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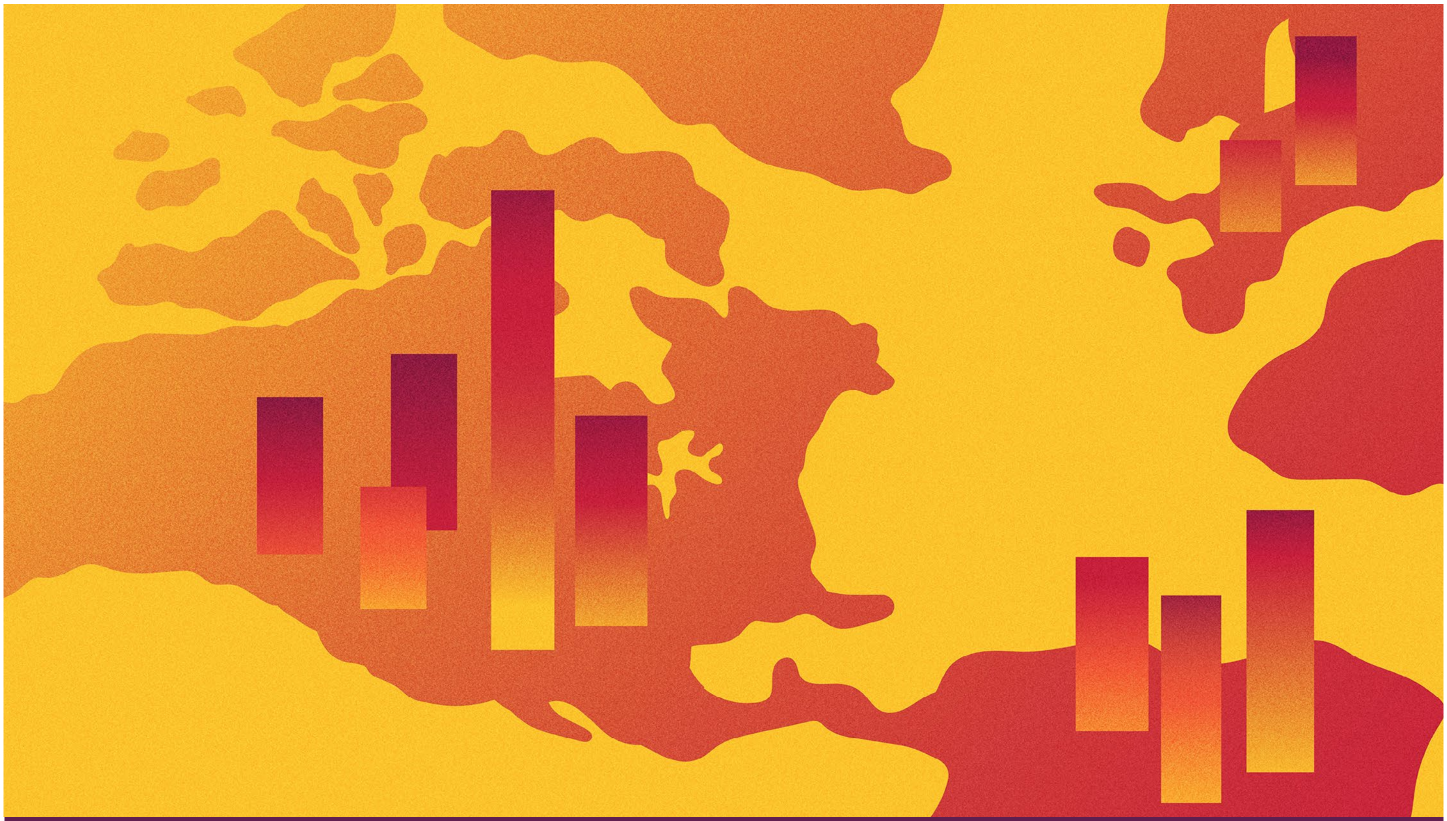

Ensuring a smooth ride as a newly public company

6 important finance areas you need to conquer

By Kelley Wall

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No matter how old you are, surely you can recall that rush as a kid when you got your first bike. It represented speed, the wind in your face and a newfound freedom. For some of us, we were mostly interested in the cool tassels or the basket for storing candy from the nearby store. Whatever the reason we wanted to get on that bike fast and get away, we couldn't just jump on the two-wheeler and take off. Not yet.

We needed to practice and maybe even put up with some training wheels at first. Maybe we had to fall off a few times before we could attain that dreamy first ride, far from the tethers of our parents. The months leading up to an IPO are like that. There's lots of dreaming and loads of great excitement and energy. It's a whole different kind of rush. But a full sense of freedom doesn't quite happen after the first day your company stock hits the exchanges. There are a lot more people to answer to and a whole lot more work that needs to get done.

As you look at the road ahead, you begin to realize that the bright and shiny S-1 is only one milestone in your company's journey, not the end game. Getting through what we call "Day 2"—the first year or two as a public company—can be challenging. It leads to heightened demands that are tenfold what they were pre-IPO life, and it exposes the company to many more sets of eyes. Dealing with the increased reporting and compliance requirements takes some practice too. If only the IPO came with a set of training wheels!

To quote a dear 3-year-old, "If you ride too fast, sometimes you crash." Once you've gone IPO, one of the biggest strategic decisions is behind you and it's full speed ahead from here on out. But you can still build in some time to pause and consider the risks that are up ahead and consider ways you can avoid or minimize them. Here are a few questions to assess whether your newly public company is in for a smooth ride.

#1 Do I have the right resources?

This is both a question of having enough staff as it is a question of whether you have the right talent. As a public company, there's just more to do—providing quarterly financial reports, drafting the management discussion and analysis, and XBRL tagging, to name a few. And there's the earnings release, which may include separate non-GAAP reporting and additional financial analysis for management in preparation for the earnings call. Pile on the coordination of internal and external reviews of financial information and other reporting controls and it's a heavy load to bear. Even companies that had a rock-star finance team as a privately held company need to scale up for public company life so they don't go flying over the handlebars.

After all, once they're listed on public exchanges, companies' falterings become well known and create lasting dents on their credibility. Approximately 31 percent of newly public companies had a financial restatement between 2004 and 2012, according to Audit Analytics data. [i] In a September 2017 *Forbes* article, KPMG explains the risks, stating, "Restatements in the first few quarters after a company goes public can result in a huge loss of public confidence, a decline in stock price, and questions from suppliers and/or customers. Recovering from such a public event may take months or even years." [ii]

Companies that have reached the IPO milestone are typically on a high growth path, and with growth comes additional work and often increased complexity. A proactive approach to creating a scalable finance and accounting team from the get-go is important and can help prevent employee burnout and minimize the risk of reporting issues. Further, successful

i http://blogs.wsj.com/cfo/2012/03/27/newly-public-companies-fumble-financials

ii www.forbes.com/sites/kpmg/2017/09/15/ipo-readiness-five-common-accounting-pitfalls finance organizations consider whether the team is able to not only address technical accounting issues but identify them as well. That can be a cost saver as well as a motivational boost. Last minute surprises and/or accounting issues identified by your auditors can cause companies to scramble at the last minute, and rushing can put accuracy at risk.

#2 Is my disclosure committee focused on key issues?

Although there is not a regulatory requirement, most public companies have established a disclosure committee as part of their process to maintain adequate disclosure controls and procedures in accordance with the Sarbanes-Oxley Act (SOX). Such a committee is simple to set up, but is yours functioning in a way that adds value to your reporting process? Working with hundreds of public companies, we've seen the gamut in terms of the role these committees play and how some of them don't live up to their potential.

When the disclosure committee is not operating effectively, we've identified a couple of key themes:

- The members are not clear about their responsibilities in the financial reporting process.
- The meetings are focused solely on what's been put in the SEC document, and there is no or minimal discussion on what's not in there but should be or that could, in some cases, have accounting implications.

Another key element to a well-functioning disclosure committee is the make-up of its members. As it is, notes law firm Foley & Lardner LLP, "Most disclosure committees are comprised of 'seasoned professionals' rather than field-level managers, which helps to ensure that the members have an understanding of the 'big picture' in terms of what information is truly material to the company as a whole, and, therefore, required to be disclosed." [iii] In other words, the disclosure committee is not meant to be a meeting just of finance and accounting minds but should be made up of individuals who can provide insight to the business and the market it serves.

Just like with any good bike, the value of the disclosure committee is measured by how it's put together and how it's driven. Both aspects should be thoughtfully considered to ensure an appropriate level of effectiveness.

> After months of preparation, decision-making, documentation and revisions, the details of the business are out there for all the world to see, and for just a moment there's a sense of relief. The advisors have left, and the training wheels have been taken off. But the fact is you won't be coasting anytime soon.

iii www.foley.com/disclosure-committee-best-practices-04-30-2007

#3 Are my SEC filings raising any red flags?

Even though you put your financial statements and associated disclosures through a rigorous internal review, which was matched by the heavy scrutiny of your auditors and legal counsel, there is always the potential that the information you have shared (or not shared) will raise flags with the SEC.

In general, the people most involved in the review of the financial statements and related disclosures are those who have in-depth knowledge of your accounting processes and transactions. A disclosure may appear clear and transparent to those "in the know," but it may be less so for investors and the SEC. Disclosures don't need to be robust, necessarily, but should be reviewed with an outsider perspective to help ensure clarity and reduce the risk of an SEC inquiry, which is never a fun thing.

Further, when the SEC staff reviews your filings, they are often looking at more than just your 10-K or 10-Q. They may also look at your website, analyst presentations, earnings releases and other publicly available information.

While it is not uncommon for companies to have different teams of people working on the various forms of public disclosure, unfortunately, disparate teams can result in inconsistent information. For example, we've seen cases where an analyst presentation discussed the business and provided financial results and projections within various markets, but the related 10-K disclosures stated that the company has only one operating segment.

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Another area where the potential is ripe for extra questions by the SEC has to do with non-GAAP disclosures. In fact, EY noted that the SEC staff's comments on the use of non-GAAP financial measures spiked after the staff updated its Compliance and Disclosure Interpretations in May 2016. As of June 30, 2017, EY reported, companies' use of non-GAAP measures topped its list of most frequent topics in staff comment letters for the first time.

Thus, companies looking to their peers for "how to" are likely to find themselves lacking in terms of regulatory compliance. And because the earnings release is not officially reviewed by the auditors, companies need to ensure on their own that their non-GAAP measures and required disclosures comply with SEC Regulation G.

These are just some examples of areas that can send up red flags with the SEC. Implementing best practices for public disclosure is important for both mitigating risk and improving effectiveness in the reporting process.

#4 Has accelerating the close process to meet financial reporting obligations created risk in terms of process or oversight?

Can you remember back to the days when month-end close depended more on board meetings and vacation schedules, and not so much a defined timeline? When quarterly financial statements were a “nice-to-have”? When you saw the auditors only once a year? Ahhh…the good ole days! Now you have an SEC reporting deadline of 45 days, or if you’re an accelerated filer, only 40 days. While we’re sure that seemed like a lot of time at first, once you start to back into the time needed to complete the XBRL tagging, get the document formatted for submission via the SEC’s EDGAR financial reporting system, give everything over for the auditor review plus the time needed to process changes, the disclosure committee process, management oversight and input, and all those footnotes and the management discussion and analysis section (MD&A) to draft, that close process now has a serious need for speed. And that’s not even considering the added effort and timing associated with putting the earning release together.

Closing the books quickly is, in and of itself, a good thing, but you also have to consider what contributed to the shorter timeline. Moving some of the accrual evaluations to the week prior to close, automating certain processes and/or improving system reporting and performance may be beneficial contributors. The risk lies in eliminating key processes and oversight, limiting collaboration and inquiries, and in general, giving greater value to the timing of the deliverables versus quality and accuracy. We often see the biggest issues arise during periods of change—such as new transactions, customer agreements, business processes—where additional accounting considerations come into play, but because of the push-and-pull demands of the growing business and escalated time schedule, they are overlooked.

The missed opportunity to get the accounting right at the outset will show cracks later on and could lead to questions about the veracity and strength of the finance team and those who oversee it. The newest publicly traded companies are especially vulnerable to this risk. “Most entrepreneurs find public company financial reporting to be far more formal and rigorous than that of private companies,” notes Deloitte. “Thus, this area usually requires serious attention…. Key activities for financial reporting include considering the competencies—and competing commitments—of staff and how best to address any shortcomings or needs.”

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It’s important to consider where the risks are in your close process and ensure that both your team and timeline are adequate to mitigate any bumps in the road.

#5 Am I meeting investor and analyst expectations in providing financial analysis and disclosure?

As a public company, you have a new class of external reviewers and a new set of expectations. The nature of information provided, the level of detail and the timing of updates are all very different for public companies. In addition, building trust with the analyst community takes time, and the penalties for missing projections is much more severe, ranging from a diminished stock price to shareholder lawsuits. External communication has to be both thoughtful and careful.

Providing adequate and timely updates is core to building credibility in the market. And it's important to provide realistic expectations, not just your best-case scenario.

Companies typically have plenty of advisors during the going-public process to help with messaging and presenting the company's financial performance and growth strategy. However, once public, many of those advisors are no longer around and the company must continue to update its story and manage expectations. It's not always a clear road ahead—changes in the business, the market and the economy can cause a company to shift gears, sometimes suddenly. Providing adequate and timely updates is core to building credibility in the market. And it's important to provide realistic expectations, not just your best-case scenario. Boris Feldman, a litigation partner with Wilson, Sonsini, Goodrich and Rosati, reminds companies, "Wall Street analysts hate surprises. Public companies are therefore punished more severely for surprises than they are for weak, but anticipated, results." [iv]

From an SEC reporting perspective, companies are required to disclose known trends and uncertainties in their filings. These are typically captured in the MD&A section as well as the risk factors. The disclosure requires a big picture view of not only what's happening with the business but what's happening in the market from a competitive standpoint and product demand perspective. And these disclosures should evolve over time. This effort should be considered not just a compliance exercise but also another mode of investor communication. Similarly, it should preclude any surprises.

#6 Is my team staying on top of changes in accounting rules, public company disclosures and regulatory requirements?

There are newly issued Accounting Standards Updates (ASUs) that have been issued but not yet implemented, and there are a bunch of projects still on the Financial Accounting Standards Board (FASB) agenda that are in process. And then there are the regulatory updates issued by the SEC, the Public Company Accounting Oversight Board (PCAOB) and other agencies that companies need to track. In the meantime, as companies grow, technology advances and businesses evolve, the applicability of US GAAP and the ability of the rules to keep up with the times continue to come into question, which gives rise to interpretations from various sources. There's a lot to stay on top of and companies need to have processes in place to ensure compliance with existing rules and in anticipation of the changes ahead.

iv www.borisfeldman.com/Being_Public.htm

"Whether driven by the increasing complexity of accounting standards, the dynamic regulatory environment or changing business activities, companies are facing an increased risk of financial reporting restatements," notes PwC partner Chad Kokenge. [v]

And the risk of restatement is greater with newly public companies that often fall into a predominantly reactive mode when it comes to accounting and regulatory updates. It's like riding your bike with your eyes closed. (Don't try this at home.) Needless to say, it's dangerous. For businesses, a reactive approach can cause unnecessary fire drills in terms of compliance, which can be costly, could expose the company to significant risk and may lead to a financial restatement, as Kokenge points out.

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It's also worth noting that many of the standard-setting changes impact much more than accounting—they affect other parts of the business as well. A proactive process to stay abreast of what's pending and issued can enable companies to prepare, collaborate and adapt. For example, the FASB's new revenue recognition guidance (ASC 606) and new lease accounting guidance (ASC 842) require cross-functional engagement, including IT, sales, human resources and investor relations, to name a few.

Conclusion

Bike riding is fun…until you sputter out to a complete stop or, worse, crash. If you answered "no" or "I'm not sure" to any of the above questions, then you could be at risk for a tumble. Without the right mix of talent that's knowledgeable and well-staffed, a disclosure committee that has the company's back, and a process that keeps pace with reporting deadlines while also providing leeway for changes, a newly public company will struggle in meeting its obligations.

You're in prime time now. The excitement of that first day of trading may have died down, but you still have a big job in front of you and so does your team. In the Day 2 phase, the stakes are higher, the expectations are steeper, and everyone is watching. By staying on top of the changes around you—inside the company and outside—always looking forward, and tending to the expertise you have within your staff and knowing when you need more, you can achieve a smooth ride. It may be a wobbly one at times, but you'll stay upright.

About the author

Before rejoining RoseRyan's Technical Accounting Group in 2017, Kelley Wall was the Director of Corporate Finance at Trimble. She has deep experience including as a senior manager with PwC's National Office. Kelley's specialty areas include technical accounting, M&A and SEC reporting.

v www.pwc.com/us/en/services/audit-assurance/accounting-advisory/restatements.html