# 5 Insights for executives

# Are you ready to go public?

## Make sure you have your internal controls house in order

Of special interest to
- Chief audit executives
- Chief financial officers

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Jasmine, Chief Executive Officer (CEO) of 123 Innovations, closed the door as Max, the Chief Financial Officer (CFO), took a seat in front of her custom-made, sustainably sourced mahogany desk.

"What do you think?" Jasmine asked as she settled herself in across from him. "Are we ready to go public?"

Max hesitated as he calculated the enormous challenge ahead. Shepherding 123 through the initial public offering (IPO) process in an environment of increased regulatory and investor scrutiny would require a significant commitment, both in terms of time and resources. Also, Max was not at all confident that 123's internal controls and procedures were sufficient to meet public company requirements. After all, 123 would have to begin acting like a public company long before it went public.

"Here's what I know," Jasmine offered, tired of waiting for Max's reply. "Our company has a good business model and outstanding growth potential given where digital technology is headed. Plus, investors are going to love 123's product pipeline and the new talent we've hired to round out our management team. The IPO market is heating up again, Max. I can't think of a better time to take 123 to the next level."

It was a daunting task, but the more he thought about it, the more he agreed that 123 was well-positioned to embark on the IPO journey. Max exhaled deeply and replied: "I'm in. Let's get started!"

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## What's the issue?

Initiating an IPO is one of the biggest decisions a private company can make. This is especially true in today's environment, where investor and regulatory scrutiny are high, and investment dollars remain scarce.

Although the IPO filing and marketing process may last only three to four months, it is only one step in a much longer journey when evolving from a private to a public company. In fact, our research and experience suggest that companies with the most successful IPOs consistently approach the IPO as a transformational process rather than an end game and begin to act and operate as public companies at least one year prior to the IPO event. Institutional investors confirm this view in a recent EY survey.[1]

Survey respondents also agree, by a wide margin, that the most important parts of a company's infrastructure when preparing to go public are strong financial reporting systems, corporate governance and compliance, and risk management and internal controls.[2]

**In today's IPO environment, investor scrutiny and regulatory demands are high, and investment dollars remain scarce.**

As a key member of the IPO management team, the CFO will play a significant role throughout the IPO journey. In particular, the CFO will need to determine that the company's infrastructure preparations are complete. Financial reporting systems, governance and compliance, and internal controls all need to be in place. Strong governance, risk and compliance systems, along with robust financial reporting systems and processes, not only promote timely and accurate reporting, but also foster a culture of accountability. This new infrastructure also enables the executive team to sign SOX 302 and 906 certifications and ultimately allows the company to satisfy the scrutiny of auditor attestation (for those to whom attestation applies) over internal controls.

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## Why now?

The chill of the financial crisis virtually froze investor appetite for IPOs. As the global economy continues to recover and investors look for growth companies to drive portfolio value, investor interest in IPOs is heating up. Although the number of IPOs was low in 2012 compared with other years, 82% of institutional investors surveyed have invested in IPO and pre-IPO stock in the past 12 months, according to our survey.[3]

Given that 60% of survey respondents say that they base their IPO investment decision on a company's financial performance measures, and 66% say that systems and controls should be implemented and operating effectively prior to the IPO, private companies considering an IPO need to put strengthening internal controls at the top of their priority list.

**66% of institutional investors say that systems and controls should be implemented and operating effectively prior to the IPO.**

[1] *Right team, right story, right price: institutional investors support IPOs that come to market well prepared*, EY, 2013. | [2] Ibid. | [3] Ibid.

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## How does it affect you?

CEOs looking to go public often cite enhancing internal controls as one of their most challenging corporate governance issues. In particular, companies struggle to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances," regarding the reliability of financial reporting and the preparation of financial statements — as required by the Securities Exchange Act of 1934 and the Foreign Corrupt Practices Act of 1977.

In addition, in 2002, the Sarbanes-Oxley Act (SOX) strengthened issuers' accountability for, and public disclosure of compliance with, the Foreign Corrupt Practices Act's internal controls requirements.

Private company CEOs looking to go public often cite enhancing internal controls as one of their most challenging corporate governance issues.

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## What’s the fix?

As challenging as it may seem to optimize internal controls and procedures to meet regulatory requirements, companies can take several steps to make the journey to IPO readiness easier:

1. **Assess internal control readiness.** Companies need to determine where they are on the continuum of internal control compliance, where they need to be and how to close the gaps. One means of assessing readiness is to conduct a “dry run” to detect early warning signs of control deficiencies. A dry run will assess identified financial reporting risks, processes and controls, as well as control designs, against leading practices.
2. **Establish an approach and timeline for remediation.** Once a company has completed its assessment and identified its deficiencies, it will need to develop a plan and timeline for closing the gaps long before going public.
3. **Document walkthroughs of processes and controls.** Companies will need to perform walkthroughs for each major class of transactions to understand and document the process flow of transactions and the controls management has put in place, the strength of their design, the completeness of the process, and any controls that prevent or detect fraud and errors.
4. **Remediate processes and controls.** Based on the readiness assessment and findings from the walkthroughs, and following the remediation plan, companies should fix any identified weaknesses within the timeline specified.
5. **Test processes and controls.** Once the remediation exercise is complete, companies will need to again test their processes and controls to determine the success of remediation efforts and assess their readiness for the new regulatory compliance and reporting requirements for internal controls.

If the resource requirements and level of effort required to achieve readiness exceed current capabilities, companies may want to consider a co-sourcing or outsourcing arrangement. This is very common for companies embarking on an IPO as the resource requirements can be demanding and distracting to the business if not properly managed. Engaging a third party that specializes in internal controls compliance offers a number of benefits, including:

- Offering a scalable support function that is more cost effective than building in-house capacity
- Providing leading-practice approach plans, documentation and testing, including a smart controls lens that does not over-engineer the control environment
- Improving the company’s internal control environment through education and training

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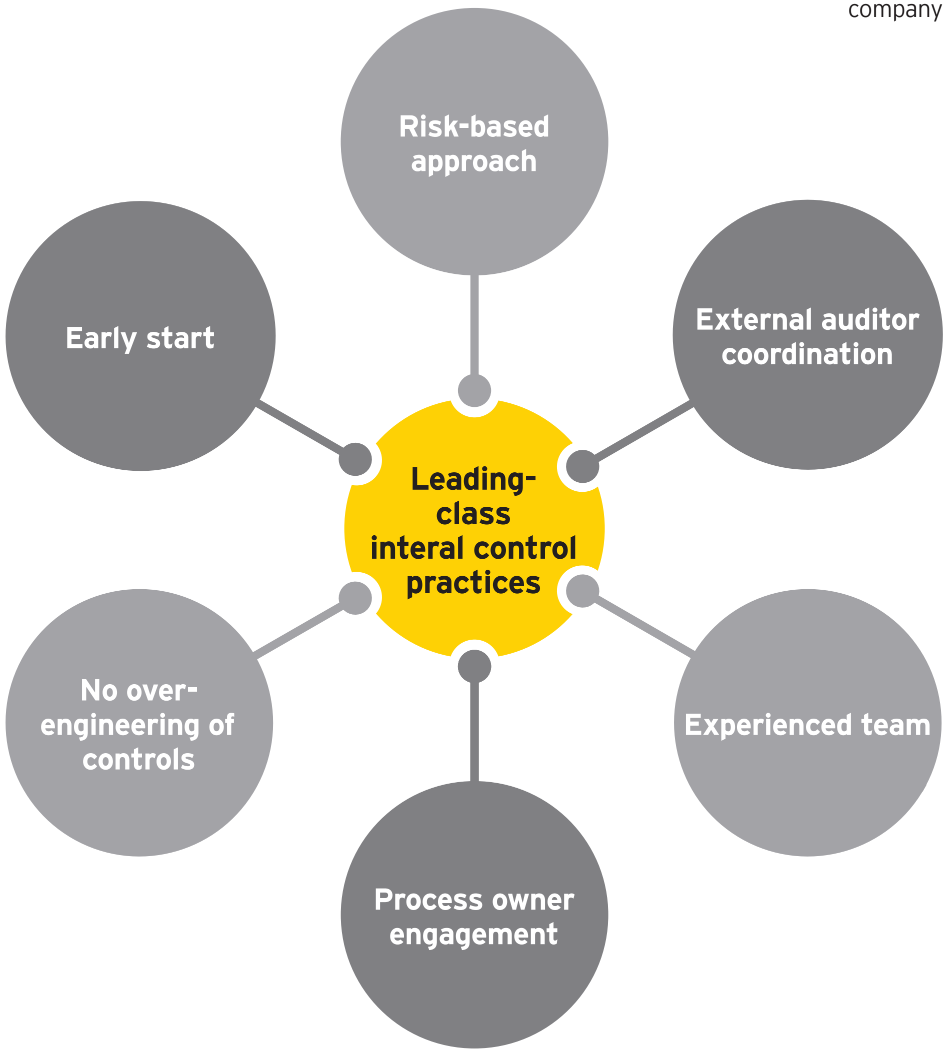
## What's the bottom line?

Getting ready for an IPO can be a daunting exercise even under ideal circumstances. In an era of increased investor scrutiny and regulatory complexity, the effort can sometimes feel insurmountable.

But it does not have to be. The key is to be prepared.

With enough time, careful planning and a risk-based approach, companies can strengthen internal controls to meet regulatory requirements. If help is necessary, CFOs should not hesitate to leverage experienced third-party providers. The initial investment will pay off over time by promoting greater accountability in the organization, reducing financial reporting risk, lowering compliance costs and avoiding unpleasant surprises after your company is public.



Becoming IPO-ready and compliant with internal control does not have to be daunting.

# Want to learn more?

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