Reaching the Pinnacle

A Guide to Going Public

And Living as a Public Company

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Table of Contents

1. Deciding Whether to Go Public

Why Go Public? ... 7

What Are the Options for Going Public? ... 9

- Initial Public Offering ... 9
- Merger Transactions ... 9
- Registered Debt Exchange Transactions ... 9
- Reverse Recapitalizations and Reverse Mergers .. 9

When Is the Right Time to Go Public? ... 11

What Are Some of the Costs of Going Public? ... 12

- Cost of Greater Scrutiny ... 12
- Financial Costs ... 14

2. Planning to Go Public

Pre-IPO Tasks ... 17

- Corporate Governance ... 18
- The Audit Committee ... 18
- Selecting the Right Advisers and Experts ... 24
- Financial Statement Requirements ... 27
- Additional SEC Disclosure Requirements ... 27
- IT System Requirements ... 27
- Exchange Listing Versus OTC Markets ... 28
- Internal Audit ... 29
- Pre-IPO Tax Considerations ... 29

The SEC Registration Process and Being a Public Company ... 30

- Phase 0 – Before the IPO Launch ... 31
- Phase 1 – The IPO Launch ... 31
- Phase 2 – The SEC Review ... 32
- Phase 3 – Going to Market ... 33
- Phase 4 – Being a Public Company ... 33

3. Registering With the SEC

The JOBS Act ... 35

- Emerging Growth Company Qualifications ... 35
- JOBS Act Accommodations ... 35
- Confidential Submission ... 36

Interaction With the SEC During an IPO ... 37

- Filing Review Process in the Division of Corporation Finance ... 37
- How to Work Effectively With Corporation Finance Staff ... 38
- Pre-clearance Process With the SEC’s Office of the Chief Accountant ... 39
- Waiver Process With Corporation Finance’s Office of the Chief Accountant ... 39

Initial Filing Process ... 40

- Identify the Registrant ... 40
- Assessment of the Filing Category ... 40
- Financial Statement Requirements ... 41
- Other Required Financial Information ... 43
- SEC Accounting and Disclosure Matters ... 47
- Other SEC Disclosure Matters ... 55

4. Living As a Public Company

SEC Reporting Obligations 60

- Filing Categories 60
- Forms 63
- Internal Control Over Financial Reporting 64
- Disclosure Controls and Procedures and SOX Section 302 Certifications 69
- Unresolved Staff Comments 69
- Interactive Data Files 70

SEC Comment Letter Process on Periodic Filings and Current Reports 71

- Forms 10-K and 10-Q 71
- Form 8-K 72

Other SEC Regulations 72

- Proxy Solicitation 72
- Tender Offers 73
- Insider Trading 73
- Foreign Corrupt Practices Act 74
- Reselling Regulations and SEC Rules 144 and 701 of the Exchange Act 75
- Deregistration 76

Appendixes

Appendix A: Private Equity Transactions Q&A........ 78

Appendix B: Foreign Private Issuers 81

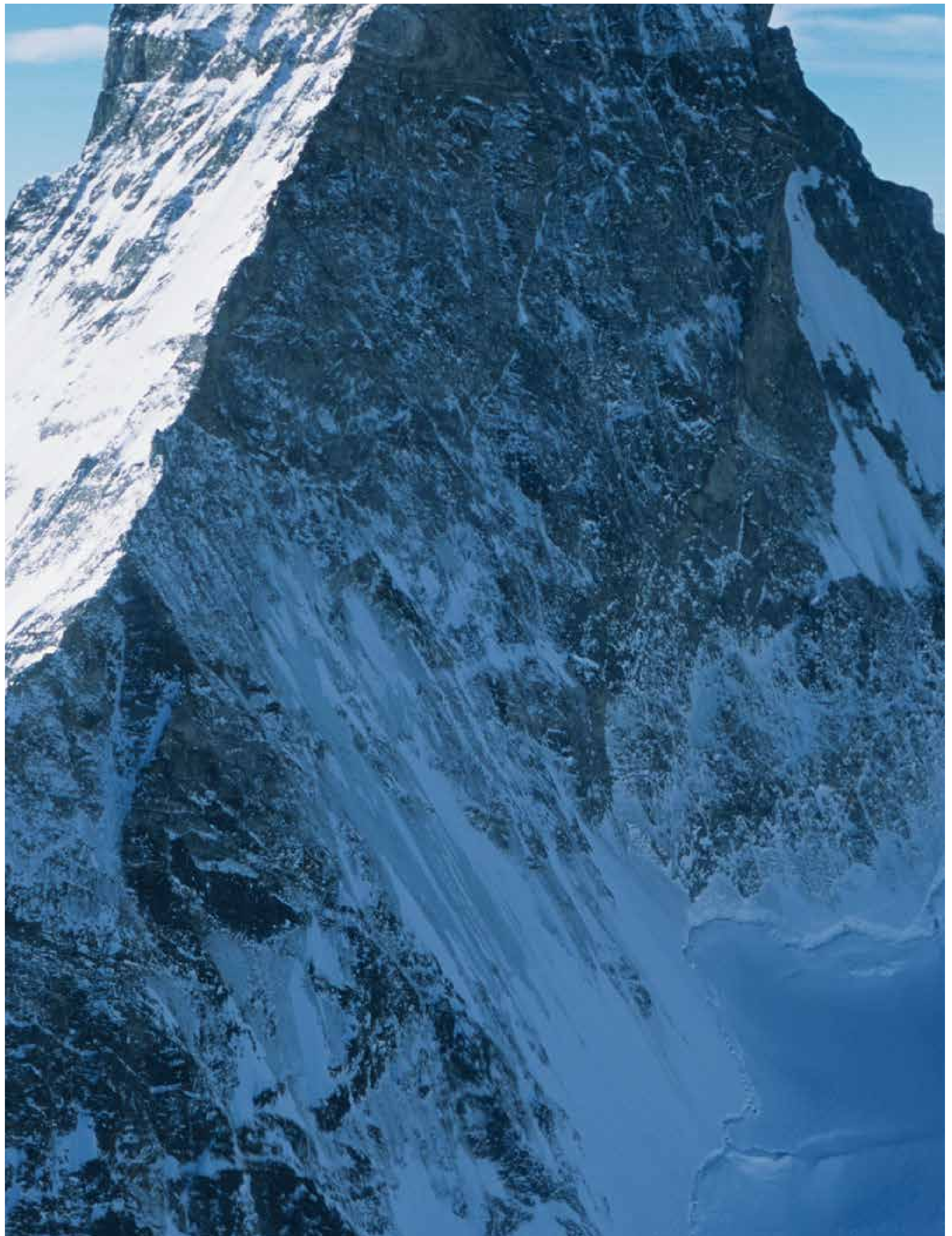
- Qualifications 81
- Forms 82
- Accommodations Affecting Registration Statements 82
- Accommodations Affecting Periodic Reports 85
- Other Matters 86
- Multijurisdictional Disclosure System 87

Appendix C: Glossary 88

Appendix D: Abbreviations 91

Final Thoughts

Final Thoughts and Contact Information 94



Introduction

Taking your company public will change your organization. Before you make the decision, be sure you know what's involved in going public – as well as the reasons for and against doing so. To help you make that decision, we at Crowe are happy to offer this guide. And if the decision is to proceed, this publication will help you plan the transition, execute the initial public offering (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. Specifically, we dedicate a section of this guide to the *Jumpstart Our Business Startups Act of 2012* (JOBS Act), highlighting the disclosure accommodations the JOBS Act granted. This helped to simplify the SEC registration process for companies that qualify as 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 hope you find this guide helpful.

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Deciding Whether to Go Public

Why Go Public?..7

What Are the Options for Going Public?.........9

- Initial Public Offering 9
- Merger Transactions...................................9
- Registered Debt Exchange Transactions ...9
- Reverse Recapitalizations and Reverse Mergers 9

When Is the Right Time to Go Public? 11

What Are Some of the Costs of Going Public?.. 12

- Cost of Greater Scrutiny........................... 12
- Financial Costs... 14

Before exploring the nitty-gritty 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 management team or a combination of the two. Some companies seek to retain high-quality employees through strong incentive plans or to provide liquidity to existing shareholders. Some want additional public exposure in their marketplace, others may have existing agreements with equity holders that require the entity to register shares with the Securities and Exchange Commission (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. However, determining an individual company's optimal capital structure, including the cost of that capital, is complex. Therefore, 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.

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.

[1] In this publication, the act of "going public" refers to the process of a private company registering an initial public offering (IPO) of securities with the Securities and Exchange Commission (SEC).

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.

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]

In certain cases, companies are legally required to register with the SEC and become a public company because they no longer qualify for an exemption under SEC rules and regulations. A common example is when a company's ownership grows to the point that the number of nonaccredited equity shareholders exceeds 500, SEC registration is generally required under Section 12(g) of the *Securities Exchange Act of 1934* (Exchange Act).[5]

Registration with the SEC is also required for any transaction that does not qualify for an exemption. Some exemptions from registration include private offerings subject to certain conditions, offerings of limited size,[6] intrastate offerings, and offerings of municipalities, states, and federal governments.

CROWE PRACTICE TIP:

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

[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* (Exchange Act) 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 another SEC filing such as Form 10-K into the Form S-3 and (2) 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* (Securities Act) 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 (Corp Fin). See Instructions I.D. of Form S-3.

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

[5] 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 less than 2,000 people or less than 500 nonaccredited investors. For bank holding companies, the investor threshold is limited to 2,000 people, as the nonaccredited investor threshold does not apply.

[6] Regulation A of the Securities Act, as amended by SEC Release 33-9741 (the amendment in March 2015 is commonly referred to as Regulation A+) is an example of a registration exemption available to small issuers of securities and includes a two-tiered system. Among other requirements in Regulation A+, Tier one relates to offerings of securities up to $20 million in a 12-month period and Tier two relates to offerings up to $50 million in a 12-month period. Issuers are subject to disclosure and reporting obligations defined in Regulation A+ which are less extensive than those obligations for offerings that are not exempt from registration under the Securities Act.

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 initial public offering (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.

There are, however, additional routes to going public for owners and executives to explore. Although the bulk of this publication discusses the traditional IPO process, with a focus on the primary offering of equity securities, in this section we describe a few additional methods for becoming a public company.

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.

CROWE PRACTICE TIP:

There are specific legal and form requirements for merger transactions that should be discussed with SEC counsel and Public Company Accounting Oversight Board (PCAOB)-registered independent accountants.

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.[7] 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.

Reverse Recapitalizations and Reverse Mergers

Another method for going public is through a reverse recapitalization or a reverse merger. 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 significant 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, to the extent the private company had operations. The new shareholders elect directors, who appoint officers of the company.

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

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. 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."[8] 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.

Each type of transaction is often paired with a follow-on offering because, unless the merged entity has cash available, the reverse recapitalization or reverse merger does not raise cash. The merged entity might be able to trade on the OTC markets, but the market for its securities is likely to be limited. 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.[9] The Form 8-K, effectively an IPO prospectus given that it must include Form 10 disclosures, includes audited financial statements, pro forma financial information, a detailed company description, and executive compensation disclosures.[10]

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, which reported the transaction.[11]

Refer to Topic 12 of Corp Fin's Financial Reporting Manual for more guidance on reverse mergers (or reverse acquisitions) and reverse recapitalizations.

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

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

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

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

When Is the Right Time to Go Public?

Whether the owners, management, 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? For example, underwriters usually prefer for IPOs to take place in the fall and spring.
- 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 operate under strict publicity guidelines during the offering process?
- Is the company prepared to make disclosures at the level required for a public company?[12]
- Is the company prepared to meet the ongoing obligations of a public company?[13]
- Are the company's insiders willing to relinquish control[14] 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 other businesses, consider (1) whether the infrastructure is in place both to go public and to absorb acquisitions and (2) the limitations on the size of businesses that can be acquired before the infrastructure breaks down.

[12] See the disclosure requirements discussed in the "Initial Filing Process," Chapter 3.

[13] See the on-going reporting requirements of a public company and other SEC regulations discussed in Chapter 4.

[14] 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 Up-C structures) so that owners can retain voting control.

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. The pressure on management is often greater once a company announces its initial public offering, primarily due to the new public scrutiny, and the direct financial costs cannot be ignored.

Cost of Greater Scrutiny

Increased 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 impact 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.

Attention to Stock Price

In effect, the act of going public introduces a new measure of the company's performance – the share price. Management must be sensitive to shareholders' expectations of higher share prices, which usually depends on consistently improving earnings.

In the effort to meet shareholders' expectations, 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 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. The obligation to keep owners informed of corporate developments must be fulfilled through annual, quarterly, and current reports; proxy statements; and shareholders' meetings. A public company 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. 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.

> *As an example, Crowe is a title sponsor of the INVEST series of conferences held in Indiana, Kentucky, Ohio, and Tennessee. Formed to facilitate investment conferences that bring together executives from a wide range of public companies, the series is guided by a steering committee that includes CFOs and investor relations professionals from participating companies, financial analyst chapters, and representatives of the accounting and legal communities.*

Financial Costs

The financial cost of becoming a public company – and also as 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 PCAOB-registered auditors with IPO and SEC experience
- Recruiting 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)
- 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), including an internal audit function that must be established within one year of the listing date on the NYSE, independent directors that must make up the majority of the board on both exchanges, and an audit committee that must be established and composed entirely of independent directors 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 liabilities
- Recruiting 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.[15]

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 ($75 million up to $700 million in public float)	75 days from fiscal year-end	40 days from fiscal quarter-end
Nonaccelerated filers, including smaller reporting companies (SRCs)[18] (less than $75 million in public float)	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.

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

[16] See "SEC Reporting Obligations," in Chapter 4, including the "Reporting Obligations by Category of Filer" 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 "Filing Category Assessment" table, Chapter 4, for the qualifications of an SRC.

Planning to Go Public

Pre-IPO Tasks 17

- Corporate Governance 18
- The Audit Committee 18
- Selecting the Right Advisers and Experts 24
- Financial Statement Requirements 27
- Additional SEC Disclosure Requirements 27
- IT System Requirements 27
- Exchange Listing Versus OTC Markets 28
- Internal Audit 29
- Pre-IPO Tax Considerations 29

The SEC Registration Process and Being a Public Company 30

- Phase 0 – Before the IPO Launch 31
- Phase 1 – The IPO Launch 31
- Phase 2 – The SEC Review 32
- Phase 3 – Going to Market 33
- Phase 4 – Being a Public Company 33

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 the board structure
- Engaging experts, such as SEC counsel and a PCAOB-registered audit firm
- 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 should include the tasks summarized within this chapter and the timing of those tasks should be addressed in a timeline. Timelines vary by company and are often 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 perspective as well as a legal perspective. The matters 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.

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 reassured 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.

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,[22] 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.

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 standard size. A minimum of three audit committee members is required by both the NYSE and the Nasdaq.[23] The exchanges also require that all audit committee members of listed companies are independent directors.[24]

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
- Knowledge of the company's operations
- Familiarity with SEC rules and regulations, generally accepted accounting principles accepted within the United States (U.S. GAAP), and PCAOB standards

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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 http://nysemanual.nyse.com/lcm/, and the Nasdaq listing rules can be found at http://nasdaq.cchwallstreet.com/NASDAQ/Main/.

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

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

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

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

- Facility in obtaining information by inquiry
- Commitment and available time
- Independence

A company is not required by the SEC to have a financial expert (as defined in Item 407(d) 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) 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.[25] 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 (e.g., 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.

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.

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:

- Oversight of the company's internal control
- Review of the internal audit function
- Selection and retention of independent auditors
- Review of the external audit plan
- Oversight of the company's financial reporting process
- Self-evaluation of the audit committee's qualifications and effectiveness

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

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
- 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 may 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.

Selection and Retention of the Independent Auditors

Typically, audit committees are responsible for recommending to the board of directors, and in some cases 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 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 (including preapproval of those services), 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 audit and engagement periods (that is, the periods covered by the financial statements and the period for which the auditor is engaged to perform the audit) for all audit periods presented in an SEC filing.

Any nonaudit services performed by the auditor or any of the auditor's affiliates during any period that will be presented in an SEC registration statement 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. If such an independence violation is identified, the only remedy is to request a waiver from the SEC's Office of the Chief Accountant, and those waivers are very rare. See "Pre-clearance Process With the SEC's Office of the Chief Accountant," Chapter 3, for what to consider when requesting a waiver.

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.

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.

CROWE PRACTICE TIP:

When planning to undertake an IPO in the next several years, begin considering matters that impact auditor independence under SEC and PCAOB rules during the years leading up to the IPO. Do not postpone consideration of such matters until the year of the IPO. Because of the more stringent SEC and PCAOB independence rules for public companies affecting all historical audit periods presented in an SEC filing, carefully consider the independent auditor's nonaudit services (such as financial statement preparation and tax services) to the company and the company's affiliates worldwide, as well as other independence-related matters, in the years preceding the IPO.

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 PCAOB Auditing Standard No. 16
- Received the independence disclosure letter from the independent auditors and discussed the auditors' independence with the independent auditors
- 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 management and the independent auditors after the audit has been completed. Among other matters, the audit committee discusses the results of the audit and the annual report with the independent auditors and company management. The matters discussed with the independent auditors typically include the following:

- The nature and resolution of any disagreements between the independent auditors and management (whether or not the disagreements have been resolved to their mutual satisfaction) about matters that could be significant to the financial statements or the auditors' report

- The nature of any major issues discussed by the independent auditors and management in connection with the retention of the auditors
- The nature and resolution of any significant or unusual accounting and auditing problems encountered during the audit
- The nature of any adjustments, reclassifications, or additional disclosures proposed by the auditors that are currently significant or may become significant in the future
- The adequacy of financial statement disclosures
- The nature and impact of the initial selection of and changes in significant accounting policies or their application
- The independent auditors' views concerning any auditing and accounting matters that were the subject of consultation by management with other accountants
- The nature of any unusual or significant commitments or contingent liabilities
- The process that management used to develop significant accounting estimates, and the independent auditors' basis for conclusions regarding the reasonableness of those estimates
- Any significant differences between the annual report and other reports, such as reports to regulatory agencies
- The independent auditors' responsibilities for other information in documents containing audited financial statements, any procedures performed related to the information, and the results of the procedures
- The independent auditors' observations on internal control, including any identified significant deficiencies and material weaknesses
- Any serious difficulties related to performing the audit that the independent auditors encountered in dealing with management
- A description of nonaudit services (including fee information) provided by the independent public accountants during the year under audit[26]

Audit committees also review with the independent auditors the quarterly financial information – to confirm:

- U.S. GAAP has been followed and applied consistently
- Fluctuations in financial statement balances, ratios, and statistics have been explained satisfactorily
- Quarterly financial information has been summarized for external reporting purposes and conforms to SEC disclosure requirements
- Significant commitments and contingent liabilities have been disclosed
- A quarterly review has been performed by the independent auditors

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[26] Note that management is required to disclose fee information for both audit and nonaudit services in the annual proxy statement. Refer to Items 9(e)(1) to (e)(4) of Schedule 14A. In the registration statement, disclosure of accounting fees incurred in connection with the issuance and distribution of shares is required. Refer to Item 511 of Regulation S-K.

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.

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

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 allow 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.

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 though drafting the registration statement and prospectus, submitting confidential treatment requests to the SEC, coordinating the SEC filing review, communicating with the SEC staff on behalf of the company, and preparing 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 Accountants

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 PCAOB independence and 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 (SEC independence rules 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.[27]

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

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 during 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.

CROWE PRACTICE TIP:

Weak ICFR increases the likelihood of inaccurate data in the financial statements and disclosures that are included 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 to limit the opportunity for material misstatements.

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. Typically, such deadlines are within a month of the end of each quarter. 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)[28] 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.”

[28] 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.

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 that a company's shares are listed and traded on an exchange rather than traded in an OTC market.
- In the past, newspapers published only security prices of listed companies. Now, however, pricing information for OTC markets can be found in newspapers and on financial websites.
- 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 recently introduced several tiers of traded companies, with different reporting and disclosure requirements applicable to each tier. In addition, trading on an OTC market does not require SEC registration unless the company no longer qualifies for exemption from registration (for example, a nonbank trading OTC 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.[29] Similarly, the Nasdaq has minimum requirements for pretax earnings in the aggregate for the prior three fiscal years and a minimum of $45 million in market value.[30] 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.

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[29] Refer to NYSE Listed Company Manual Section 102.01C.

[30] Refer to Nasdaq Listing Rule 5315(f)(2).

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 top management

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. 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.

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.

Furthermore, if the private company is converting from an S corporation to a C corporation, deferred income tax accounts 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.

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.

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 Topic 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.

Also, once the company is public, if compensation to a covered executive exceeds $1 million under IRC Section 162(m) and does not satisfy certain performance-based criteria, the compensation above $1 million is not tax-deductible and would have a negative effect on the company's earnings. 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.

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.

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 company. 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 JOBS Act) to the SEC. 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.

Phase 1 – The IPO Launch

The launch phase encompasses drafting the registration statement, due diligence performed by underwriters, and the initial confidential SEC filing. 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 publicly, management should seek counsel from its legal experts about all external communications, in order to avoid entering into a prohibited offer before the registration statement is made public (often referred to as "gun jumping").

Section 5(c) 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."[31]

During this phase, the company hosts a formal kick-off meeting, 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 be associated with the transaction. If it decides not to be associated with the transaction, the transaction would not proceed and the company would need to find another path forward. Otherwise, the transaction continues through the IPO timeline. Also at this stage, all parties to the IPO 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. At this time, the underwriter uses the company's historical financial information to model financial forecasts for the company and develop financial forecasts and project 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.

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.

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

Phase 2 – The SEC Review

Phase 2 begins with the initial review by the SEC of the confidential filing and ends with the finalization of the underwriting agreement that includes pricing of the transaction. 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. An accommodation granted to EGCs, 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 21-day filing requirement described below.[32]

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.

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. An EGC must publicly file the registration statement at least 21 days prior to launching the road show.[33]

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, legal opinions, and comfort letter. 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.

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[32] 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.

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

Typically, 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 management's discussion and analysis (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 tie out to the company's books and records or the financial statements.

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.

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 closes at "T+3" – that is, three 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:

As suggested in AU 634.15, companies, auditors, and underwriters should meet together to discuss the procedures to be completed in connection with a comfort letter. The auditors typically describe procedures that are commonly completed as discussed in AU 634.64 and underwriters may request other procedures to be performed as well. Auditors may not be able to provide all of the procedures initially requested by underwriters depending on the guidance in AU 634, but the final expected form and terms of the procedures are typically outlined in a draft of the comfort letter that is tailored to scope described in the underwriting agreement. This draft of the comfort letter provides the underwriters and the auditors the ability to clearly outline the expectations of the procedures to be performed and the opportunity to discuss any changes.

Registering With the SEC

The JOBS Act..35

- Emerging Growth Company Qualifications..35
- JOBS Act Accommodations....................35
- Confidential Submission..........................36

Interaction With the SEC During an IPO......37

- Filing Review Process in the Division of Corporation Finance................................37
- How to Work Effectively With Corporation Finance Staff 38
- Pre-clearance Process With the SEC's Office of the Chief Accountant.................39
- Waiver Process With Corporation Finance's Office of the Chief Accountant.................39

Initial Filing Process......................................40

- Identify the Registrant 40
- Assessment of the Filing Category...........40
- Financial Statement Requirements........... 41
- Other Required Financial Information.......43
- SEC Accounting and Disclosure Matters . 47
- Other SEC Disclosure Matters 55

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

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.

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 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 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.[34]

JOBS Act Accommodations

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

- Submit certain registration statements for SEC staff review on a confidential basis to Corp Fin
- 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

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

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

- Omit selected financial data (SFD) for periods preceding the earliest audited period
- 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 and has $75 million or more in public float, which qualifies the company as either an accelerated or large accelerated filer
- Not hold nonbinding 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 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.

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 draft registration statement. However, 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, the staff contacts the company to inform it that the Corp Fin review is deferred until a substantially complete submission is made. Corp Fin staff target a time frame of 30 calendar days to perform an initial review of all confidential submissions of draft registration statements that are substantially complete when submitted.

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

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 then evaluate the quality of such document. The draft registration statements that are initially confidential submissions must be publicly filed at least 21 days before the roadshow. 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.

Interaction With the SEC During an IPO

The SEC is organized into multiple divisions and offices, each focused on its own goals, with the 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. Corp Fin also has its own chief accounting office.

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.

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.

Filing Review Process in the Division of Corporation Finance

Corp Fin is organized into 12 assistant director (AD) offices that are responsible for different industries. Each AD office has an assistant director 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 AD 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.

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 common to receive at least three rounds of comments in an initial registration statement review, and it is common to receive at least 10 comments in the initial letter.

If the company wants to maintain confidentiality of a portion of a response letter, the company may request confidential treatment. See the SEC's Staff Legal Bulletin No. 1, "Confidential Treatment Requests" (CTRs) 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. A continuous 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 form submission is made to the SEC, whether it is submitted confidentially or filed publicly.

During the first phone 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.

If the company is unable to reach an agreement on a particular issue with the staff member assigned to review its registration statement, it may request reconsideration of the issue in question by the branch chief; the AD office senior assistant chief accountant (SACA); CF-OCA; and ultimately the chief accountant of the division. If the company is still unable to resolve the issue, and it is a U.S. GAAP or IFRS-IASB accounting matter, management may make a request for OCA to reconsider the matter.

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 Office of the Chief Accountant (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 to OCA and copied to Corp Fin.[35] 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 "Guidance for Consulting with the Office of the Chief Accountant" 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 (which could include the staff accountant, accounting reviewer, and the AD office senior assistant chief accountant (SACA) 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.

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. For example, when considering whether financial statements of an acquired entity are required under Rule 3-05 of Regulation S-X, Topic 2025.5 of Corp Fin's Financial Reporting Manual indicates that waivers may be requested if registrants believe applying Rule 3-05 of Regulation S-X produces anomalous results.

[35] Email them to the OCA at OCA@sec.gov and, so that Corp Fin has a copy of the correspondence, copy Corp Fin at dcaoletters@sec.gov.

CF-OCA can be contacted by emailing dcaoletters@sec.gov or by calling 202 551 3400. A pre-clearance, accommodation, or waiver request should include an email message that identifies the company name, date of letter, correspondent's name, central index key (CIK) number, AD office, and filing number, and the correspondence requesting action by CF-OCA should be attached as a PDF file.

Initial Filing Process

Identify the Registrant

The first question to answer as a potential SEC registrant 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.[36] 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 hold 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. Topic 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.

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.[37]

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

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

[37] See additional SEC guidance on identifying a predecessor provided at the SEC Regulations Committee meeting on Sept. 23, 2014.

than $75 million threshold to qualify). If the issuer has no public float (due to the lack of a market for shares or no equity outstanding), the issuer must have annual revenues of less than $50 million in its most recent audited annual financial statements included in the initial registration statement to qualify as an SRC.

Some of the scaled disclosure options available to SRCs are discussed in the remainder of this chapter as well as in "Filing Categories," Chapter 4. Also refer to Topic 5 of Corp Fin's Financial Reporting Manual and Article 8 of Regulation S-X.

EGC qualifications and certain accommodations are described earlier in this chapter, under "The JOBS 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 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).[38]

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.[39]

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

[39] 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)[40]	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**[41]; audited statements of income, comprehensive income,[42] changes in stockholders' equity,[43] and cash flows[44] for **three years**	Interim-period-end balance sheet within 135 days of effectiveness; most recent interim period from FYE[45] to balance sheet date and corresponding PY[46] 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[47]	Within 45 days of the FYE[48]	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 – Within 45 days of FYE[49]; SRC EGC – same as SRC below	Non-SRC EGC: Interim or audited annual financial statements must be as of a date within 135 days of the effective date; 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[50]	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

[40] 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.

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

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

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

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

[45] FYE means fiscal year-end.

[46] PY means prior year.

[47] Note that a reconciliation of the stockholders' equity beginning and ending balances is required for each period that an income statement is required. However, only one interim stockholders' equity statement is required rather than the two interim period statements an income statement requires. This is due to the requirement that an analysis of changes in stockholders' equity is required only for each caption presented in the balance sheets. Because only one interim balance sheet, in addition to the fiscal year-end (FYE) balance sheets, is required in an initial registration statement, an analysis of stockholders' equity is required for only the interim period between the most recent FYE balance sheet date and the interim balance sheet date. See Rule 3-04 of Regulation S-X.

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

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

[50] 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 Topic 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.

Additional Financial Information

Some companies may elect to disclose in an initial registration statement financial information that goes beyond the SEC rules and requirements. For example, some companies may disclose quarterly financial data in their initial registration statement or include quarterly financial statements in addition to the interim financial statements required by Rules 3-01(e) and 3-02(b) of Regulation S-X. Neither of these disclosures is required in an initial registration statement. However, if the election is made to include such disclosures, the form and content specified by the respective rules should be considered. In these examples, Rule 302(a) of Regulation S-K should be considered for quarterly financial data disclosed, and Article 10 of Regulation S-X should be considered for the quarterly financial statements disclosed.

Other Required Financial Information

Selected Financial Data

Selected financial data (SFD) is required by Item 301 of Regulation S-K in order to highlight trends in the registrant's financial condition and the results of operations. SFD is a tabular disclosure of specific amounts, including revenue, income from continuing operations, earnings per share, total assets, total long-term debt, and dividends per share for the most recent five fiscal years. Amounts in addition to those required by the item may be disclosed if management believes it would enhance an understanding of additional trends consistent with the objective of the disclosure requirement.

SFD is not an audited set of financial statements. Rather, it is financial information for multiple fiscal years to provide investors with an understanding of historical performance for selected financial accounts. It is common and acceptable to include a statement preceding the SFD that indicates the information is derived from audited financial statements, but that disclosure is not required under Item 301 of Regulation

S-K. If an auditor is engaged to audit the SFD in accordance with AU 552, the SFD may be labeled as audited; otherwise, it should not be labeled as audited. See Topic 4870 of Corp Fin's Financial Reporting Manual.

SRCs are not required to include SFD in their filings, although many choose to include it. Similarly, EGCs are afforded an accommodation to omit SFD for periods preceding the earliest audited period (see the "JOBS Act Accommodations" section of this chapter). FPIs are also given an accommodation, subject to the existence of specific criteria to omit the first two years of SFD (see "Appendix B: Foreign Private Issuers").

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 and information the registration statement requires, in addition to 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 Acquisition Financial Statements

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. The three tests for significance included in Rule 1-02(w) of Regulation S-X are as follows: (1) the investment test (the registrant's investment in the subsidiary as a percent of the registrant's total consolidated assets as of the most recent FYE); (2) the 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 FYE); and (3) the income test (the registrant's equity in pretax income from continuing operations as a percent of such income of the registrant for the most recent fiscal year). If any of the three significance tests exceed 20 percent, financial statements of the acquired or to-be-acquired company must be included in the registrant's filing.

Additional thresholds are imposed on significance test calculations for acquisitions. Specifically, only the most recent fiscal year and interim period financial statements of the acquired or to-be-acquired entity are required to be included in the registrant's filing if significance exceeds 20 percent but is less than 40 percent. The two most recent fiscal years and interim periods are required if significance exceeds 40 percent but is less than 50 percent. The most recent three fiscal years and interim periods are required if significance exceeds 50 percent and net revenues of the acquiree are at least $50 million in the most recent fiscal year.

The fiscal year 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.

See Topic 2000 of Corp Fin's Financial Reporting Manual for additional guidance on financial statement requirements for significant acquisitions.

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 percent using the investment or income tests (as previously described for significant acquisitions) 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 they 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.[51]

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

Pro Forma Financial Information

U.S. GAAP already requires that certain pro forma information – such as the pro forma disclosures related to a business combination, pursuant to ASC 805 – be disclosed in an SEC registration statement. In addition, the SEC requires that specific pro forma financial information be provided in registration statements when certain transactions are consummated. The objective of such pro forma financial information is stated in Rule 11-02(a) of Regulation S-X: "Pro forma financial information should provide investors with information about the continuing impact of a particular transaction by showing how it might have affected historical financial statements if the transaction had been consummated at an earlier time."

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,[52] or a business that was previously part of another entity (such as a carved-out business) might require pro forma disclosure. In general, when the historical financial statements of the registrant are not indicative of the ongoing entity, pro formas should be provided.[53] See Article 11 of Regulation S-X and Topic 3 of Corp Fin's Financial Reporting Manual to evaluate whether such a transaction has occurred and whether a business combination or disposition transaction is significant.

CROWE PRACTICE TIP:

If the threshold for calculating significance for pro forma financial information is exceeded and pro forma financial information is required for a business combination, one or more years of separate financial statements of the business acquired or to-be-acquired is required, pursuant to Rules 3-05 or 8-04 (for SRCs) of Regulation S-X.

[51] See Topic 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.

[52] 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.

[53] See ASC 205-10-S99-7.

Similar to the requirements for Rule 3-05 financial statements, there are three tests that must be calculated to determine whether a transaction is significant and pro forma financial information should be presented, pursuant to Rule 11-01(b) of Regulation S-X. Use a 20 percent threshold when calculating the investment, asset, and income significance tests to determine whether pro forma financial information is required.

Once it is determined that a transaction requiring pro forma financial information has occurred, the pro forma financial information must be drafted subject to 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.

The pro forma income statement should be completed assuming the transaction was consummated at the beginning of the fiscal year presented and should include adjustments that reflect events that are (1) directly attributable to the transaction, (2) expected to have a continuing impact on the registrant, and (3) factually supportable. 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 adjustments that reflect the events that are directly attributable to the transaction and factually supportable regardless of whether they have a continuing impact.

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 percent 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 Topics 2000 and 2400 of Corp Fin's Financial Reporting Manual for additional guidance on financial statement requirements for significant acquisitions and equity-method investments. See Topic 2810 of the manual for additional information on the required condensed financial information of the registrant or parent company.

CROWE PRACTICE TIP:

In addition to considering the Article 11 criteria for including pro forma adjustments to the income statement and balance sheet, the primary consideration in evaluating the quality of a pro forma disclosure should be verification that such a disclosure is not misleading.

Also, if a material transaction has occurred that is not specifically identified in Article 11 of Regulation S-X or Topic 3 of Corp Fin's Financial Reporting Manual, but for which pro forma financial information is not specifically prohibited, consider disclosing pro forma information for such transactions as long as it is not misleading and provides investors with material information. See Rule 11-01(a)(8) of Regulation S-X.

SEC Accounting and Disclosure Matters

Companies registering with the SEC must analyze a number of accounting 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 some particular concerns during registration statement reviews. The following is an explanation of a few matters companies should consider carefully prior to submitting a registration statement to the SEC.

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).

The FASB provided guidance related to the assessment of material error corrections in ASC 250-10-45-27. The guidance states that amounts in error should be related to the estimated income for the full fiscal year, the interim period, and the effect on the earnings trend. Broader guidance on the subject of materiality was issued in 1999 by the SEC in Staff Accounting Bulletin (SAB) 99 (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 misstatements of less than 5 percent, for example, of a financial statement line item 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 percent 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 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 SEC conference speech in December 2011, Corp Fin staff clarified that the label “restated” can be removed after updated annual financial statements have been issued. Therefore, 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 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.

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.

Finally, because under PCAOB Auditing Standard No. 5 the restatement of financial statements is an indicator of a material weakness, the impact an error has on ICFR should be considered.

Revenue Recognition

Revenue recognition guidance issued by the FASB is included in ASC 605, and SEC-issued guidance on revenue recognition can be found at ASC 605-10-S99. Specifically, the SEC states that revenue is realized or realizable and earned when four criteria are met: there is persuasive evidence of an arrangement, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectibility is reasonably assured.

The SEC is considering whether it is necessary to revise or rescind this guidance because of the FASB's new revenue recognition standard (Accounting Standards Update No. 2014-09). The FASB standard is effective for public business entities, including entities that have issued securities traded, listed, or quoted on an exchange or OTC market for annual reporting periods beginning after Dec. 15, 2017,[54] including interim reporting periods in that reporting period.[55]

Presentation of revenue is often a key consideration for SEC registrants as well. Specifically, Rule 5-03 of Regulation S-X requires separate disclosure of net sales of products and revenues from services.

Goodwill

Generally, the disclosures related to a goodwill impairment analysis are limited to those required by ASC 350-20-50 and those required in management's discussion and analysis (MD&A), pursuant to Item 303 of Regulation S-K. SEC Release 33-8350 suggests that management provide additional supplemental disclosure in MD&A that could be material to an investment decision, such as critical accounting estimates. The guidance encourages registrants to disclose supplemental information about material accounting policies rather than duplicate the accounting policy note to the financial statements. Those policies articulate the uncertainty of the respective amounts and the susceptibility of the amounts to change due to the level of subjectivity and judgment applied to account for such matters. 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.

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[54] The effective date of the original revenue standard was deferred by Accounting Standards Update No. 2015-14.

[55] See Scott Lehman and Alex J. Wodka, "Revenue From Contracts With Customers: Understanding and Implementing the New Rules," Crowe Horwath LLP, October 2014.

The company should provide recommended disclosures noted in Topic 9510 of Corp Fin's Financial Reporting Manual or assert and disclose that material goodwill does not exist for reporting units that are at risk of failing step 1 of the impairment test. Those recommended disclosures for reporting units that are at risk of failing step 1 are as follows:

- The percentage by which fair value exceeded carrying value as of the date of the most recent test
- The amount of goodwill allocated to the reporting unit
- A description of the methods and key assumptions used and how the key assumptions were determined
- A discussion that specifies, when possible, the degree of uncertainty associated with the key assumptions
- A description of potential events and changes in circumstances that could reasonably be expected to negatively affect the key assumptions

Note that neither a quantitative sensitivity analysis nor the quantification of specific assumptions is recommended in Topic 9510 of Corp Fin's Financial Reporting Manual. However, a qualitative discussion of key assumptions and reasonably likely events or changes in circumstances is recommended.

Valuation of Stock Compensation

Sometimes companies contemplating an IPO grant stock options or stock awards to key employees before the company goes public. Determining the fair value of such awards before the offering date is inherently subjective because the underlying shares are not actively traded.[56]

Generally, the disclosures related to the valuation of stock compensation are limited to those required by U.S. GAAP in ASC 718 and in MD&A, pursuant to Item 303 of Regulation S-K. The SEC's suggested additional supplemental disclosure in MD&A that might be material to an investment decision, such as critical accounting estimates, should also be considered. Because the SEC's guidance is targeted at disclosures of material known trends and uncertainties, the company should disclose the following:

- The method and nature of the assumptions used to value the stock options or awards
- The extent of complexity and subjectivity
- The fact that the fair value of the company's stock will be readily determinable once the stock begins trading
- The expected impact of stock compensation to the extent that a material charge will be incurred once the IPO is effective and the shares begin trading

The company might need to provide SEC staff with supplemental information in a comment letter (and not in disclosure) to clarify the underlying factors that support any material changes in the fair value of shares leading up to an IPO. Note that this

[56] Refer to guidance on the valuation of stock compensation before a company goes public within the AICPA Accounting and Valuation Guide, "Valuation of Privately-Held-Company Equity Securities Issued as Compensation."

is a change from the historical practice of including voluminous disclosures in a registration statement related to the fair value of shares leading up to the date of the IPO, even though they are not relevant once the company's stock begins trading. See Topic 9520 of Corp Fin's Financial Reporting Manual for this guidance.

Complex Financial Instruments

Redeemable Financial Instruments

Generally, there are two types of redeemable financial instruments: those in the scope of ASC 480-10 (formerly SFAS 150); and those in the scope of Rule 5-02.27 of Regulation S-X, which is codified as ASC 480-10-S99. ASC 480-10-25 includes the definition of "mandatorily redeemable instruments" and requires liability classification of such instruments – a financial instrument that embodies an unconditional obligation to redeem the instrument. The SEC's broader definition of redeemable instruments is included in Rule 5-02.27(a), and such instruments must be presented outside stockholders' equity – instruments redeemable at the option of the holder or upon occurrence of an event not solely in the issuer's control. The SEC's view is that if ASC 480-10-25 applies to an instrument, then the classification otherwise required by Rule 5-02 does not apply. If ASC 480-10-25 does not apply to an instrument, then Rule 5-02 might apply.

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[57] 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).

The scope of ASC 480-10-25 is defined in ASC 480-10-15. Paragraph 15-8 states that it does not apply to obligations under stock-based compensation arrangements, such as ESOPs, if those obligations are accounted for under ASC 718 (specifically, ASC 718-40 in the case of an ESOP). As previously noted, if ASC 480-10-25 does not apply to an instrument, then Rule 5-02 may apply.

The guidance in 480-10-15-8 indicates that puttable shares in an ESOP (whether or not allocated) are not covered by ASC 480. Thus, 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 the Nasdaq, or are traded on certain foreign exchanges.[58] In this case, companies registering with the SEC would classify their ESOP shares outside of permanent equity until the put terminates.

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[57] 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).

[58] See IRS guidance in Section 4.72.4.2.8 (04-01-2006) of the Internal Revenue Manual.

Convertible Financial Instruments

Management should consider whether convertible instruments, such as convertible preferred stock or convertible debt, fall in the scope of other portions of ASC 480-10. For example, management should assess whether the instruments can be settled in a variable number of shares under ASC 480-10-25-14.

Furthermore, such convertible instruments should be evaluated under ASC 815 if it is determined that they are not "mandatorily redeemable," and not within the scope of ASC 480-10. Specifically, an assessment to determine if the conversion feature is an embedded derivative that should be accounted for as a derivative, pursuant to ASC 815-15-25-1, should be performed, and the SEC's guidance in ASC 815-10-S99-3[59] should be taken into account if the instrument is convertible preferred stock. Note that when a company goes public, the accounting under ASC 815 should be revisited, as the evaluation of whether or not an embedded derivative as a separate instrument meets the definition of a derivative, particularly the characteristics of net settlement, is often different for public vs. nonpublic companies due to the impact of an active market for the common stock in that the shares of a public company are typically readily convertible to cash. Then, an analysis of whether the convertible instrument is subject to the scope exceptions in ASC 815-10-15-74 through 15-78 should be completed.

If bifurcation of the conversion feature as a derivative is not required, the convertible debt should be evaluated to determine whether a cash settlement feature exists and therefore can be accounted for partially as a liability and partially in equity (ASC 470-20-25-22 through 25-27). If not (or if the instrument is convertible preferred stock), management should determine if a beneficial conversion feature exists; if a beneficial conversion feature does exist, the conversion option should be accounted for separately from the equity instrument (ASC 470-20-25-4 through 25-7).

Finally, if the instrument that includes any embedded features is not in the scope of ASC 480-10-25 and is not required to be classified as a liability under other U.S. GAAP, the equity component of the instrument (whether it is only the instrument or both the instrument and its conversion feature) that contains a redemption feature should be evaluated under the SEC guidance for temporary equity presentation under ASC 480-10-S99-3A. The primary question in this presentation analysis is whether the instrument is redeemable at the balance sheet date under circumstances that are outside the control of the issuer. If so, classification in temporary equity would be required for an SEC registrant.

CROWE PRACTICE TIP:

Work closely with external auditors when considering the accounting for complex financial instruments because it involves voluminous literature that can be difficult to navigate.

Income Taxes

Companies contemplating an IPO should focus on income taxes, including deferred tax assets (DTAs), the DTA valuation allowance, and the indefinite reinvestment of foreign earnings assertions. DTAs and the related valuation allowance is an area of risk in situations where the realizablilty of the company's DTAs is in question. The company must be able to assert that the DTAs will more likely than not be realized if no valuation allowance is recorded. All positive and negative evidence must be weighed when determining whether to record an allowance (see ASC 740-10-30). Separately, companies

[59] In addition, consider ASC 815-15-25-16 through 25-17D upon adoption of Accounting Standards Update No. 2014-16.

must disclose the amount of unrecognized deferred tax liabilities related to investments in foreign subsidiaries that are essentially permanent in duration, or a statement that such determination is not practicable (see ASC 740-30-50-2(c)). Companies should make a reasonable amount of effort to make the determination, if true, that it is not practicable to disclose the amount of unrecognized deferred tax liabilities. If investments in foreign subsidiaries are not permanent in duration, companies should record a deferred tax liability for the related foreign earnings.

Fair Value Disclosures

When preparing a fair value footnote disclosure, the guidance that needs to be considered is ASC 820-10-50. It is important to ensure that all applicable disclosures are made. At a summary level, required disclosure includes (1) the valuation techniques and inputs for assets and liabilities that are measured on a recurring or nonrecurring basis after initial recognition, and (2) the effect of recurring level 3 measurements using significant unobservable inputs on earnings.

Related-Party Disclosure

The SEC defines a “related party” in Rule 1-02(u) of Regulation S-X in the same way the FASB ASC master glossary does. Related parties include affiliates, equity-method investees, certain trusts, principal owners and immediate family, management and immediate family, and other controlled or controlling entities, including those with significant influence over management or operating policies, among other parties. Disclosure of related-party transactions is required on the face of the financial statements, pursuant to Rule 4-08(k) of Regulation S-X. The financial statements should reflect all costs of doing business, including those paid on the registrant’s behalf by a related party.

Other guidelines for related-party disclosures can be found in Topics 7 and 9600 of Corp Fin’s Financial Reporting Manual, including reference to the related party disclosure requirements in Item 404 of Regulation S-K.

Offering Costs

The SEC’s guidance on the deferral of offering costs can be found in SAB Topic 5.A, which is also included in ASC 340-10-S99-1. Specifically, offering costs that are directly attributable to a proposed or actual securities offering should be deferred and netted against the offering proceeds, 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. This definition accounts for the fact that as more time passes in the postponement period between incurring offering costs and a postponed offering, it becomes more difficult to link the costs to the offering.

U.S. GAAP Disclosure Matters

As a company evaluates new disclosures that will be required once it becomes a public company, management should consider the U.S. GAAP disclosure requirements that are specific to public entities (including SEC reporting companies) and not applicable to private entities. See Topic 2005.1 of Corp Fin's Financial Reporting Manual and the summary of such disclosures in this section.

Public Company Adoption Dates

Public company adoption dates apply to companies registering with the SEC except when an EGC has elected, during the IPO process, to use the private company adoption date accommodation for new or revised standards. Usually public companies must adopt FASB standards more quickly than private companies. Standards can provide transition guidance to varying subsets of companies, so knowing the definitions of companies used in the guidance is important. Generally, the more recent FASB standards use the definition of a public business entity consistently, which includes entities that file, furnish, or are required to file or furnish financial statements with the SEC, among other criteria. Public business entities for purposes of applying U.S. GAAP transition dates include companies registering an IPO with the SEC with the exception of those that qualify as EGCs and elect private company adoption dates.

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.

CROWE PRACTICE TIP:

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 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.

Pension and Post-retirement Benefit Plan Disclosures

Certain pension and post-retirement benefit plan disclosures are required for public entities (including SEC reporting companies), pursuant to ASC 715-20-50-5. The required disclosures include roll-forwards of the benefit obligation, the fair value of plan assets, the funded status of the plans, a detailed schedule of net benefit cost, and a sensitivity analysis of assumed healthcare cost trend rates on postretirement healthcare benefits.

[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 SEC Disclosure Matters

In addition to considering the accounting disclosures required for SEC registrants, management should contemplate SEC-specific presentation and disclosures that also are required for registrants. Non-GAAP measures, pro forma financial information, the capitalization table, and MD&A are some of the SEC-specific presentation and disclosure matters discussed in this section.

Non-GAAP Financial Measures

Typically, non-GAAP disclosures are used to present the performance of a company through the eyes of management when management uses performance measurements other than GAAP measurements. As a general rule, the SEC staff does not encourage the use of non-GAAP information, nor does the SEC staff 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 and provides to investors, which is about the company's results, liquidity, and financial condition outside of SEC filings, to be consistent with the disclosure in SEC filings and other public information.

As defined in Item 10(e) of Regulation S-K, a non-GAAP financial measure is:

> *"[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."*

Press releases, analyst calls, periodic filings, and other presentations should not include potentially misleading non-GAAP measures, and proper disclosure should be made in order to avoid investor confusion.

Common non-GAAP measures identified in Topic 8120 of Corp Fin's Financial Reporting Manual include the following: earnings before interest, tax, depreciation, and amortization (EBITDA); adjusted revenues; and core earnings. If non-GAAP measures are used, there are additional disclosure requirements, including reconciling the differences between the non-GAAP measure and the comparable GAAP measure and presenting the GAAP measurement with prominence equal to or greater than the non-GAAP measure.

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 valuable information to investors – and to confirm that statements and disclosures are consistent across all publicly available information, including earnings calls, presentations, and SEC filings.

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 backing out recurring cash operating expenses to arrive at a profit measure or backing out the largest expense(s) necessary to generate a registrant's revenues.

James Kroeker, who at the time was chief accountant of the SEC, provided another example when he covered non-GAAP financial measures related to pension plan expense during a speech.[61] Some companies had changed their method of accounting for pension plan investments to immediately recognize actual gains and losses attributable to the fair value of plan assets. These companies included a non-GAAP measure to remove the actual gain or loss from the performance measure and include the expected long-term rate of return. However, they did not disclose clearly why the non-GAAP measure was important for an investor, particularly in light of the change in accounting policy. Sometimes companies who had not adopted the immediate recognition method of gains and losses in defined-benefit pension or other plans presented non-GAAP financial measures that removed the noncash components of their net periodic pension cost from GAAP results but did not clearly disclose what "noncash" means.

Additional guidance on this topic is available in the SEC's "Conditions for Use of Non-GAAP Financial Measures" (SEC Release No. 33-8176), Corp Fin's "Compliance and Disclosure Interpretations – Non-GAAP Financial Measures," and Topic 8 of Corp Fin's Financial Reporting Manual.

Capitalization Table

Many domestic registrants are asked by the underwriter of the offering to disclose 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 Topic 6270 of Corp Fin's Financial Reporting Manual. Domestic registrants analogize to 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.

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 Topic 3320

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.

[61] James Kroeker's speech was made at Baruch College's 11th Annual Financial Reporting Conference held in New York on May 3, 2012.

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.

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, 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 to the periods disclosed in the filing. The discussion should cover the annual and interim periods presented in the financial statements. For an EGC or an SRC, it can be limited to two years if the financial statements cover only two years. An EGC is not afforded additional disclosure accommodations in MD&A unless the entity also qualifies as an SRC.

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).[62] This disclosure, 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

[62] See Item 303(A)(3)(ii) and (iii) of Regulation S-K.

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 certain liquidity disclosures, such as the tabular disclosure of contractual obligations. The disclosure is meant to provide aggregated information in a single location about contractual obligations related to a company's short- and long-term liquidity needs. In the footnotes to the table, management should describe any provisions in its contracts that will facilitate an understanding of the timing and amount of a company's payment obligations and identify the nature, timing, and amount of any payment obligations that management excluded from the table. See Item 303(a)(5) of Regulation S-K, Topic 9240 of Corp Fin's Financial Reporting Manual, and SEC Release Nos. 33-8182 and 33-9144 for additional guidance. Note that SRCs are not required to make this tabular disclosure.

When developing MD&A, management should give detailed consideration to all of the required disclosures that go beyond those discussed in this section. Investors and the SEC spend a considerable amount of time reviewing and assessing the quality of MD&A because it is management's story of the company's financial performance. For additional guidance, see Topic 9 of Corp Fin's Financial Reporting Manual and SEC Release No. 33-8350.

Living As a Public Company

SEC Reporting Obligations 60

- Filing Categories 60
- Forms 63
- Internal Control Over Financial Reporting 64
- Disclosure Controls and Procedures and SOX Section 302 Certifications 69
- Unresolved Staff Comments 69
- Interactive Data Files 70

SEC Comment Letter Process on Periodic Filings and Current Reports 71

- Forms 10-K and 10-Q 71
- Form 8-K 72

Other SEC Regulations 72

- Proxy Solicitation 72
- Tender Offers 73
- Insider Trading 73
- Foreign Corrupt Practices Act 74
- Reselling Regulations and SEC Rules 144 and 701 of the Exchange Act 75
- Deregistration 76

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.

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.

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 also might lead to SEC enforcement actions and could even preclude future use of certain simplified registration forms.

Filing Categories

Once an IPO is completed and a company becomes an SEC registrant, 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, whether the company's annual internal control report needs to be audited, and whether the company can apply scaled disclosures in its periodic filings.

Because the filing category is assessed at the end of each fiscal year, any change in status will first affect the Form 10-K filed as of year-end and not the Form 10-Q that covers the period when the public float test is performed. As part of the filing category 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).

Filing Category Assessment

Category of Filer	Public Float Test for Entry Into Category	Revenue Test
Large accelerated filers[63]	$700 million or more in public float	None
Accelerated filers[64]	$75 million to less than $700 million in public float	None
Nonaccelerated filers	Less than $75 million in public float (i.e., not a large accelerated or accelerated filer)	None
Smaller reporting companies (SRCs)[65]	Less than $75 million in public float	If zero public float, less than $50 million in revenue for the most recent audited fiscal year
Emerging growth companies (EGCs)[66]	Less than $700 million in public float (i.e., not a large accelerated filer)	Less than $1 billion in revenue for the most recent fiscal year

Exiting a filing category is based on thresholds different from those used to determine if a company enters the category. Specifically, an issuer exits accelerated filer status when public float falls below $50 million as of the company's most recent second fiscal quarter, and an issuer exits large accelerated filer status when public float falls below $500 million but not below $50 million as of the same date.

[63] In addition, a large accelerated filer must have been subject to the Exchange Act for at least 12 calendar months, filed at least one annual report under the Exchange Act, and must not be SRC-eligible. See Regulation 12b-2 of the Exchange Act and Topic 1340 of Corp Fin's Financial Reporting Manual.

[64] In addition, an accelerated filer must have been subject to the Exchange Act for at least 12 calendar months, filed at least one annual report under the Exchange Act, and not be SRC-eligible. See Regulation 12b-2 of the Exchange Act and Topic 1340 of Corp Fin's Financial Reporting Manual.

[65] To qualify as an SRC, the company must not be an investment company, asset-backed issuer, or majority-owned subsidiary of a parent company that is not an SRC. See Item 10(f) of Regulation S-K and Topic 5 of Corp Fin's Financial Reporting Manual.

[66] Qualifying as an EGC requires a company to meet different criteria. See "Emerging Growth Company Qualifications," Chapter 3.

Reporting Obligations by Category of Filer

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.

Category of Filer	Filing Deadlines	Periods Presented in Form 10-K	Periods Presented in Form 10-Q (Unaudited)[67]	Management's Assessment of ICFR[68]	Auditor's Report on ICFR[69]	Disclosure Controls and Procedures (DC&P) and SOX 302 Certifications
Large accelerated filers	10-K: 60 days 10-Q: 40 days	3 FYs except 2 FY balance sheets[70]	Balance Sheets: Most recent fiscal quarter-end and FYE Income and Comprehensive Income Statements: YTD and PY comparable period, QTD and PY comparable quarter Cash flow statements: YTD and PY comparable period[71] Stockholders' Equity statement: Not required[72]	Required in the second Form 10-K; any change in ICFR as defined by Item 308(c) of Regulation S-K to be disclosed in the subsequent Form 10-Q	Required in the second Form 10-K	Required in all Forms 10-Q and 10-K
Accelerated filers (non-EGC)	10-K: 75 days 10-Q: 40 days	3 FYs except 2 FY balance sheets[73]	Same as above	Same as above	Same as above	Same as above
Nonaccelerated filers	10-K: 90 days 10-Q: 45 days	Same as above	Same as above	Same as above	Not required	Same as above
SRCs	10-K: 90 days 10-Q: 45 days	2 FYs[74]	Same as above[75]	Same as above	Not required	Same as above
EGCs	Refer to accelerated, nonaccelerated, or SRC, as applicable.	Non-SRC: 3 FYs except 2 FY balance sheets[76] SRC: 2 FYs	Same as above	Same as above	Not required[77]	Same as above

67 For periods presented in Form 10-Q (unaudited) for non-SRCs, see Rule 10-01(c) of Regulation S-X for financial statement requirements in filings on Form 10-Q. For SRCs, see Rule 8-03 of Regulation S-X for interim financial statement requirements on Form 10-Q.

68 See Instruction 1 to Item 308 of Regulation S-K.

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

70 See Rules 3-01, 3-02, 3-04 of Regulation S-X.

71 See Rule 10-01(c)(3) of Regulation S-X for interim cash flow statement requirements on Form 10-Q.

72 There is no requirement for an interim stockholders' equity statement on Form 10-Q for any filer. See Article 10 (or for SRCs, Article 8) of Regulation S-X for Form 10-Q condensed financial statement requirements. If the registrant elects to provide such a statement in the financial statements or in the notes to the financial statements, an interim change in stockholders' equity statement should be provided for the period between fiscal year-end (FYE) and the most recent quarter-end. A statement for the prior year (PY) comparable period should not be presented pursuant to Rule 3-04 of Regulation S-X, which requires only an analysis of changes in stockholders' equity for each caption presented in the balance sheets. As only two balance sheets are required on Form 10-Q (as of FYE and as of the most recent quarter-end), an analysis of stockholders' equity should be presented for only the interim period between those balance sheet dates, if the registrant elects to provide such a statement.

73 See Rules 3-01, 3-02, 3-04 of Regulation S-X.

74 See Rule 8-02 of Regulation S-X for annual financial statement requirements on Form 10-K for SRCs.

75 See Rule 8-03 of Regulation S-X for interim financial statement requirements on Form 10-Q for SRCs.

76 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").

77 See Section 103 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 certain current reporting disclosures on Form 8-K upon the occurrence of a specified event. 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.[78]

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, and a description of business. For non-SRCs, the form also includes risk factors and selected financial data (SFD).

Form 10-K deadlines are summarized in the table "Reporting Obligations by Category of Filer" earlier in this section. Some of the information required in Form 10-K also is required in other SEC filings or in 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 on 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 and will be filed within 120 days of the FYE. All disclosure requirements and instructions of 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 prior to the Form 10-K and can be incorporated by reference. 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.

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 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. In addition, certain specified events (such as legal proceedings, material changes in risk factors, and certain material defaults) 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 Category of Filer" 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.

[78] See Topic 1310.1 of Corp Fin's Financial Reporting Manual.

An obstacle 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[79]), 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 form must be filed. See the table "Reporting Obligations by Category of Filer" earlier in this section.

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, entry into or 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.

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 percent 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 external auditor activities. 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.

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[79] 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 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 FAQs on "Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports").

Beginning with the Form 10-Q filed after the second Form 10-K is filed, disclosure of any change in ICFR that has materially affected, or is reasonably likely to materially affect, ICFR is required.[80] Also, an independent auditor's attestation report on ICFR is required for only non-EGC accelerated and large accelerated filers (that is, non-EGC companies with public float of $75 million or more). The ICFR requirements are summarized in the "Reporting Obligations by Category of Filer" table earlier in this chapter.

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.

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.

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

Following is a list of seven phases 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.
   - 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).[81]
   - A risk assessment 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 (e.g., flowcharts, narratives, or a combination of the two).
   - Technology tools are chosen for purposes of maintaining adequate SOX 404 documentation.
   - Processes are documented and controls in the processes are prioritized and mapped to financial statements.
3. **Controls design assessment**
   - Controls are identified and assessed including enterprise controls, corporate governance and management controls, and IT general and application controls.
   - 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.

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 align the scoping of systems, processes, and controls in addition to testing methods and sample sizes.

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[81] 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.

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.[82]
    - The principal executive and financial officers are required to make quarterly ICFR certifications and disclose any changes in ICFR in Forms 10-Q and 10-K.[83] Note that if there has not been a change in ICFR, as described by Item 308, a disclosure that there has been no change is not required.
    - The principal executive and financial officers are required to make the annual assertion on ICFR in Form 10-K.[84]

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.

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.[85] 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.[86]

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 Topic 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 or that the company lacks the infrastructure to maintain compliance with public company rules and regulations.

[82] See Item 308(a)(3) of Regulation S-K.

[83] See the certifications required at Item 601(B)(31) of Regulation S-K and Item 308(c) of Regulation S-K.

[84] See 308(a) of Regulation S-K.

[85] Refer to PCAOB Auditing Standard No. 5.

[86] See Rule 1-02(a)(4) of Regulation S-X.

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, 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.

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 (e.g., whether the correct system(s) and control activities are included)
- Subvendors (e.g., 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, as highlighted by Principle 11 of "A Compendium of Approaches and Examples" for the 2013 COSO framework. 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.

CROWE PRACTICE TIP:

Following are some common data security pitfalls to avoid:

- ***The assumption that a system enforces a control*** *(such as dual verification). 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.*
- ***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.*

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."*

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 Category of Filer" 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

Interactive data files are created using eXtensible Business Reporting Language (XBRL), 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.[87]

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. Following are some questions to consider that could help to prevent common errors in XBRL exhibits:

- Is the XBRL valid? Today's financial reporting systems produce very good XBRL code, but the underlying HyperText Markup Language (HTML) that employees and vendors use to create their filings might be deficient. For example, the HTML might not include all the required data.
- Are dates consistent? All dates must be checked for consistency before the files are converted to XBRL.
- Are parentheticals complete? Calculations of shares outstanding, for example, are typically presented as parenthetical data that has to be separated out and tagged in separate tables. The appropriate collections of links, known as calculation linkbases, must be included.
- Is information the same in the XBRL filing and the traditional filing? The SEC requires that XBRL filings include the same information as the corresponding traditional format elements, and no data element can be changed, deleted, or summarized in the interactive data file. When CFOs are doing last-minute reviews of their SEC filings with their audit committees, and they have parallel versions in both HTML and XBRL, it is common for a handwritten change on the HTML printout to be accidentally omitted from the electronic XBRL version. It is important to verify that such errors do not occur.
- Are all tags and extensions correct and necessary? Consider these questions carefully:
  - Have all numbers embedded in the text of the notes been tagged, including those that are spelled out? For example, the tag for "twelve months" should be the same as the tag for "12 months."
  - Are any extensions unnecessary? Can tags available in the current XBRL taxonomy be substituted?
  - Are descriptions of extensions too detailed? Wordy extensions could create the need to make additional disclosures.
  - Are any tags that are no longer valid being used? Replace invalid tags with valid ones.

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[87] 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 staff 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. Corp Fin generally follows a risk-based selection process that results in reviews of registrants that make up 90 to 95 percent of the market capitalization annually. 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 assistant director (AD) office in Corp Fin is 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, as determined by the AD office. 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).[88]

If the staff issues a comment letter, the registrant has 10 business days to submit a response or submit an acknowledgement letter on EDGAR stating that the company has received the letter and requests an extension (which typically is no more than an additional 10 business days). 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.

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[88] 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.

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.

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) and the business matters for which the security holders are required to vote. 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. Generally, stockholders who own $2,000 of capital or 1 percent of the stock for one year have the ability to include proposals in the company's proxy material. However, state laws limit the scope of shareholder approvals.

When the annual meeting relates to the election of directors, the ratification of independent accountants, 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 previously listed topics, the SEC requires a preliminary proxy to be sent to the SEC at least 10 days prior to the distribution to stockholders and that 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 company executives make an annual report available to stockholders on their website each year, regardless of whether directors are being elected.

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.

Tender Offers

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 percent of the company's shares or make a tender offer that would result in more than 5 percent 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 Schedule 13G is required if the acquisition is more than 5 percent but less than 20 percent, 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 apply only to companies subject to the Securities Act in a registered public offering.

Insider Trading

Certain insiders, including all directors and officers, as well as any shareholders with more than a 10 percent 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 completed monthly.

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. 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. However, Rule 10b5-1 protects insiders who purchase or sell stock using a trading plan (i.e., a programmed sale), even when they have material nonpublic information.

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 help prevent illegal activities that occur when employees abuse their access to insider information, executives should develop an insider trading policy before their company goes 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 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, and Rule 701 pertains to the exemptions for transactions involving securities issued in a compensation arrangement.

To clarify the restrictions on sales of restricted and control stock, the SEC adopted Rule 144 in 1972 and revisions to Rule 144 in February 2008. Rule 144 provides a safe harbor for such sales. Essentially, the rule and its revisions allow controlling shareholders and affiliated 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, the controlling shareholder or affiliated 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 (i.e., 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.

Note that 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 by companies via a Rule 144A filing. In connection with such a filing, a private placement is issued under Regulation D to qualified institutional buyers (large institutions that hold a significant amount of investments). Even though the private placement is exempt from registration, underwriters prepare the document

as they would a registration statement. Underwriters perform due diligence in a manner similar to due diligence for a nonexempt registration. For example, the trust indenture might stipulate that the 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 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 continues 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 (or 1,200 shareholders in the case of banks and bank 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 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.[89]

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

Appendixes

Appendix A: Private Equity Transactions Q&A 78

Appendix B: Foreign Private Issuers 81

- Qualifications 81
- Forms 82
- Accommodations Affecting Registration Statements 82
- Accommodations Affecting Periodic Reports 85
- Other Matters 86
- Multijurisdictional Disclosure System 87

Appendix C: Glossary 88

Appendix D: Abbreviations............91

Appendix A: Private Equity Transactions Q&A

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 explicitly answer 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 same control 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 transcription 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 (i.e., what are the entities being acquired)?
- Which entity is the registrant?
- Is the registrant different from the predecessor (in other words, what 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 shed any light on 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); or 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. Accounting for a 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 (i.e., the date on which the control group gained control of the separate entities).[90] 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.[91] 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.[92]

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:

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[90] See ASC 805-50-25-2

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

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

- If the merger of entities under common control occurs after the date as of which the financial statements are presented in a registration statement (i.e., 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?[93]
- 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 pursuant to SAB 80 instead of Rule 3-05 in an initial registration statement? See the conditions for reliance on SAB 80 in Topic 2070 of Corp Fin's Financial Reporting Manual.

- 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?

Given the recent uptick in private equity transactions, 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. See highlights from the Sept. 23, 2014, SEC Regulations Committee meeting. Also, refer to an SEC staff speech on these types of transactions on the SEC's website.

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.

[93] 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

In addition to domestic registrants, foreign registrants file IPOs with the SEC. In 2014, the largest IPO in history was Alibaba Group, a foreign registrant that qualified as a foreign private issuer (FPI), which raised a record $22 billion.[94]

A foreign business 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. Qualification as an FPI 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 encourage and allow FPIs to import ownership of their foreign businesses to U.S. markets 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.[95]

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 emerging growth company (EGC) under the JOBS Act and choose to take advantage of this status to apply the scaled disclosure provisions. However, an FPI might not be able to take advantage of disclosing only two balance sheets if the FPI is a first-time adopter of IFRS-IASB due to the requirement of IFRS 1 to include three statements of financial position. See Topic 10300 of Corp Fin's Financial Reporting Manual for more on the applicability of EGC status to FPIs.

Qualifications

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."

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[94] "2014 U.S. IPO Annual Review," Renaissance Capital, Jan. 2, 2015.

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

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.[96]

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 or to be quoted on the over-the-counter bulletin board (OTCBB).[97]

Alternatively, an FPI might elect to use the domestic forms for registering and periodic filings with the SEC (e.g., 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.

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 structures. Certain accommodations for domestic filers such as the scaled disclosure requirements 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.

Accommodations Affecting Registration Statements

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

Confidential Treatment

Initial registration statements of foreign issuers are allowed to be submitted on a nonpublic basis only when the registrant is: 1) a foreign government registering its debt securities; 2) an FPI that is listed or is concurrently listing its securities on a non-U.S. securities exchange; 3) an FPI that is being privatized by a foreign government; or 4) an FPI that can demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction.

Under these circumstances, FPIs are allowed to file a draft registration statement and amendments with the SEC on a confidential basis, and until the registration statement has been made public on EDGAR, the SEC staff comments and the FPI responds to those comments on a confidential basis. When the registration statement is publicly filed, the FPI also publicly files its previously submitted draft registration statements and resubmits all previously submitted response letters to staff comments as correspondence on EDGAR.

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

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

The SEC staff reserves the right to request that an FPI publicly file the registration statement in certain circumstances, such as when there has been publicity about a proposed offering or listing.[98] If the FPI qualifies and elects to register as an EGC, the confidential treatment process for EGCs would be followed (see "The JOBS Act," Chapter 3).

Accounting Basis

FPIs are allowed to present their financial statements in conformity with IFRS-IASB and exclude any 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 Topic 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 FPI that qualifies as an EGC and elects to present financials on a home-country GAAP basis might take advantage of the extended transition period for complying with new or revised financial accounting standards in the U.S. GAAP reconciliation (see Topic 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 12 months when the document is filed and the registration statement is effective. Note that the SEC's Office of the Chief Accountant (OCA) may grant waivers for audited financial statements older than 12 months but not older than 15 months when 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 Topic 6220.3 of Corp Fin's Financial Reporting Manual).

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.[99]

The age requirements for financial statements required for other entities (such as those required by Rules 3-05 for business acquisitions and 3-09 for equity-method investees under Regulation S-X) are the same as the age requirements for the FPI's financial statements.[100]

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[98] See the SEC's Office of International Corporate Finance statement on "Non-Public Submissions From Foreign Private Issuers," updated May 30, 2012.

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

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

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 12 months, or if a waiver is granted by the OCA, up to 15 months old.
- Unaudited interim financials may be as old as six months, or if a waiver is granted by the OCA for the audited financials, up to nine months old.

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. Topic 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.

Selected Financial Data (SFD)

Non-EGC FPIs are allowed to omit the earliest two of the total five years of SFD if certain conditions exist. Specifically, SFD for either or both of the earliest two years of the five-year period may be omitted if the company represents and discloses that the information cannot be provided, or cannot be provided on a restated basis, without unreasonable effort or expense.

In addition, SFD may be presented on the same accounting basis as the primary financial statements, and if that basis is home-country GAAP, SFD also should include amounts in accordance with U.S. GAAP.[101]

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 individual directors and members of management is required to be disclosed only in a registration statement by Item 6.B of Form 20-F by operation of Item 4.A of Form F-1 if disclosure on an individual basis is required in the company's home country or otherwise is disclosed publicly.

[101] See Item 3.A of Form 20-F and Instruction 2 to Item 3.A by operation of Item 4.A of Form F-1; and Topic 6420 of Corp Fin's Financial Reporting Manual.

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)

Filing deadlines for FPI annual reports are extended to 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.

Interim financial statements are not required to be filed with the SEC, but should be provided on Form 6-K if they contain material information 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. For FPIs listed on the Nasdaq, the exchange requires 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 (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 (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 reports on ICFR (such as an auditor's report on a registrant's ICFR effectiveness) 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. The issuer might make the information public pursuant to the conditions of Form 6-K, but disclosure of a change in auditor is not required absent other requirements of the form being met. The change in auditor is required, however, to be disclosed in Form 20-F pursuant to Item 16F.[102]

XBRL Taxonomy

FPIs that prepare their financial statements in accordance with IFRS-IASB are not required to file XBRL data (or interactive data files as defined by Rule 11 of Regulation S-T) until the SEC publishes an IFRS-IASB taxonomy. See the Center for Audit Quality SEC letter dated April 8, 2011. However, FPIs that use either U.S. GAAP or reconcile home-country GAAP to U.S. GAAP must file XBRL data and use the U.S. GAAP-XBRL taxonomy.

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.

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. 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 (Topic 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 Topic 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.

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[102] See Topic 6830 of Corp Fin's Financial Reporting Manual.

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 (e.g., 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 required 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.

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

Also referred to as "Corporation Finance" or "the Division" or "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.

dual verification

A method of authorization that usually includes two user identifications in order to release a transaction.

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 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 December 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, or to be quoted on the OTCBB (Over-the-Counter Bulletin Board).

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 3 of the Exchange 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 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.

road show

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

Sarbanes-Oxley Act of 2002

Also referred to as "SOX" and 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.

ticketing system

A system that tracks end user requests, incidents, and resolution procedures, including key steps such as authorization and resolution.

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
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
HTML	HyperText Markup Language
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
OTCBB	Over-the-Counter Bulletin Board
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

Final Thoughts

Final Thoughts and Contact Information.....94

Final 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.

For answers to specific accounting, disclosure, or SEC registration questions, please contact one of the partners in our Assurance Professional Practice or an author of this guide:

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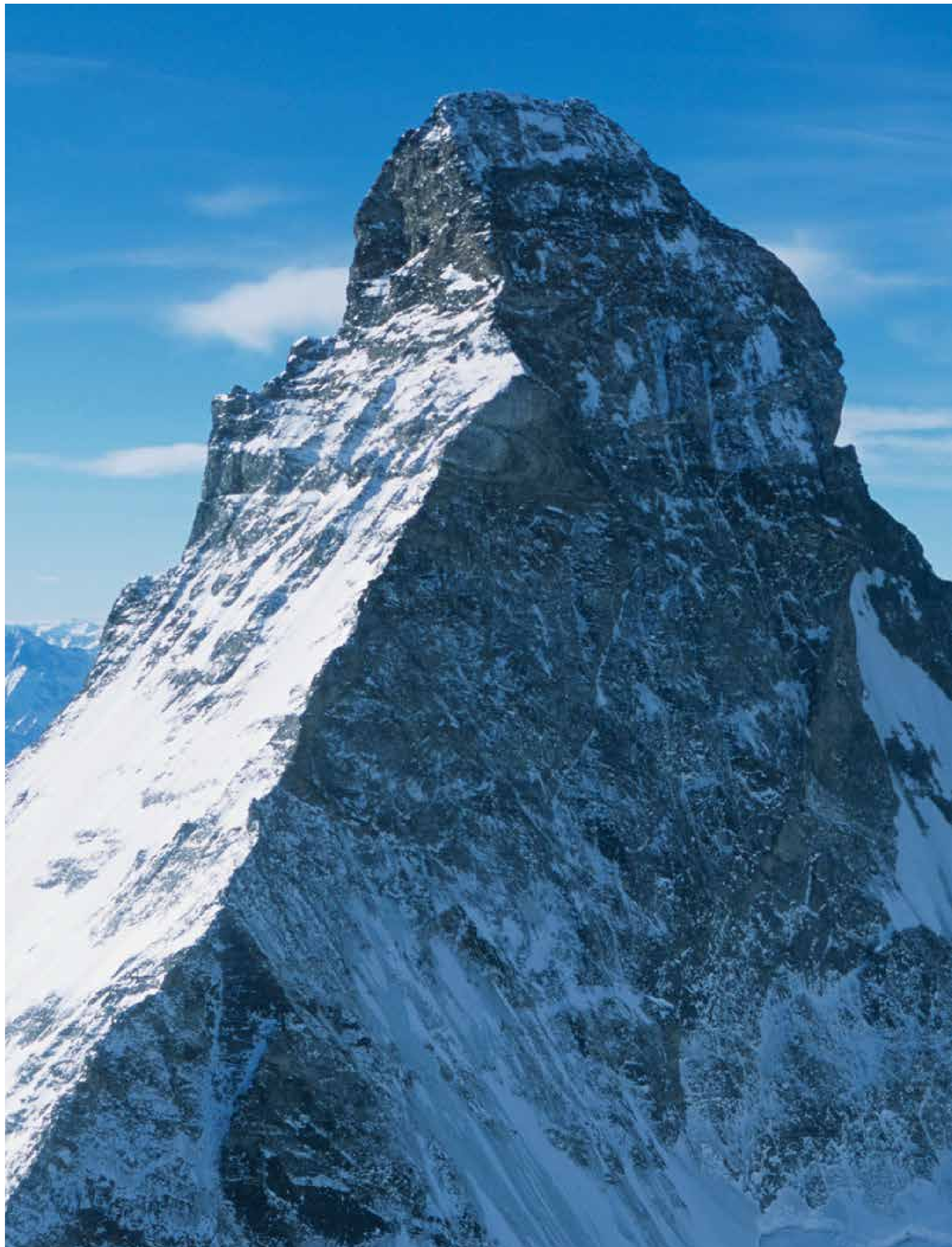
When the decision has been made for your company to proceed with an IPO, Crowe can help your company at every step of the long and demanding IPO process. To discuss the IPO process with a partner, please contact us. Contact information is available at www.crowehorwath.com/leadership.



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