicability of exhibits to forms, for not all exhibits must be filed in all SEC forms. All companies must include hyperlinks to each exhibit listed in the exhibit index.

Form 10-Q

The Form 10-Q quarterly report is a summary report principally containing quarterly unaudited condensed financial statements and MD&A of financial condition and results of operations. In addition, certain specified events (such as legal proceedings, material changes in risk factors, and certain material defaults), when present, need to be disclosed in the 10-Q. Form 10-Q deadlines for each of the first three fiscal quarters are summarized in the "Reporting obligations by filer status" table earlier in this section. See Form 10-Q and Article 10 (or for SRCs, Article 8) of Regulation S-X for additional information on interim reporting requirements and instructions.

CROWE PRACTICE TIP

Cybersecurity governance disclosures include information about how the board and management assess, respond to, and manage cyber risk as well as information about how cybersecurity-related threats, including previous cyber incidents, have materially affected or are reasonably likely to materially affect the registrant.

CROWE PRACTICE TIP

Climate-related disclosures include the items discussed in Chapter 3 and, for LAFs and AFs, material Scope 1 and Scope 2 greenhouse gas emissions (GHG). Compliance dates for each disclosure and attestation on GHG disclosure is phased in based on filer status. The SEC's fact sheet on the final rules outlines the phase-in dates for each disclosure and filer status, though court challenges could affect the compliance dates.

[62] See Section 1310.1 of Corp Fin's Financial Reporting Manual.
[63] See Item 1C of Form 10-K and Item 106 of Regulation S-K.

A challenge that newly public companies must overcome is the requirement to make quarterly filings, which include the most recent quarter and interim year to date period as well as the comparative periods in the prior year, on a regular basis. Because quarterly information is not always required in a registration statement (interim information is required in certain cases depending on the timing of the filing[64]), the company's first Form 10-Q could be the first time that the company has to close its books on a quarterly basis in the short period of time (40 to 45 days, depending on the category of the filer) that the SEC allows before the quarterly report must be filed. See the table "Reporting obligations by filer status" earlier in this section.

CROWE PRACTICE TIP

It is prudent to begin a quarterly close process prior to registering with the SEC so that interim information is available for the current fiscal year and prior fiscal year if needed in the registration statement. In addition, adopting this process before registering with the SEC will help prepare the company to close its books on a quarterly basis as an SEC registrant, including making all period-end adjusting entries on a quarterly rather than annual basis.

Form 8-K

Form 8-K is required to be filed within four days of the occurrence of certain events including, but not limited to, material cybersecurity events, a change in control, significant acquisition or disposition of assets, bankruptcy or receivership, a change in auditor, entry into material amendment or termination of material definitive agreements, earnings releases, new material obligations, material restructurings or impairments, restatements, and certain changes in directors or officers. The form specifies certain minimum disclosures for such events.

Significant acquisitions of assets are defined differently for purposes of Form 8-K disclosure than for purposes of assessing whether financial statements are required under Rule 3-05 of Regulation S-X. For more information about significant acquisition or disposition of assets, see Instruction 4 to Item 2.01 of Form 8-K.

In general, an asset acquisition or asset disposition is significant if the net book value or the purchase price of the acquired or disposed assets exceeds 10% of total consolidated assets of the registrant. An acquired or disposed business is significant if that business meets the definition of a significant subsidiary under Rule 11-01(b) of Regulation S-X.

Internal control over financial reporting

An effective system of ICFR is a key aspect of a company's ability to meet the ongoing reporting requirements of a public company. SOX enhances standards for corporate responsibility and governance, places additional requirements on executives of publicly traded companies, and restricts the types of services external auditors can provide to the company. CEOs and CFOs must certify financial results, and substantial penalties have been established for corporate wrongdoing. Compliance with SOX 404 provisions is reinforced through fines, imprisonment, and other penalties.

SOX 404 requires the largest share of SOX compliance efforts. SOX 404 applies to all SEC registrants subject to the Exchange Act reporting requirements, including all significant subsidiaries. It requires documentation, evaluation, and testing of ICFR. CEOs and CFOs are required to issue an assertion on those controls annually. In some cases (that is, when the registrant is not an EGC and qualifies as an accelerated or large accelerated filer), external auditors must issue an attestation report on ICFR effectiveness.

[64] Refer to the table "Financial statement requirements for initial registration statements," Chapter 3, for unaudited interim financial statement requirements in an IPO.

Management's assessment of ICFR

Management's assessment of ICFR is required by SOX 404(a), regardless of filer status, when the second Form 10-K after an IPO is filed. A SOX 404 assessment covers ICFR, which is defined by Rule 13a-15(f) of SEC Regulation 13A, as follows:

> *"A process designed by, or under the supervision of, the registrant's principal executive and principal financial officers, or persons performing similar functions, and effected by the registrant's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:*
>
> *(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the registrant*
>
> *(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the registrant are being made only in accordance with authorizations of management and directors of the registrant*
>
> *(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the registrant's assets that could have a material effect on the financial statements."*

A registrant is permitted to limit the scope of its ICFR assessment to exclude a current-year acquisition when it is not possible to conduct an assessment of the acquired entity's ICFR between the acquisition date and the assessment date. (See question 3 in the SEC's FAQ on "Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports.")

Beginning with the second Form 10-K and subsequent Form 10-Qs, disclosure of any change in ICFR that has materially affected, or is reasonably likely to materially affect, ICFR is required.[65] Also, an independent auditor's attestation report on ICFR is required for large accelerated filers and accelerated filers that are not EGCs. The ICFR requirements are summarized in the "Reporting obligations by filer status" table earlier in this chapter.

CROWE PRACTICE TIP

Because the SOX compliance process is a significant and time-consuming task, we recommend that your management team begin addressing it at least 18 months before compliance is required.

SOX 404 compliance program

A typical SOX 404 compliance program includes seven phases, for which management is responsible. Management might choose to have an internal audit department or a third party perform some of these activities on its behalf.

The following is a list of seven best practices of SOX 404 compliance for a company that is going public and the activities to be performed during each phase:

1. **Planning and scoping**
   - A SOX 404 steering committee is formed. The steering committee often includes the CFO, general counsel, HR, internal audit, IT and major process owners; and sometimes the CEO.
   - The steering committee should decide on frequency and content of meetings. The independent auditor may attend some of the meetings, depending on content.

CROWE PRACTICE TIP

So that management can limit surprises in an audit of ICFR, accelerated filers should engage their independent auditor throughout the SOX 404 process to understand the auditor's scoping of systems, processes, and controls in addition to testing methods and sample sizes.

[65] See Item 308 of Regulation S-K as well as question 7 of the SEC's FAQ revised Sept. 24, 2007, on "Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports."

- A recognized control framework is selected as a standard for management's assessment – for example, the framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).[66]
- A risk assessment of internal controls is performed.
- Processes are prioritized and mapped to financial statements.

2. **Process and controls documentation**
   - Existing documentation is evaluated to determine the extent to which it can be used in the SOX 404 process.
   - A documentation format is selected (for example, flowcharts, narratives, or a combination of the two).
   - Technology tools are chosen for purposes of maintaining adequate SOX 404 documentation. Tools should be considered as an enabler of the process and documentation, not as a substitute for thoughtful analysis of the financial reporting risks and related process.
   - Controls in the processes are documented.
3. **Controls design assessment**
   - Controls are identified and assessed including enterprise controls, corporate governance and management controls, and IT general and application controls.
   - Control design deficiencies are identified and tracked for potential remediation.
   - Results of controls design assessments are reviewed with the steering committee.
4. **Controls effectiveness testing**
   - In the first year of SOX 404 implementation, controls testing often occurs in multiple cycles that may include: 1) pre-filing year testing, 2) filing year testing, and 3) filing year retesting. Each round of testing is followed by a period of controls remediation.
   - Results from controls effectiveness testing are reviewed with the steering committee.
5. **Remediation of design and testing deficiencies**
   - Controls design and effectiveness deficiencies are fixed.
6. **Filing year retesting**
   - Remediated controls are tested.
   - Any update testing necessary for effective controls through year-end is completed.
   - Any necessary remediation activities are implemented prior to year-end.
7. **Year-end certification and assessment procedures**
   - Results from final controls testing are reviewed with the steering committee.
   - Any significant deficiencies and material weaknesses are reported to the audit committee and the auditors. In addition, material weaknesses must be disclosed in the annual assessment of ICFR in Form 10-K. The assessment must state that ICFR is ineffective if a material weakness is identified.[67]
   - The principal executive and financial officers are required to make quarterly ICFR certifications and disclosures about any material changes in ICFR in Forms 10-Q and 10-K.[68]
   - The principal executive and financial officers are required to make the annual assertion on ICFR in Form 10-K.[69]

CROWE PRACTICE TIP

As SEC Chief Accountant Paul Munter mentioned in his August 2023 statement, management's risk assessment of internal controls should "comprehensively and continually consider issuers' objectives, strategies, and related business risks; evaluate contradictory information; and deploy appropriate management resources to respond to those risks."

CROWE PRACTICE TIP

Even in situations where the external auditors are not required to issue an attestation report on ICFR effectiveness, if a material weakness in ICFR has been identified by either management or the auditors, that material weakness must be identified and disclosed.

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66 COSO is the Committee of Sponsoring Organizations of the Treadway Commission, which developed a control framework that is commonly used for purposes of SOX 404 compliance. The original 1992 COSO framework was superseded by the new 2013 COSO framework after Dec. 15, 2014.

67 See Item 308(a)(3) of Regulation S-K.

68 See the certifications required at Item 601(b)(31) of Regulation S-K and Item 308(c) of Regulation S-K.

69 See Item 308(a) of Regulation S-K.

When assessing internal control design and operating effectiveness, management should keep in mind the definitions of "deficiency," "significant deficiency," and "material weakness." A deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.[70] A significant deficiency is defined as a deficiency, or a combination of deficiencies, in ICFR that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the registrant's financial reporting. A material weakness is defined as a deficiency, or combination of deficiencies, in ICFR in which there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.[71]

Material weaknesses are observed more commonly in certain areas than others, such as:

- Revenue recognition
- Income tax processes
- Departments with personnel turnover in areas where significant judgments and estimates are made on a quarterly basis
- IT, due to a lack of control structures and processes, including restricted access and segregation of duties
- Key spreadsheets, due to the manual nature of spreadsheets

See Section 4300 of Corp Fin's Financial Reporting Manual for more on the topic of ICFR compliance.

CROWE PRACTICE TIP

Other material weaknesses disclosed by registrants that cause concern among investors include control weaknesses that indicate that the tone at the top of an organization is not ethical (for example, whistleblower allegations against executive management would require particularly careful evaluation) or that the company lacks the infrastructure to maintain compliance with public company rules and regulations.

IT systems under SOX 404

One significant consideration for SOX 404 compliance is IT systems. To evaluate IT controls (information technology application and general controls) in all relevant systems and to avoid surprises late in the process, companies should begin by identifying all financially significant systems early in the process. In many cases, supporting systems are overlooked. Supporting systems include those that support internal control activities, such as source code control systems, program-change deployment tools, ticketing systems (ones that track end-user requests, incidents, and authorization and resolution procedures), and monitoring tools. It is important to understand how these systems are used, how documentation is maintained, and whether access and operational controls are necessary.

Management should also consider whether there are any planned system conversions and, if so, the strategy to use to validate the effectiveness of internal control and data integrity after the conversion. If an acquisition is planned, management should identify the key systems (the company's own systems as well as the target company's systems) that will be affected by the acquisition and determine the timeline for any conversions of the target company's systems to the company's existing systems.

[70] Refer to Appendix A of auditing standard 2201.
[71] See Rule 1-02(a)(4) of Regulation S-X.

An appropriate level of segregation of duties should be implemented at all levels of the organization, and this includes IT systems. Access control lists to all key systems should be maintained to support such segregation.

If certain aspects of IT are outsourced, management should develop an inventory of vendors and providers in order to gain an understanding of outsourced systems. If service organization controls (SOC) reports are available and cover the company's outsourced business activities, management should consider the following when evaluating the reports:

- Time periods covered
- Scope (for example, whether the correct system(s) and control activities are included)
- Subvendors (for example, whether a key function has been outsourced to another vendor or a subservice organization and, if so, whether that function is financially significant enough to merit an evaluation of the subservice organization's controls)
- Independent auditors' report (a review of the issued opinion, including test results and deficiencies identified)

As part of the SOC report evaluation, management should analyze gaps in the control environment and implement additional controls design or testing activities in order to address any such gaps. Furthermore, if SOC reports are not available or not reliable, other control activities should be implemented to address the important identified risks.

External threats, including cybersecurity threats, are also important considerations. Specifically, management should select and develop control activities that are designed and implemented to restrict technology access rights to authorized users commensurate with their job responsibilities and to protect the entity's assets from external threats. An appropriate level of scrutiny, including a look at the ability of external parties to access the company's data, should be given to data security.

Disclosure controls and procedures and SOX Section 302 certifications

SOX 302 requires quarterly certifications by the principal executive and financial officers to confirm that the financial statements not only fairly present the company's financial position and results, but also that those officers have evaluated the effectiveness of disclosure controls and procedures (DC&P), among other certifications. DC&P is defined by the SEC in Rule 13a-15(e) of Regulation 13A:

> *"[C]ontrols and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the [Exchange Act] is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure."*

CROWE PRACTICE TIP

Following are some common data security pitfalls to avoid:

- *The assumption that a system enforces a control. All key systems with automated or application controls, including those with dual verification, must be tested in order to validate the effectiveness of controls related to the system. Dual verification is a method of authorization that usually includes two user identifications in order to release a transaction.*
- *Absence of segregation of duties. Even when segregation of duties is in place, a failure to enforce those duties with system controls may occur.*
- *Program changes. Often overlooked, program changes should be authorized and tested prior to migrating into a production environment. The impact of not implementing program change controls can be significant to data integrity, system function, and system performance.*
- *User access rights. Rights must be updated to reflect terminated users. Employees or former employees could retain access to financially significant systems, and monitoring controls are often insufficient for confirming unauthorized activity.*

DC&P is broader than ICFR because it includes all the disclosures made in filings with the SEC. Therefore, to determine the effectiveness of DC&P, management must consider ICFR and the controls and procedures in place to ensure that disclosure outside the audited financial statements is complete and accurate.

Additional disclosure of DC&P is required by Item 307 of Regulation S-K. Quarterly, the principal executive and financial officers must offer conclusions about the effectiveness of the registrant's DC&P. These certifications and disclosure of the effectiveness of DC&P are required to be filed upon the first periodic filing whether it is a quarterly or annual filing.

Unresolved staff comments

In addition to being required to make the disclosures summarized in the "Reporting obligations by filer status" table earlier in this chapter, large accelerated filers and accelerated filers must disclose unresolved SEC staff comments pursuant to Item 1B of Form 10-K. This disclosure is required if the registrant received material written comments regarding periodic or current reports 180 days or more before the end of the fiscal year to which the Form 10-K relates.

CROWE PRACTICE TIP

"Material" is a matter of judgment. Consult with independent auditors and external SEC counsel in situations in which there is a question about whether disclosure is required. Discussion with the SEC staff might also be helpful.

Interactive data files – XBRL

The SEC has adopted rules that require public companies to tag their financial statements using eXtensible Business Reporting Language (XBRL). XBRL is a type of computer code that enables users of financial data to search SEC filings more easily because software applications can recognize and process XBRL-tagged financial information files. XBRL must be filed as exhibits to periodic reports, some current reports, and most registration statements, as well as transition reports for a change in fiscal year. Such exhibits, however, are not required in IPOs.[72]

The SEC adopted a rule in 2018 to require the use of Inline XBRL for tagged data. Inline XBRL involves embedding XBRL data directly into a filing so that the filing can be read by both a human and a machine. The new rules do not change the categories of XBRL filers or the scope of disclosures subject to XBRL requirements.

For U.S. GAAP financial statements, a filer should use the U.S. GAAP taxonomy, which is a list of tags that contains descriptive labels, definitions, and authoritative references to U.S. GAAP and SEC regulations.

CROWE PRACTICE TIP

Corp Fin provides a sample comment letter to assist companies in understanding common areas of staff comment on XBRL data.

[72] See SEC Release No. 33-9002.

SEC COMMENT LETTER PROCESS ON PERIODIC FILINGS AND CURRENT REPORTS

Corp Fin not only reviews registration statements, as noted in "Interaction with the SEC during an IPO," Chapter 3; Corp Fin also reviews periodic and current reports filed with the SEC pursuant to the Exchange Act.

Forms 10-K and 10-Q

SOX requires that a review of every registrant occur at least every three years, and Corp Fin typically reviews a significant number of companies more frequently. Annual periodic filings, primarily on Form 10-K for domestic registrants and Forms 20-F and 40-F for foreign registrants, are selected as of the beginning of the SEC's fiscal year, which is Oct. 1. Each review office in Corp Fin is industry focused and responsible for reviewing those annual filings – in addition to other filings, such as those selected due to the identification of a risk indicator or due to a recent filing of a registration statement – during the fiscal year that runs from Oct. 1 to Sept. 30.

Often, the selected filings are prioritized by market capitalization of the registrant and key risk indicators. The most recent interim and current reports on Forms 10-Q and 8-K (or Form 6-K for FPIs) are usually considered during the review of the annual periodic filings. During the review, the staff might consider additional publicly available information, such as analyst reports, the company's website, and earnings call transcripts.

A review team usually includes at least two accountants and may include at least two attorneys as well. In some situations, however, only one accountant or one attorney reviews a filing.

The staff might complete a review in a number of ways, but usually a review results in one of the following outcomes: The staff 1) issues comments on the filing(s) that were reviewed, 2) determines that no comments should be issued, or 3) refers a filing to the SEC's Division of Enforcement (Enforcement).[73]

If the staff issues a comment letter, the letter requests the registrant respond within 10 business days or tell the staff when the registrant intends to respond. As in the registration process, the number of comments and letters received from the SEC staff depends on the quality of the document initially filed with the SEC, the number of significant legal and accounting issues included in the filing, and the quality of responses sent to the SEC. It is common for a company to receive one or two rounds of comments during a Form 10-K review, and if a letter is issued it is common to receive two to 10 comments in the initial letter.

See "Interaction with the SEC during an IPO," Chapter 3, for additional considerations that might apply to the periodic filing review and comment letter process.

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[73] A filing might be referred to Enforcement 1) because the registrant is not responding to comments, 2) because the issuer is severely delinquent in its periodic filings, or 3) for other reasons that suggest that a referral to Enforcement is warranted.

Form 8-K

Typically, the Corp Fin staff reviews all Items 4.01 (change in auditors) and 4.02 (restatement of financial statements) that are filed on Form 8-K, and comment letters sometimes are issued only on these filings. These item requirements of the Form 8-K are the source for the vast majority of the comments on Form 8-K. The Form 8-K comment letter process generally follows the same procedures as Form 10-K reviews, but usually only accountants are involved in the Form 8-K comment letter process for these specific items.

OTHER SEC REGULATIONS

Compliance with SEC rules as a public company involves a number of legal nuances. Some of the more common matters are highlighted in this section for informational purposes only. The following section should not be construed as legal advice or used for ultimate compliance. Management should consult SEC legal counsel for legal advice on these matters.

Proxy solicitation

SEC rules dictate the form and content of a company's proxy solicitation materials and its proxy statement (the materials that the company provides to its shareholders in advance of their vote) depending on the business matters for which the security holders are voting. Voting usually occurs in connection with the shareholders' annual meeting, though there are events, such as mergers or large share issuances, that also require shareholder approval, which can also occur at a special meeting. Matters for which security holders typically vote at annual meetings include director nominations, stock plans and amendments to stock plans, and auditor ratifications.

CROWE PRACTICE TIP

As part of corporate governance, we recommend that management consider the standards of proxy advisory firms that provide voting advice to shareholders, because an advisory firm's standards and reports can influence shareholders.

The NYSE and Nasdaq require that the process for selecting directors be disclosed. State laws typically require a majority of shares to be represented in person or by proxy at a meeting in order to conduct business. SEC Rules generally allow a stockholder who has owned a certain dollar value of shares for a specified period of time to have their proposal included in the company's proxy material. However, state laws limit the scope of shareholder approvals.

Annual proxy statements require disclosure of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function, and the effect that this has on the board's leadership structure. The SEC has reminded registrants how to apply the principles-based disclosure system to emerging risks and the risk oversight role of the audit committee. The board should consider the consistency of its risk oversight disclosure with the risk factor disclosures included in the registrant's periodic filings.

CROWE PRACTICE TIP

SEC staff recently issued comment letters on governance disclosures. Disclosures of the board's role in risk oversight should address why the entity's chosen leadership structure addresses the specific challenges of the business.

An annual proxy or information statement that includes executive compensation disclosures[74] must also include pay versus performance[75] information. However, the pay versus performance rules do not apply to EGCs, FPIs, or registered investment companies. SRCs have scaled-back disclosures. Registrants are required to include a table disclosing specific executive compensation and financial performance measures for the five most recently completed fiscal years or, if an SRC, the three most recently completed fiscal years.

When the annual meeting relates to the election of directors, the ratification of independent accountants, a shareholder proposal or the approval of a benefit plan, management must file the proxy solicitation materials with the SEC no later than the date they are first distributed to the stockholders. When stockholders will be voting on matters beyond the previously listed topics, the SEC requires a preliminary proxy to be filed with the SEC at least 10 days prior to the distribution to stockholders. The preliminary proxy could prompt an SEC review and, potentially, a comment letter.

An annual report (also known as a glossy) must be submitted to shareholders when shareholder approval is needed for the election of directors. However, most companies make an annual report available to stockholders on their website each year, regardless of whether directors are being elected. In addition, submission of the glossy annual report to the SEC must be done using an electronic submission on EDGAR.

Exceptions to the rules exist: FPIs are not required to submit proxy statements, and EGCs are exempt from the proxy requirements to hold a say-on-pay vote, a say-on-pay-frequency vote, and – in a business combination transaction – a say-on-golden parachute vote. Also, there is no need for compliance with the proxy rules if there is a registration under the Securities Act but no registration under the Exchange Act.

Tender offers and ownership reports

The SEC regulates both the mechanics for making tender offers and the procedures for management to resist tender offers. Shareholders or groups of shareholders acting together who acquire more than 5% of the company's shares or make a tender offer that would result in more than 5% ownership are subject to specified disclosure requirements.

Reports must be filed with the SEC and provided to the company and any stock exchanges listing the shares. The reports must provide specified information, which usually includes the identity and background of the purchaser, the source and amount of funds used in the purchase, the purpose of the transaction, and the number of shares owned.

A short-form Schedule 13G is allowed if the acquisition is by certain institutional stockholders and relates to more than 5% but less than 20% of a company's shares, and there is no intention to change or influence control. If the intention is to change or influence control, a Schedule 13D must be filed. As with the proxy solicitation rules, the tender offer rules generally apply only to companies that have securities registered with the SEC under the Exchange Act.

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[74] See Item 402 of Regulation S-K.

[75] See the Instructions to Item 402 of Regulation S-K.

Insider trading

Certain insiders, including all directors and officers, as well as any shareholders with more than a 10% holding in a company's shares, are required under Section 16 of the Exchange Act to report their holdings to the SEC within certain time periods. Any subsequent changes in those holdings must likewise be reported. These reports on Form 4 must be filed with the SEC within two business days of any change.

To prevent the unfair use of insider information, these insiders are also subject to the Exchange Act's provisions about short-swing profits – that is, profits realized by insiders on the purchase and sale, or sale and purchase, of any of the company's securities within a six-month period, whether or not those transactions were based on insider information and whether or not the same shares are involved. The insiders are required to turn over to the company an amount equal to the difference between the highest sale price and the lowest purchase price, with no offset for losses. If the company does not recover those profits, either voluntarily from the insider or by suing the insider, any shareholder may do so on behalf of the company.

The Exchange Act prohibits insiders from selling shares they do not own (short sales) and from selling shares they own but do not deliver within 20 days after the sale (short sales against the box). Blackout trading restriction regulations further prohibit directors and officers from trading securities during a pension blackout period.

Rule 10b5-1 protects insiders who purchase or sell stock using a trading plan (that is, a programmed sale), even when they have material nonpublic information. On Dec. 14, 2022, the SEC issued final rules, "Insider Trading and Related Disclosures," that update conditions of the affirmative defense to insider trading liability in Exchange Act Rule 10b5-1, places certain restrictions on Rule 10b5-1 plans, and requires new disclosures. Insider trading plan disclosures required in Form 10-Q and Form 10-K include the material terms of any director or officer 10b5-1 plan adopted, modified, or terminated during the period. Additional annual disclosures include the issuer's policies and procedures, including governance over the timing of option or similar awards and the disclosure of material nonpublic information and tabular disclosure of options or other awards granted either four days before or one day after the release of nonpublic information (for example, on Form 10-K, 10-Q, or 8-K). The disclosure requirements are effective for issuers other than SRCs for the first full fiscal period beginning on or after April 1, 2023, and for SRCs for the first full fiscal period beginning on or after Oct. 1, 2023. The SEC issued interpretive guidance on the effective date of quarterly and annual disclosures.

Individuals (regardless of whether they are Section 16 insiders) are prohibited from engaging in transactions when they are aware of material nonpublic information and from disclosing ("tipping") this information to others who then trade on such insider information. This applies equally to those privy directly to the insider information (such as company employees and consultants) and anyone receiving such information before it is made public. Both the insider (whether or not he or she personally benefits) and the person being tipped might be subject to liability for damages to everyone who traded in the security during the period of the illegal insider trading.

To comply with statutory and regulatory requirements and help prevent illegal activities that occur when employees abuse their access to insider information, companies should develop an insider trading policy before they go public. Often, companies adopt blackout dates (usually close to the end of the fiscal quarters and the earnings releases), during which insiders cannot trade the company stock. Controls should be in place to protect the confidentiality of sensitive information, and anyone who must have access to such information must be made aware of the consequences of trading on or tipping such information. Furthermore, to minimize the number of people with access to the information, executives might decide to coordinate all press statements and contacts with analysts, reporters, and other public figures through a single individual.

Foreign Corrupt Practices Act

Contrary to what its title might imply, the *Foreign Corrupt Practices Act* (FCPA) does not apply only to companies with foreign operations. The FCPA was passed by Congress in 1977 in response to disclosures of questionable or illegal foreign payments made by U.S. companies. Thus the FCPA deals in part with prohibitions of such practices by all U.S. companies and their shareholders, directors, officers, employees, and agents.

The law imposes certain other requirements not related directly to foreign practices. Specifically, it requires that all publicly held companies do the following:

- Devise and maintain a system of internal control sufficient to, among other things, provide reasonable assurance that transactions are properly authorized and recorded
- Keep records that “accurately and fairly” reflect financial activities in reasonable detail

Although these requirements were intended to strengthen the anti-bribery provisions, the law does not limit the internal control requirement to the prevention or detection of foreign bribery. Consequently, the directors and management of a public company are responsible for ensuring that the provisions of the FCPA are complied with, whether or not the company has foreign operations.

Reselling regulations and SEC Rules 144, 144A, and 701 of the Exchange Act

Controlling shareholders are not free to sell their shares in the public markets at will; rather, they must sell them by either registering a secondary offering or relying on a specified exemption. Similarly, shares acquired in a private placement (such as Regulation D offerings) are considered restricted stock and subject to resale restrictions intended to ensure that the private placement was not simply one step in a broader public distribution.

The securities are considered restricted securities because they are initially sold under a rule that exempts them from registration. The holders of such securities are subject to limitations on their ability to resell the securities unless they are registered or held for a specified duration. Rule 144 of the Exchange Act pertains to the reselling of restricted securities or the selling of any shares by directors and executive officers (control stock), and Rule 701 pertains to the exemptions for transactions involving securities issued in a compensation arrangement by a nonpublic company.

Rule 144 provides a safe harbor for sales of control stock and restricted securities. Essentially, the rule and its revisions allow insiders and holders of restricted stock who have held the stock for six months or one year (the former if the issuer is subject to the Exchange Act reporting requirements for at least 90 days and the latter if not) after it was fully paid to sell up to the greater of the following in any three-month period:

- One percent of the securities of that particular class of securities that is outstanding
- The average weekly trading volume if the security is listed on a stock exchange

In addition to these volume limitations, insiders and holders of restricted stock also must comply with the manner-of-sale requirements imposed by Rule 144 – and with its revisions for equity securities and its filing of Form 144 (if the proposed sales based on Rule 144 within a three-month period exceed 5,000 shares or $50,000).

Restricted stock held by noncontrolling shareholders (that is, restricted stock held by nonaffiliates) becomes free of resale restrictions after a one-year holding period, again measured from the date the stock was fully paid. The restricted stock held by nonaffiliates might be sold even sooner, after six months but before one year, if the issuer has been subject to the Exchange Act reporting requirements for at least 90 days.

The SEC has interpreted payment in full to exclude, for example, certain notes accepted in payment under stock option or stock purchase plans. Such notes from officers and employees might need to be classified as subscriptions receivable under Rule 5-02.30 of Regulation S-X and ASC 310-10-S99-2. Furthermore, because of the restrictions, these securities commonly have fair values that are lower than those of a corresponding unrestricted security.

In addition, debt is often issued in a private placement under Regulation D to qualified institutional buyers (QIBs – large institutions that hold a significant amount of investments). Resales of these securities by QIBs to QIBs may take place without registration under the Securities Act under SEC Rule 144A.

Underwriters perform due diligence in a manner similar to due diligence for a nonexempt registration. For example, a trust indenture might stipulate that the underlying debt is being filed with registration rights, which will require the company to file a registration statement within a defined period of time after the initial debt is issued. Upon registration, the private placement debt is exchanged for the registered debt in an exchange offer.

Rule 701 generally requires that securities issued to employees as compensation may not be resold until at least 90 days from the date the company's registration statement becomes effective. However, other factors may contribute to a longer required holding period. For example, prior to the IPO, underwriters often require existing shareholders to enter into contractual lockup agreements, in which they agree to refrain from selling their stock during a specified time after the IPO, usually 180 days. In addition, if escrow arrangements are created to hold securities that vest over a service period for employees or directors, the arrangements could be viewed as stock-based compensation awards and subject to Rule 701.

Because the provisions of Rules 144, 144A, and 701 are complex, management should consult with SEC counsel about any proposed sales under the rules. More information related to Rules 144 and 701 can be found on the SEC's website, including "Revisions to Rules 144 and 145: A Small Entity Compliance Guide" and questions and answers on these Securities Act rules.

Deregistration

As previously discussed, after a company is registered with the SEC, it must continue to file periodic reports and maintain the registration in accordance with the Exchange Act. However, some situations result in a company no longer needing or wanting to maintain its registration status. In such situations, careful consideration of the Securities Act and the Exchange Act is required for deregistration, or what is also referred to as the suspension of the duty to file periodic reports.

Management is required to file periodic reports for the first fiscal year, but after the first fiscal year-end, the duty to file such reports may be suspended immediately if there are fewer than 300 shareholders of record (or 1,200 shareholders of record in the case of bank and savings and loan holding companies) with respect to the class of securities registered; or, after the first two fiscal years subsequent to the offering, there are fewer than 500 shareholders of record and the company reported less than $10 million in assets on the last day of each of the previous three years. A registrant may not suspend periodic reporting in the fiscal year when the registration statement becomes effective, when there is a requirement to update a registration statement in order to sell securities, or when the securities continue to be listed on an exchange.

As long as the appropriate conditions for suspension have been met, the reporting suspension becomes effective immediately upon the filing of a Form 15.[76]

[76] See Rule 12h-3 of the Exchange Act.

APPENDIXES

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APPENDIX A: COMMON CONTROL TRANSACTIONS

Private equity transactions often take on a form that is distinct from the traditional IPO of a private company. In the traditional IPO of a private company, a holding company might be formed to hold the private operating company and to issue the common equity securities in the IPO. In a private equity transaction, though, a holding company might be formed in order to issue the common equity securities in the IPO, and a separate holding company or group of holding companies might hold the private operating company or companies. In the private equity transaction, multiple legal entities are usually involved, and the ownership structure immediately after the IPO can be complex. After the IPO, the private equity owners typically control the voting interests of the publicly held holding company and maintain the controlling economic interest in the separate holding company (or companies) that owns the operating companies. This structure gives rise to accounting and reporting matters for entities under common control that the registrant must consider before filing a registration statement with the SEC.

In this appendix, we do not seek to answer all questions related to common-control transactions involving varying facts and circumstances. Instead, we propose a series of questions that companies should consider when evaluating their own common-control transactions.

The process for analyzing the accounting and reporting matters for these transactions tends to be complex. We encourage companies to consider the proposed questions, develop answers using the applicable guidance, and reach a conclusion after considering the facts and circumstances. Finally, we encourage companies to discuss their analysis and conclusions with their independent auditors, and consider SEC pre-clearance of disclosure and accounting matters on these types of transactions, as encouraged by the SEC staff.

Q. Is the transaction a business combination or a common control merger?

A. A business combination is a merger of two or more entities that are not under common control.

A common control merger occurs when two or more entities under the control of the same entity are combined – where "control" is defined by ASC 810-10-15-8 as a controlling financial interest that includes direct or indirect ownership by one entity of a majority voting interest in another entity. Alternatively, "control" could be the power of one entity to control another entity by contract, lease, agreement with other stockholders, or court decree. Examples of common control transactions are identified in ASC 805-50-15-6, and among them are a transaction in which "an entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity" and a transaction in which "a parent transfers its controlling interest in several partially owned subsidiaries to a new wholly owned subsidiary" – which is a change in legal organization but not a change in reporting entity.

Note that the combination of entities under common control is excluded from the scope of the business combination and fair value purchase accounting guidance in ASC 805-10-15-4c.

CROWE PRACTICE TIP

Organizational charts are often the starting point for both internal discussions and consultations with independent auditors and SEC staff, as such organizational charts are useful tools for analyzing the accounting and reporting requirements for this type of transaction. The most useful organizational charts depict the legal ownership structure of the related companies both prior to the IPO and immediately after the IPO becomes effective. These charts should include the ownership structure of the operating companies that reflects the ownership by the private equity companies and other entities as well as the ownership structure of all holding companies. The ownership structure of the registrant, its predecessor, and all operating companies should be reflected in the organizational chart. The charts should also reflect the differences in control held by each entity, such as voting interests and equity ownership or economic interests.

Q. If the transaction is a common control merger, what questions are key to the registrant determining how to report the transaction?

A. The following are among the questions for the registrant to consider when determining how to report the common control merger:

- Which entities or individuals represent the control group?
- Which entities were acquired by the control group (that is, which are the entities being acquired)?
- Which entity is the registrant?
- Is the registrant different from the predecessor (in other words, which entity is the acquirer)?
- Does the registrant succeed to substantially all of the business of another entity?
- Are the registrant's own operations relatively insignificant? Are multiple entities being combined? If so, does the parent company obtain control of each entity on different dates or in different fiscal periods?
- Is it reasonable to conclude that, considering the relevant facts and circumstances, the entity purchased first is the predecessor?
- Is one of the entities larger than all the others?
- Do the management, governance, and financing arrangements of the combined entity suggest which entity might be the predecessor?
  - What was the acquisition date (that is, the date on which the control group gained control of the acquired entities); were there multiple acquisition dates for merger transactions with multiple entities under common control?

Q. How should the registrant measure and recognize the net assets in a common control merger?

A. The transfer of assets or exchange of shares between entities that were initially under common control should be recognized by the entity that receives the net assets or the equity interests at the transfer date (that is, the date on which the control group gained control of the separate entities).[77] Common control mergers should be reflected as a reorganization transaction and a change in reporting entity, with net assets of the acquired entity being recorded at historical cost.[78] In addition, a common control merger or a reorganization should be applied retroactively to the financial statements for all prior periods presented when the financial statements are issued for the period that includes the transaction date.[79]

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[77] See ASC 805-50-25-2.

[78] See ASC 250-10-45-21.

[79] See ASC 250-10-45-21 and ASC 805-50-45-2 through 45-4.

Q. What considerations are most important when the registrant is determining which financial statements to present?

A. Following are among the questions for a registrant to consider when the financial statements for entities under common control are being developed:

- If the merger of entities under common control occurs after the date as of which the financial statements are presented in a registration statement (that is, subsequent to the balance sheet date or subsequent to the date the registration statement is effective, often upon effectiveness of the IPO), should the merger of such entities be reported in the historical financial statements?[80]
- Are Rule 3-01 and 3-02 of Regulation S-X predecessor financial statements required prior to the transaction?
- Have combined or consolidated historical financial statements been presented for all required periods in the registration form?
- If not, are separate predecessor financial statements required prior to the date control was obtained since the combination of entities is reflected only from the date the parent company gained control?
- Are separate financial statements of the acquired companies required under Rules 3-05 (for non-SRCs) or 8-04 (for SRCs) of Regulation S-X?
- Have combined or consolidated historical financial statements been presented for all required periods in the registration form?
- Are Rule 3-05 financial statements required for the nonpredecessor entities or the acquired entities prior to the date control was obtained (that is, the combination of entities is reflected only from the date the parent company gained control)?
- Are conditions present that would allow significance to be calculated by reference to pro forma financial information?
- If the historical financial statements do not include the combined entities, should the combination of the entities under common control be reflected in pro forma financial statements pursuant to Article 11 (or for SRCs, Article 8) of Regulation S-X?

The SEC staff continues to encourage pre-clearance of the form and content of required financial statements and pro forma financial information for these types of transactions.

The accounting matters discussed in this appendix are not a comprehensive list of matters that are specific to private equity transactions. Rather, these issues are common to private equity transactions and are incremental to the accounting matters already discussed in this publication.

[80] If so, a waiver request should be submitted to CF-OCA, as described in Chapter 3. The waiver request should address whether the transaction will occur after the balance sheet date but prior or subsequent to the IPO's effectiveness. See Topic 13410.3 of Corp Fin's Financial Reporting Manual, in which the SEC staff encourages consultation with them if registrants want to present consolidated or combined financial statements as the primary financial statements of the registrant in lieu of separate financial statements of the registrant and the separate combined entities.

APPENDIX B: FOREIGN PRIVATE ISSUERS

A foreign incorporated or organized entity seeking to issue equity or debt in U.S. markets should carefully assess whether the foreign entity qualifies as an FPI under the SEC's rules and regulations. FPI qualification affords an entity a number of accommodations compared to a domestic registrant when filing with the SEC. The accommodations were originally granted in 1979 in an effort to facilitate U.S. capital formation for foreign domiciled entities in the face of differences in national laws and accounting regulations. The disclosure requirements for FPIs continue to evolve as both domestic and international regulatory bodies attempt to achieve some manner of consistency on accounting and other nonfinancial statement disclosures.[81]

Typically, FPIs issue American depositary shares (ADS) instead of ordinary shares, and the ADS represent some quantity of U.S. dollar-denominated ordinary shares that are held by a depositary or custodian bank. ADS holders do not automatically have the same rights as ordinary shareholders because it is up to the company to define ADS-holder rights in the terms of the deposit agreement. However, ADS can trade on the NYSE or Nasdaq.

An FPI can qualify as an EGC under the JOBS Act and choose to take advantage of EGC scaled disclosure provisions, if applicable to the form requirements. Notwithstanding any EGC disclosure accommodations, an EGC FPI that is a first-time adopter of IFRS-IASB must include three statements of financial position due to the requirements of IFRS 1. See Section 10300 of Corp Fin's Financial Reporting Manual for more information about EGC FPIs.

Qualifications

Exchange Act Rule 3b-4(c) defines an FPI as "any foreign issuer other than a foreign government except an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter:

(i) More than 50 percent of the outstanding voting securities of such issuer are directly or indirectly owned of record by residents of the United States; and

(ii) Any of the following:

(A) The majority of the executive officers or directors are United States citizens or residents;

(B) More than 50 percent of the assets of the issuer are located in the United States; or

(C) The business of the issuer is administered principally in the United States."

Note that in the case of a new issuer, the determination of FPI status is made as of a date within 30 days prior to the issuer's filing of an initial registration statement.[82]

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[81] Refer to SEC Release No. 33-8959.

[82] Refer to SEC Release No. 33-8959.

Forms

For purposes of an IPO of either debt or equity securities, an FPI will likely use Form F-1, which incorporates a significant number of the disclosure requirements of Form 20-F. Form 20-F is used to report annually under the Exchange Act, or it can be used to register securities under the Exchange Act, which might be appropriate if an FPI is registering with the SEC solely for the purpose of being listed on the NYSE or Nasdaq.[83]

Alternatively, an FPI might elect to use the domestic forms for registration and periodic filings with the SEC (for example, Forms S-1, 10-K, 10-Q, and 8-K). However, the accommodations for FPIs discussed later in this section would generally not be available to an FPI filing on domestic forms, and the FPI would be required to meet the deadlines and filing requirements of the domestic forms.

The remaining discussion in this section assumes an FPI does not elect to file on domestic forms (that is, the entity files on "F" forms).

Accommodations affecting registration statements

Some of the accommodations affecting registration statements granted to FPIs that are not available to domestic registrants (except for the JOBS Act accommodations that are available to domestic and foreign registrants) are as follows:

Accounting basis

FPIs are allowed to present their financial statements in conformity with IFRS-IASB without reconciliation to U.S. GAAP. If the FPI elects to use IFRS-IASB, the accounting policy footnote and the auditor's opinion must explicitly state compliance with IFRS as issued by the IASB (see Section 6300 of Corp Fin's Financial Reporting Manual). Alternatively, FPIs can present their financial statements in conformity with either U.S. GAAP or home-country GAAP along with a reconciliation to U.S. GAAP. An EGC FPI that elects to present financials on a home-country GAAP basis can elect the extended transition period for complying with new or revised financial accounting standards in the U.S. GAAP reconciliation (see Section 10300 of Corp Fin's Financial Reporting Manual).

Financial statement requirements (age and interim requirements)

In general, a non-EGC FPI is required to file the following in a registration statement: audited financial statements that include a two-year balance sheet and three-year statements of income, comprehensive income, cash flows, and shareholders' equity (see Item 8.A.2 of Form 20-F). In an FPI IPO, the audited financial statements cannot be older than 15 months at the time the registration statement is declared effective; however, in limited cases where a nonpublic company is registering its initial public offering of securities, the audited financial statements can be no older than 12 months at the time of the filing, unless the FPI is able to represent adequately that compliance with more current audited financial information is not required in any other jurisdiction, and it is impracticable or involves undue hardship (see SEC Release 33-10532).

CROWE PRACTICE TIP

When executives of an FPI consider whether to file on domestic forms or use FPI forms, they should perform a thoughtful analysis to understand the short- and long-term impact of using different reporting regimes. Certain accommodations for domestic filers such as the scaled disclosure options afforded to SRCs (see Chapter 3 and Chapter 4) should be compared to the accommodations provided to FPIs on FPI forms. As noted previously, a company filing on domestic or FPI forms is allowed to use EGC accommodations, if eligible. However, FPIs can only use SRC disclosure accommodations when filing on domestic forms using U.S. GAAP.

[83] See the SEC's Office of International Corporation Finance discussion on "Accessing the U.S. Capital Markets – A Brief Overview for Foreign Private Issuers."

In addition, interim financial statements are required in a registration statement if the effective date is more than nine months after the end of the most recent audited fiscal year, and these statements may be unaudited and must cover at least the first six months of the fiscal year.[84]

Financial statements of entities other than the registrant (for example, financial statements of a significant acquired business (Rule 3-05 of Regulation S-X) or of a significant equity method investee (Rule 3-09 of Regulation S-X) might be required in an FPI's registration statement.[85]

In summary, the accommodations regarding the age of financial statements in an FPI IPO registration statement are as follows:

- The audited financials may be as old as 15 months
- Unaudited interim financials may be as old as nine months

Reporting currency

Foreign registrants are allowed to select any reporting currency that the issuer deems appropriate pursuant to Rule 3-20 of Regulation S-X. However, the same rule states that the issuer must measure its own transactions, and the transactions of its material operations, in the currency of the primary economic environment in which the issuer operates (or the currency in which cash is primarily generated and expended). Then the financial statement amounts should be translated into the reporting currency.

This rule also describes the translation adjustments. Some registrants elect to present a convenience translation in U.S. dollars. Section 6620 of Corp Fin's Financial Reporting Manual notes that a convenience translation may be presented only for the most recent fiscal year and interim period. Therefore, the translation should be made at the exchange rate on the balance sheet date or most recent date practicable, if materially different, and that rate should generally be the rate that would be used if dividends were to be paid in U.S. dollars.

Executive compensation

Disclosure of executive compensation for FPIs is scaled down considerably from the domestic registrant requirements contained in Item 402 of Regulation S-K. Compensation paid to directors and members of management is required to be disclosed by Item 6.B of Form 20-F by operation of Item 4.A of Form F-1 only for the most recent fiscal year. Disclosure is allowed on an aggregate basis unless disclosure on an individual basis is required in the company's home country or otherwise is disclosed publicly.

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[84] See Item 8 of Form 20-F by operation of Item 4.A of Form F-1 and Section 6220 of Corp Fin's Financial Reporting Manual.

[85] See Instruction 1 to Item 8 of Form 20-F.

Accommodations affecting periodic reports

Some of the accommodations affecting periodic reports granted to FPIs that are not available to traditional domestic registrants are as follows:

Financial statement requirements (age and interim requirements)

The filing deadline for FPI annual reports is four months subsequent to the issuer's fiscal year-end. This exceeds the reporting deadline for the smallest domestic issuers (nonaccelerated filers and SRCs), which is 90 days after the issuer's fiscal year-end.

FPIs are not subject to the interim reporting requirements of the Exchange Act; however, certain information, including interim financial statements, are required to be included in Form 6-K if material information is distributed to stockholders or made public after filing with a stock exchange, or if the information is required to be made public by home country laws. Some exchanges require that an interim balance sheet and income statement as of the end of the second fiscal quarter be submitted on Form 6-K no later than six months after the end of the second fiscal quarter (for example, Section 802.01E of the NYSE Listed Company Manual, Nasdaq Listing Rule 5250(c)(2)).

Internal control

For FPIs, management's assertion on the effectiveness of disclosure controls and procedures (DC&P) is required on only an annual basis (versus quarterly for domestic registrants). Similarly, FPIs are required to disclose any material changes in ICFR that occurred during the year on an annual basis (rather than quarterly like domestic registrants). Other requirements for management's annual report on ICFR and auditor attestation on the effectiveness of ICFR are similar to domestic filing requirements. See "Internal control over financial reporting," Chapter 4.

Current reports

FPIs file current reports on Form 6-K rather than the Form 8-K that is required for domestic registrants. On Form 6-K, disclosure is required of material events that are similar in nature to those events required to be disclosed on Form 8-K but also for which the:

> *"issuer (i) makes or is required to make public pursuant to the law of the jurisdiction of its domicile or in which it is incorporated or organized, or (ii) files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange, or (iii) distributes or is required to distribute to its security holders."*

Form 6-K must be filed promptly after the material contained in the report is made public. One example of an important difference in the information required to be included on Form 8-K but not Form 6-K is related to the disclosure of a change in auditor. Disclosure of a change in auditor in Form 6-K is not required unless the conditions of Form 6-K are met; however, an issuer might choose to include such disclosure in Form 6-K even when not required. Additionally, the change in auditor is required to be disclosed in Form 20-F pursuant to Item 16F.[86]

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[86] See Section 6830 of Corp Fin's Financial Reporting Manual.

XBRL taxonomy

FPIs that prepare their financial statements in accordance with IFRS-IASB are required to file XBRL data (or interactive data files as defined by Rule 11 of Regulation S-T) using the IFRS taxonomy, which was first made available March 1, 2017. FPIs that use either U.S. GAAP or reconcile home-country GAAP to U.S. GAAP must file XBRL data using the U.S. GAAP taxonomy.

For additional information, see SEC Release 33-9002.

Other matters

Independent auditor selection

For a more general discussion about selecting an independent accountant as an auditor, see "Selecting the right advisers and experts," Chapter 2. One incremental matter that tends to affect foreign registrants more than domestic registrants relates to accounting firms required to perform a significant amount of audit work on operations outside the U.S. This matter usually is a concern only when the auditor is performing work in a jurisdiction where the PCAOB is not allowed to perform inspections, because the lack of a PCAOB inspection raises the question of whether the auditor is qualified to practice before the SEC. Under the *Holding Foreign Companies Accountable Act*, a registrant is required to disclose, among other items, if it has retained an auditor the PCAOB is unable to inspect. A registrant that retains an auditor that is not inspected for three years is subject to a five-year prohibition of public trading of its securities.

In addition, SEC staff might ask for disclosure that investors are deprived of the benefits of a PCAOB inspection of the quality of such an auditor's work (for example, in a risk factor). Similarly, if the auditor is not familiar to the SEC staff, the staff might request information about the accountant's qualifications to audit financial statements filed with the SEC (Section 6810 of Corp Fin's Financial Reporting Manual). Finally, if the audit firm operates, performs work, or issues opinions primarily in a jurisdiction that is materially different from the location of the primary operations or the location where the primary books and records are kept, management should carefully consider how the auditor could be able to perform an audit in accordance with PCAOB standards. See Section 6800 in Corp Fin's Financial Reporting Manual for additional foreign auditor matters.

See Topic 6 of Corp Fin's Financial Reporting Manual for additional FPI qualifications and disclosure requirements.

Multijurisdictional disclosure system

The SEC originally adopted a multijurisdictional disclosure system (MJDS) for Canadian issuers in 1991 to allow eligible Canadian issuers to register securities under the Securities Act and to report under the Exchange Act using documents prepared primarily in accordance with Canadian requirements. The type of security being issued or the transaction being consummated usually determines the type of form an MJDS filer requires, and the requirements vary for different forms (for example, Forms F-7 for a rights offering, F-8 for an exchange offering or business combination, F-9 for investment grade debt or preferred stock securities offering, or F-10 for equity securities offerings). Some of the minimum requirements to be eligible under MJDS that are generally similar among all the types of forms include that an issuer must:

- Be incorporated or organized in Canada and be an FPI
- Have been reporting for at least the preceding 12 months to Canadian securities regulatory authorities
- Be currently in compliance with its Canadian reporting obligations
- Have a public float of at least $75 million

A Canadian issuer filing under MJDS might qualify as an EGC and take advantage of the EGC accommodations if allowed by the SEC form or by Canadian rules. See Topic 16 of Corp Fin's Financial Reporting Manual and the requirements of the applicable form for more specific requirements.

APPENDIX C: GLOSSARY

American depositary shares

A U.S. dollar-denominated equity share of a foreign-based company available for purchase on an American stock exchange.

Center for Audit Quality (CAQ)

An autonomous, nonpartisan, and nonprofit public policy organization based in Washington, D.C. The CAQ provides thought leadership on proposed rules and standards and collaborates with key stakeholders. The CAQ is supported by a membership of U.S. accounting firms registered with the Public Company Accounting Oversight Board.

comfort letter

The comfort letter is provided by the independent accountants to the underwriter and typically includes agreed-upon procedures performed by the independent accountants, who agree that certain financial information in the registration statement (such as disclosures in management's discussion and analysis [MD&A]) conform to the company's books and records or the audited financial statements. Agreed-upon procedures do not represent an audit of the amounts, merely a verification that certain amounts tie out to the company's books and records or the audited financial statements.

Corp Fin's Financial Reporting Manual

Manual maintained by the SEC's Division of Corporation Finance that serves as an internal reference guide for the division's staff. The division has shared the manual with the public.

Division of Corporation Finance (Corp Fin)

The SEC's Division of Corporation Finance is composed primarily of accountants and attorneys, who are responsible for reviewing registration statements and periodic filings for compliance with the Securities Act and the Exchange Act, as applicable.

emerging growth company (EGC)

A new category of issuer created by Title I of the JOBS Act. An EGC is an issuer with less than $1 billion in total gross revenues (indexed for inflation by the SEC every five years) that has not previously sold common stock pursuant to an effective registration statement on or before Dec. 8, 2011. The issuer continues to be an EGC until the earliest of the following: it reaches its fifth anniversary of its initial public offering, its revenues reach or exceed $1 billion, it becomes a large accelerated filer (defined by the SEC as public float of $700 million or more), or it has issued more than $1 billion in nonconvertible debt over the previous three years.

firm-commitment underwritten offering

Underwriters commit to purchase all of the securities in the offering including any securities that are not resold to the public.

foreign private issuer (FPI)

An FPI is defined by Exchange Act Rule 3b-4(c) as "any foreign issuer other than a foreign government except an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter:

(i) More than 50 percent of the outstanding voting securities of such issuer are directly or indirectly owned of record by residents of the United States; and

(ii) Any of the following:

(A) The majority of the executive officers or directors are United States citizens or residents;

(B) More than 50 percent of the assets of the issuer are located in the United States; or

(C) The business of the issuer is administered principally in the United States."

Form 8-K

Form 8-K is required to be filed within four days of the occurrence of certain events including, but not limited to, change in control, significant acquisition or disposition of assets, bankruptcy or receivership, change in auditor, termination of material definitive agreements, earnings releases, new material obligations, material restructurings or impairments, restatements, and changes in directors or officers. The form specifies certain minimum disclosures for such events.

Form 10

The general form used to register securities under the Exchange Act which includes, among other disclosures, audited financial statements, MD&A, a description of business, executive compensation disclosures, and for non-SRCs, risk factors and selected financial data.

Form 10-K

The primary report used to update annually much of the information contained in the original registration statement. The form includes annual financial statements, MD&A, a description of business, risk factors, and selected financial data (SFD).

Form 10-Q

The 10-Q quarterly report is a summarized report principally containing quarterly unaudited condensed financial statements, and MD&A of financial condition and results of operations.

Form 20-F

Used by FPIs to report annually under the Exchange Act, or it can be used to register securities under the Exchange Act, which might be appropriate if an FPI is solely registering with the SEC in order to be listed on the NYSE or Nasdaq.

Form F-1

The form typically is used by FPIs for purposes of an IPO of either debt or equity securities and incorporates a significant amount of disclosure requirements of Form 20-F.

Form S-1

The registration form that is typically required to be filed with the SEC for traditional IPOs that include an initial offering of equity shares to the public.

initial public offering (IPO)

A transaction in which a private company issues new shares that will be listed on an exchange or traded in OTC markets and that the general public is able to buy and sell.

issuer

Any person who issues or proposes to issue any security as defined by the SEC in Section 2 of the Securities Act. An issuer has registered securities under Section 12 of the Exchange Act, is required to file reports under Section 15(d) of the act, or files or has filed a registration statement that has not yet become effective under the Securities Act and has not been withdrawn.

JOBS Act

The *Jumpstart Our Business Startups Act* was enacted on April 5, 2012, and aims to help businesses to raise capital by minimizing regulatory requirements.

public business entity (PBE)

A PBE is a business entity that meets the one of the requirements defined by FASB and must follow the public company accounting standards and guidance.

public float

Defined in Corp Fin's Financial Reporting Manual as the aggregate worldwide market value of an entity's voting and nonvoting common equity held by nonaffiliates. The calculation for public float is defined in Item 10(f) of Regulation S-K.

Regulation A

The JOBS Act prompted the March 25, 2015, amendment to Regulation A, commonly referred to as "Regulation A+," which provides a conditional securities registration exemption for offerings up to $50 million annually. The eligibility and reporting amendments in Regulation A+ went into effect on June 19, 2015.

Regulation Crowdfunding

The regulation provides a structure for startups and small businesses to seek small individual contributions from a large number of people (a crowd) using the Internet. It implements the securities registration exemption contained in Title III of the JOBS Act for crowdfunding transactions. Regulation Crowdfunding went into effect on May 16, 2016.

Regulation S-K

Reporting requirements for information outside the financial statements included in SEC filings.

Regulation S-X

Form and content requirements of financial statements included in SEC filings.

road show

A presentation by management of the company undergoing an IPO to financial analysts and potential investors.

***Sarbanes-Oxley Act of 2002* (SOX)**

SOX includes Section 404 (a section of the legislation also referred to as “SOX 404”). SOX Section 404 includes three primary parts related to financial reporting and disclosure:

- Section 404(a), “SOX 404(a),” includes the requirement for management to assess internal control over financial reporting as of the end of its most recent fiscal year and state whether it is effective
- Section 404(b), “SOX 404(b),” includes the requirement for publicly held companies’ auditors to attest to, and report on, management’s assessment of its internal control over financial reporting
- Section 404(c), “SOX 404(c),” issued in September 2010 (and much later than the original act), limits the auditor attestation requirement in SOX 404(b) to accelerated and large accelerated filers, as defined in Rule 12b-2 under the Exchange Act

shell company

A registrant that has 1) no or nominal operations and 2) no or nominal assets, assets consisting solely of cash and cash equivalents, or assets consisting of any amount of cash and cash equivalents and nominal other assets.

APPENDIX D: ABBREVIATIONS

AD	assistant director (of Corp Fin offices)
ADS	American depositary shares
AICPA	American Institute of Certified Public Accountants
ASC	Accounting Standards Codification (issued by the FASB)
ASU	Accounting Standards Update
CAQ	Center for Audit Quality
CF-OCA	the Office of the Chief Accountant in the SEC's Division of Corporation Finance
CIK	central index key
Corp Fin	the SEC's Division of Corporation Finance
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CTR	confidential treatment request
DC&P	disclosure controls and procedures
DTA	deferred tax asset
EBITDA	earnings before interest, tax, depreciation, and amortization
EDGAR	the SEC's Electronic Data Gathering, Analysis, and Retrieval system
EGC	emerging growth company
ENF-OCA	the Office of the Chief Accountant in the SEC's Division of Enforcement
ERISA	*Employee Retirement Income Security Act*
ESOP	employee stock ownership plan
Exchange Act	*Securities Exchange Act of 1934*
FASB	Financial Accounting Standards Board
FCPA	*Foreign Corrupt Practices Act*
FPI	foreign private issuer
FY	fiscal year
FYE	fiscal year-end
GAAP	generally accepted accounting principles
ICFR	internal control over financial reporting
IFRS-IASB	International Financial Reporting Standards as issued by the International Accounting Standards Board
IM-OCA	the Office of the Chief Accountant in the SEC's Division of Investment Management
IPO	initial public offering

IRC	Internal Revenue Code (issued by the IRS)
JOBS Act	*Jumpstart Our Business Startups Act of 2012*
MD&A	management's discussion and analysis (required by Item 303 of Regulation S-K)
MJDS	multijurisdictional disclosure system
NOL	net operating loss
NYSE	New York Stock Exchange
OCA	the SEC's Office of the Chief Accountant
OTC	over-the-counter
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PY	prior year
QIB	qualified institutional buyer
QTD	quarter to date
Regulation FD	Regulation Fair Disclosure
SAB	Staff Accounting Bulletin (issued by the SEC)
SACA	senior assistant chief accountant
SEC	U.S. Securities and Exchange Commission
Securities Act	*Securities Act of 1933*
SFD	selected financial data
SOC	service organization controls
SOX	*Sarbanes-Oxley Act of 2002*
SRC	smaller reporting company
TTW	testing the waters
U.S. GAAP	generally accepted accounting principles in the United States
WKSI	well-known seasoned issuer under the Securities Act
XBRL	eXtensible Business Reporting Language
YTD	year to date

CONCLUDING THOUGHTS AND CONTACT INFORMATION

Deciding whether your company should become public can be a difficult and complex decision, and we hope you have found this guide useful for evaluating the option to go public.

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