

To the Point

Leading practices for a smooth IPO registration

Companies beginning the IPO process can benefit from SEC staff suggestions and lessons learned by other companies.

What you need to know

- ▶ Many companies are considering initial public offerings because of the JOBS Act, which eases regulatory requirements for emerging growth companies.
- ▶ Being familiar with SEC staff “hot buttons” and understanding leading practices in the SEC registration process will help a company meet its deadlines and have the flexibility to respond to market conditions.

Overview

The number of initial public offerings (IPOs) in the US has increased over the past two years. Now the Jumpstart Our Business Startups Act (JOBS Act), which was enacted in April 2012, is intended to encourage more IPOs by creating a new category of issuer called an emerging growth company (EGC).¹

In planning IPOs, all companies should consider leading practices and lessons learned by other companies. This publication highlights suggestions from the Securities and Exchange Commission (SEC) staff and observations from our extensive experience with companies that have successfully completed IPOs.²

Leading practices

Discuss complex or unique accounting matters with the SEC staff before submitting your initial registration statement

Companies that are uncertain about the SEC staff’s view on the application of US GAAP or IFRS in a specific fact pattern should consider formal preclearance of accounting conclusions with the Office of the Chief Accountant³ (e.g., revenue recognition, consolidation, debt versus equity classification). Companies seeking relief or guidance on how to comply with the SEC’s financial reporting requirements (e.g., whether to include acquiree or investee financial statements) should submit

written requests to the Division of Corporation Finance's Chief Accountant's Office.⁴ Resolving these issues may take a few weeks, but waiting to resolve them until after the registration statement is in review will often be more time consuming and can be more complicated. For example, a company may have to restate its historical financial statements or obtain an audit of the financial statements of an investee or an acquired company. We strongly encourage companies to confirm in advance any questions regarding the measurement of significance of an investee or acquisition, or whether an acquisition involves assets or a business.

At the outset, companies also should inform the examiners assigned to their IPO documents about any previous correspondence with other Division of Corporation Finance staff members or the Office of the Chief Accountant. The examiners can review documents more efficiently if they know about conclusions already reached by other members of the SEC staff.

Be aware of all information that is publicly available about your company

The SEC staff reviews all available information about a company (e.g., websites, press releases) when reviewing an IPO registration statement. Companies should consider all public information (financial and nonfinancial) and confirm that their IPO documents are consistent with these communications. In particular, the staff uses public information when evaluating how a company describes its business in its registration statements, its management's discussion and analysis of financial condition and results of operations (MD&A) and its segment reporting under Accounting Standards Codification Topic 280, *Segment Reporting*.

Write a robust MD&A

SEC rules and regulations require management to discuss a company's financial condition, changes in financial condition and results of operations in MD&A. The purpose of MD&A is to provide information relevant to an assessment of the financial condition and results of operations of the registrant by evaluating the amounts and certainty of cash flows from operations and outside sources. Generally, requirements include:

- ▶ Specific information about the registrant's liquidity, capital resources, off-balance sheet arrangements, aggregate contractual obligations and results of operations
- ▶ Material trends, events and uncertainties that may make historical financial information not indicative of future operations or financial condition
- ▶ The cause of material changes in line items of the consolidated financial statements from prior-period amounts
- ▶ Any other information the registrant believes necessary for an investor to understand its financial condition, changes in financial condition and results of operations

Companies should take the time to write an informative MD&A that helps readers understand the company through the eyes of management. When disclosing nonfinancial metrics or statistics deemed key performance indicators, companies should clearly indicate their importance and how they affect the financial statements. For example, a disclosure of the number of website users is more meaningful if it helps readers understand how the statistic drives operating results.

Follow SEC requirements for non-GAAP financial measures

Since the SEC staff issued Compliance and Disclosure Interpretations in January 2010⁵ that made it easier for registrants to include non-GAAP financial measures in their filings, the SEC staff has focused more on compliance with presentation and disclosure requirements than on whether a non-GAAP financial measure is appropriate. For example, companies are prohibited from presenting non-GAAP financial measures with greater prominence than GAAP measures. This prohibition covers both the order of presentation and the degree of emphasis. Therefore, the SEC staff has objected to companies presenting anything resembling a full non-GAAP income statement as a form of reconciliation.

The SEC staff also has recently identified certain measures that it believes may be misleading to investors. The staff has objected to companies adding back any cash operating expenses for the purposes of a non-GAAP performance measure. To help resolve potential concerns, companies should include clear and specific disclosure of how a particular non-GAAP measure is useful for investors.

Disclose any preliminary results or capsule information carefully

Capsule financial information (i.e., financial information such as sales or net income for a recently completed period for which financial statements are not included in the IPO registration statement) may be presented in a registration statement for the most recent interim period and the corresponding period of the prior year. While a discussion of preliminary results or estimates for the latest reporting period can be useful to investors, companies should provide the proper context for such a discussion and determine that the disclosure of such amounts is balanced. For example, a company highlighting increases in revenue also should highlight any declines in net income or other key metrics. Given the potential liabilities associated with false or misleading disclosures, companies should consider excluding financial estimates that are subject to a high risk of change.

Prepare substantially complete registration statements, even when submitting confidentially

Under the JOBS Act, a company that qualifies as an EGC can submit its IPO registration statement and subsequent amendments to the SEC on a confidential basis.⁶ Through the confidential registration statement submission process, the SEC staff will be able to comment and the company will be able to respond confidentially before filing publicly through the SEC's EDGAR system. However, the SEC staff expects draft registration statements to be substantially complete, including a signed audit report and financial statement schedules, at the time of submission. As with filed registration statements, the confidential submission should include all required financial statements, including those to comply with Rule 3-05 of Regulation S-X, *Financial statements of businesses acquired or to be acquired*, and Rule 3-09 of Regulation S-X, *Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons*.

The confidential submission of the draft registration statement or amendment does not constitute a "filing." Therefore, it's not required to be signed on behalf of the company or include the consent of auditors and other experts. However, all confidential submissions must be filed as exhibits when the IPO registration statement is filed at least 21 days before the road show.

The SEC staff is on heightened alert for any non-GAAP measures that might appear misleading.

Keep an open line of communication with the SEC staff

Companies should be proactive with the examiners regarding their anticipated timing so that the staff is able to consider it in the review process. If the staff isn't aware of a company's timetable, the company may have trouble clearing SEC comments to maintain the offering schedule.

Even when a company submits a well-organized and well-written response to an SEC comment letter, sometimes a live discussion with the SEC staff is the most productive way to resolve a difficult comment. For example, if a comment remains outstanding after two rounds of comments, a company should consider requesting a conference call to discuss the SEC staff's and the company's understanding of the issues and appropriate resolution.

Include your estimated price range in the filing as soon as possible

To complete its review, the SEC staff requires a complete registration statement, including the capitalization table, dilution calculation and pro forma financial information. These disclosures are all determined using the estimated sales price range in the IPO document. The sooner the estimated sales price is included in the document, the sooner the SEC staff can fully review the document for possible comment and provide sufficient time for any concerns to be addressed.

Next steps

Planning is critical for companies beginning the IPO process. They should involve legal counsel and their accountants early in the process.

Endnotes:

- ¹ See our To the Point publication, *JOBS Act to promote capital formation* (SCORE No. CC0345), and our Technical Line, *Implementing the JOBS Act* (SCORE No. CC0348).
- ² Many of the leading practices we describe were communicated by the SEC staff at the Practising Law Institute SEC Speaks Conference in Washington, DC, in February 2012.
- ³ See guidance for consulting with the Office of the Chief Accountant at <http://www.sec.gov/info/accountants/ocasubguidance.htm>.
- ⁴ See guidance for written requests to the Division of Corporation Finance at <http://www.sec.gov/divisions/corpfin/cfconcise.shtml>.
- ⁵ The non-GAAP financial measures C&DIs are available at <http://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm>.
- ⁶ See the SEC staff's confidential filing process guidance at <http://www.sec.gov/divisions/corpfin/cfannouncements/cfsecuremailinstructions.pdf>.

Ernst & Young

Assurance | Tax | Transactions | Advisory

© 2012 Ernst & Young LLP.

All Rights Reserved.

SCORE No. CC0349

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 152,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com.

This publication has been carefully prepared but it necessarily contains information in summary form and is therefore intended for general guidance only; it is not intended to be a substitute for detailed research or the exercise of professional judgment. The information presented in this publication should not be construed as legal, tax, accounting, or any other professional advice or service. Ernst & Young LLP can accept no responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. You should consult with Ernst & Young LLP or other professional advisors familiar with your particular factual situation for advice concerning specific audit, tax or other matters before making any decision.