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Companies Filing IPOs Shouldn't Underestimate Accounting Challenge

It's IPO season. Companies that have been planning for the past year-and-a-half to file an initial public offering will likely do so now, accounting sources told Bloomberg BNA.

But only if they have deep pockets. Companies rack up millions of dollars in costs—some, about 7 percent of what a company hopes to raise through the offering. Accounting costs and budget for the finance department's IPO process varies based on the size of the organization, practitioners said.

Sixty percent of incurred costs are around people costs: general counsel, investor relations professionals and other expertise as well as board members who are compensated differently than private company board members.

''Compensation and benefits costs end up being some of the biggest costs we noted on a go forward basis,'' Jackie Kelley, EY's Americas IPO markets leader, said. ''And then you layer in the costs of the ongoing reporting and compliance costs. These activities and costs assimilate into the culture of the company,'' she said.

A company's state of readiness will determine its incurred IPO costs and success, sources said. And every company has a different state of readiness. ''I think what happens to some companies is they enter into an IPO, it sounds glamorous, executives are able to get stock compensation, big bonuses,'' said Peter Vinci, a consultant at Resources Global Professionals (RGP), the operating subsidiary of Resources Connection, Inc., a multinational professional services firm that helps business leaders executive internal initiatives. ''But they don't have a realistic perspective of what it's going to take to make it happen,'' he said.

CFO Portion Weighty The Chief Financial Officer and his team of accountants play a big role in getting the entire organization ready to be a public company, practitioners said. The CFO and the team often time take the lead in getting the entire organization ready to be a public company,'' said Kelley. ''It isn't uncommon that the CFO is at the helm and works directly with the investment banks, lawyer, external auditors and other IPO advisers required to coordinate he overall effort,'' she said.

Companies' financial statements that aren't up to par with Securities and Exchange Commission filing requirements guarantee swift IPO failure. ''You have some investors that might say 'is that an indication of management; 'is that an indication of lack of resources and the skills sets the company has','' Dean Bekas, partner with PwC who specializes on private companies, said. ''Then secondarily they would say 'under the revised accounting or restated accounting what does the future outlook look like from a financial perspective because that drives valuation and may drive other decisions that a user of the financial statements has,'' he said.

Hope for Market Rebound Because of the costs and stringent regulatory requirements companies meet, interest in filing an IPO among startups has waned over the past two decades.

Today, IPO watchers are hopeful for a rebound. They point to reports of the strong first quarter start this year compared to Q1 2016 levels in terms of number of IPOs and proceeds as a forecast of glad tidings to come. There were 24 IPOs, which raised $10.8 billion, an increase of 1,380% in terms of proceeds and 200% by number of IPOs on Q1 2016, according to an EY report.

The U.S. accounted for four of the global top ten IPOs and nine of the global top 20 IPOs, of which eight IPOs were on NYSE and one IPO on NASDAQ, the report states.

The IPOs of Snap Inc. and Invitation Homes Inc., both $1 billion plus megadeals by proceeds, were the largest IPOs in the U.S. since Q4 2015.

Practice Being Public Company For those companies that have to newly apply U.S. accounting rules for SEC filers, getting financial reporting up to scratch is more costly and time consuming, practitioners said. Companies have to get used to the new frequency of issuing financial reports – quarterly as opposed annually -- and the speed of the financial close. It takes internal practice to get it right.

Companies practicing to close out their financial statements as if they were public companies sometimes report internally within 45 days or two-to-three months or longer. They need to ''shorten that close to report process down to 20 or 25 days and a close that's closer to 10 days,'' EY's Kelley said. ''And so that takes a lot of effort to sure up that calendar and change the process internally,'' she said.

Other issues relate to disclosure requirements. Companies will have to provide new and expanded financial disclosures, therefore they have to determine whether they have a strong regulatory process in place so that they have predictability and are able to execute their SEC reports seamlessly every quarter.

Typically, Sarbanes Oxley readiness takes time. Compliance efforts also fall on the accounting and finance groups. ''At the end of the day the finance department owns the financial controls,'' Kelley said. ''And so putting financial controls and processes together early is critical. Usually finance starts that effort 12 months prior to the IPO as well,'' she said.

Examine Accounting Rules The accounting rules themselves also have to be considered: whether international financial reporting standards (IFRS) or U.S. generally accepted accounting principles (GAAP). ''Accounting is not simply adding numbers, there are subjective judgments that management must make, and the audit committee must make and the auditors must sign off on in connection with preparation of financial statements,'' Steven Kuperschmid, a lawyer at corporate and securities law firm Ruskin Moscou Faltischek, PC, told Bloomberg BNA.

''And those judgments are where life gets interesting because there may be more than one way to account for a particular transaction or stream of revenue,'' said Kuperschmid, also co-Chair of the firm's corporate and securities practice in Uniondale, New York.

Going public takes stringent effort and requires more resources than other strategies such as looking for investors or selling a business, practitioners said.

''In fact, there are a whole bunch of additional steps in addition to what you needed for those investors or exit,'' Wayne Spivak of SBA Consulting, Ltd. said. ''Everything needs to be pristine, otherwise the investment bankers won't work with you, the Exchange won't accept you and let's not discuss what the SEC will do,'' said Spivak, President of the Long Island, New York-based company, which provides project management system implementation to chief executive officers and chief financial officers.

Once the company has the IPO, it's going to cost a couple of million dollars a year extra for accounting and legal services, Spivak said. ''Besides, your new partner— that's the SEC—of the business isn't your friend. You thought the IRS wasn't your friend, the SEC definitely isn't,'' he said.

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