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Technical Line

Navigating the reporting requirements related to an initial public offering

In this issue:

What you need to know

- Companies beginning the IPO process need to consider the numerous financial statement accounting and disclosure requirements that apply to public companies, which will require a change in practice in many cases.
- Involving professional advisers (e.g., legal counsel, external auditors) early in the process will help companies effectively navigate the registration process.
- While the SEC's rules and regulations can be complex, some companies may be able to take advantage of the relief provisions afforded to emerging growth companies and smaller reporting companies during the IPO and in subsequent periodic filings.

Overview

A nonpublic entity that is considering the transition to become a public company will have to comply with many new accounting and disclosure requirements, including United States Generally Accepted Accounting Principles (US GAAP) applicable to public companies and Securities and Exchange Commission (SEC) rules and regulations and SEC staff interpretations.

Before filing an initial public offering (IPO) registration statement with the SEC, a nonpublic entity should review its accounting policies and practices to determine whether they are appropriate and should include the required additional financial statement disclosures in annual and interim financial statements. Companies contemplating an IPO should also have a good understanding of the IPO process and timeline considerations (e.g., the deadlines for SEC filings, when financial statements "go stale," when the SEC staff issues comment letters).

Building a better working world

This publication provides an overview of the securities registration process in an IPO and addresses certain significant accounting and disclosure considerations for financial statements included in Form S-1 based on the requirements in effect as of the publication date.[1]

Reading this publication does not replace the need to read the disclosure requirements in Regulations S-X and S-K or the Form S-1 instructions. In addition, there may be additional and/or different requirements and considerations for other forms or transaction types (e.g., mergers with a special purpose acquisition company (SPAC), direct listings). See our Technical Line, ***Navigating the requirements for merging with a special purpose acquisition company***, for further guidance on SPAC IPOs and de-SPAC transactions.

Securities laws overview

Public companies are impacted by many complex securities laws, including throughout the IPO process. Some of the laws with the most significant impact are summarized below and referred to throughout this publication.

Securities Act of 1933

The Securities Act of 1933 (Securities Act) addresses the requirements to register primary offerings of securities before they may be sold to the public market. The requirements are intended to make sure registrants fully and accurately disclose all pertinent information to help prospective investors decide whether to purchase the securities. The Securities Act provides for the use of various registration statement forms, each for a particular type of issuer, security and transaction (including Form S-1, which is used for an IPO).

Securities Exchange Act of 1934

All companies that have registered securities under the Securities Act are required to comply with the reporting requirements of the Securities Exchange Act of 1934 (Exchange Act). The Exchange Act provides for the use of certain forms for periodic reporting following an IPO, including Form 10-K for annual reports, Form 10-Q for quarterly reports, Form 8-K for important events and transactions, and proxy information when soliciting shareholder votes. The Exchange Act also addresses registration requirements for secondary trading of securities in public markets, which are not in the scope of this publication.

Jumpstart Our Business Startups Act of 2012

The Jumpstart Our Business Startups (JOBS) Act, among other things, created a new category of issuer called an emerging growth company (EGC) to encourage IPOs by providing relief from certain SEC regulations. The Fixing America's Surface Transportation (FAST) Act of 2015 further enhanced the relief offered to EGCs and other smaller companies.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010

After the 2007-2008 financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) established a number of new government agencies and required rulemaking to address the regulation of financial products, corporate governance, and disclosure and transparency, among other items, in an effort to protect investors.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act mandated reforms to enhance corporate responsibility and financial disclosures, as well as combat corporate and accounting fraud. The Sarbanes-Oxley Act created the Public Company Accounting Oversight Board (PCAOB) to oversee the activities of the auditing profession and establish public company auditing standards. Additionally, it required the external auditor, in specific circumstances, to report on a company's internal control over financial reporting (ICFR).

Registration statement filing and review

Process overview

Once a company or its selling shareholders and an underwriting firm agree to proceed with a public offering of securities, an organizational meeting is usually held with a working group comprising the company's financial officer(s) and legal counsel, the independent auditors, the underwriters and the underwriters' legal counsel, among others. This working group is generally responsible for overseeing the IPO process, including managing the IPO timetable, executing due diligence activities and preparing the registration statement.

The registration statement must be filed with the SEC in accordance with the applicable disclosure requirements before proceeding with a public offering of securities, including any presentations (i.e., road shows) in which the offering is marketed to prospective investors. The registration statement includes a prospectus, which is the investor's principal source of information about the securities to be offered for sale.

All IPOs under the Securities Act are subject to a full review by the SEC staff. The review process begins when the initial registration statement is filed or submitted. The registration statement can be filed publicly or submitted on a nonpublic basis through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. See *Confidential and nonpublic submissions* section below for additional information.

Companies may omit certain information from their initial filings with or nonpublic submissions to the SEC, such as the public offering price, other offering-related information and certain financial statements, as discussed in the *Financial statements that may be omitted* section. However, the SEC staff otherwise expects draft registration statements to be "substantially complete" at the time of submission, including a signed audit report, financial statements and exhibits. These requirements are discussed in the *Financial statements, schedules and other financial information section* below.

The SEC staff's review of a registration statement can, on occasion, be expedited by submitting pre-filing correspondence to the SEC staff to clear complex or judgmental accounting or SEC reporting matters in advance of the initial registration statement filing or submission. The need for pre-filing submissions should be considered as part of the IPO planning process. Pre-filing communications on accounting matters usually are submitted to the SEC's Office of the Chief Accountant (OCA).[2]

Issues involving revenue recognition, consolidation and classification of financial instruments as debt or equity are commonly pre-cleared with the SEC. Pre-filing communications on financial statement requirements and related compliance with SEC rules (e.g., financial statements of predecessor or acquired companies) are submitted to the Office of Chief Accountant within the SEC's Division of Corporation Finance.[3] The SEC staff has the delegated authority to waive certain financial statement requirements under Rule 3-13 of Regulation S-X, and the staff bases its decisions on whether to grant such requests on the individual facts and circumstances of the issuer requesting relief.

How we see it

If a company fails to include the required information in a filed or draft registration statement, the SEC staff can refuse to review it (sometimes referred to as "bed bugging" a filing) or it can "restart the clock" once the deficiencies are corrected. Either of these events can significantly delay an IPO. Proper planning will help reduce their likelihood of occurring. Companies that want to submit incomplete filings should discuss the matter in advance with the SEC staff, unless they are using the exceptions discussed in the *Financial statements that may be omitted* section of this publication.

Any comments provided by the SEC staff during the review process must be cleared before the registration statement is declared effective.

The SEC staff will review the registration statement for compliance with the SEC's disclosure requirements and provide the company with comments that must be cleared before the registration statement is declared effective. The SEC staff will generally provide the first round of comments within one month of receiving the registration statement.

The company is responsible for responding to all SEC staff comments and filing or submitting an amended registration statement (i.e., a pre-effective amendment) reflecting the responses to the comments as soon as practicable. The amended filing usually includes a complete resubmission of the registration statement in electronic form, excluding exhibits unless there are changes. The SEC staff reviews the amended filing and typically responds in one to two weeks with another comment letter. Companies can expect multiple rounds of staff comment letters in an IPO, including comments on additional information provided in an amendment.

Additional amendments are filed or submitted until all issues relating to the SEC staff's review of the registration statement and pre-effective amendments are resolved. Depending on the amount of time between amendments, the company may need to update other information in the filing, including financial statements, in addition to responding to the comments.

How we see it

Involving advisers (e.g., legal counsel, external auditors) early in the IPO process may help a company avoid multiple rounds of SEC staff comments. In our experience, companies that develop full and accurate first responses that directly address the staff's questions are more likely to resolve staff comments in less time than those that don't.

The staff is open to discussing its comments in a conference call to avoid confusion and help guide companies on the best path to resolution. However, the staff cannot clear comments over the phone. While companies may engage the staff in a dialogue at any time, we find that conference calls are most valuable when only a few matters are left to resolve.

Upon completion of the SEC staff's review, a final or "pricing" amendment is usually filed along with a request for acceleration. The SEC staff generally will declare the registration statement effective upon a request for acceleration. Once the registration statement is declared effective, the company and the underwriter are able to sign the underwriting agreement, price the securities and proceed with the public offering. If the issuer has not already disclosed the public offering price in the registration statement at the time of effectiveness, the pricing information must subsequently be filed as part of a prospectus supplement.

If the company's initial registration statement and any related amendments were nonpublic submissions (see *Confidential and nonpublic submissions section* below), all previously submitted documents must be publicly filed before the SEC can declare the registration statement effective. All nonpublic correspondence between the staff and the company (e.g., comment letters and responses) will be posted to the EDGAR system no earlier than 20 business days after the registration statement has been declared effective.[4]

Comfort letters

As part of the IPO process, the company's auditors usually provide a comfort letter at the request of the underwriters on the effective date (i.e., upon execution of the underwriting agreement and pricing of the securities). The comfort letter assists the underwriters with their statutory due diligence defense from liability under Section 11 of the Securities Act for false and misleading statements or omissions in the registration statement.

After the effective date of a registration statement, the issuer and the underwriter conduct a "closing" in which numerous documents and the net proceeds of the offering are conveyed to the issuer. The independent auditors generally are not involved in this closing, except when the underwriter requests a second comfort letter (i.e., the "bring-down" letter).

Confidential and nonpublic submissions

Under the JOBS Act, an EGC can submit its IPO registration statement and subsequent amendments to the SEC on a confidential basis (i.e., a confidential submission). Additionally, SEC staff comments and the company's responses are also submitted confidentially. To do this, a company must qualify as an EGC at the time it submits its initial draft registration statement. Once an EGC confidentially submits its initial IPO registration statement, it will continue to be treated as an EGC through the earlier of the completion of the IPO pursuant to the registration statement or one year after losing its EGC status (see *Emerging growth companies* section below for more details on EGCs and qualifying for EGC status).

A similar process is also available to non-EGCs through the SEC's nonpublic review program, whereby companies may submit draft IPO and certain other registration statements for review by the SEC staff on a nonpublic basis (i.e., a nonpublic submission).

Issuers that seek a nonpublic review of an IPO registration statement under the Securities Act (including EGCs that make a confidential submission) have to publicly file their IPO registration statement, including all prior nonpublic submissions as exhibits, 15 days before their road show commences or the anticipated effective date if a road show is not conducted. The submission of a draft registration statement for nonpublic review is not required to be signed by the registrant, its officers or directors, nor is it required to include the consent of auditors and experts.

Post-effective amendments and prospectus supplements

After the effective date of a registration statement, there can be developments (e.g., a change in the underwriting arrangements, a material change or event that occurs while the offering is still in process) that require the registration statement to be updated.

The registrant can update the registration statement by filing a post-effective amendment, which is then required to be declared effective by the SEC. A post-effective amendment is deemed to be a new registration statement, establishing a new starting point for the three-year statute of limitations regarding liabilities under Section 11 of the Securities Act. Alternatively, the registrant can file a prospectus supplement or "sticker," which is attached to or distributed with the original prospectus. A prospectus supplement is not deemed to be a new registration statement and is not subject to review by the SEC staff.

The decision about which method to use can be critical and will involve legal counsel. A post-effective amendment may be subject to review, which could delay the offering process. Additionally, a post-effective amendment requires signatures by the registrant and consents of experts to be filed, while a prospectus supplement does not.

Financial statements, schedules and other financial information

Unless the exceptions discussed in the *Financial statements that may be omitted* section of this publication are used, the initial registration statement should include at the time of nonpublic submission or filing all disclosures, exhibits, financial statements and financial statement schedules required by the Securities Act. That means following the rules on the form and content of financial statements required by Regulation S-X, including those of significant businesses acquired and to be acquired and those of significant equity investees. Determining whether the appropriate financial statements have been included in the nonpublic submission or filing can be complex. In addition, there are multiple considerations when determining which entities and for which periods financial statements are required.

General considerations

Emerging growth companies

As discussed in the *Confidential and nonpublic submissions* section above, a private company seeking to complete an IPO will generally qualify for certain relief offered to EGCs, if it meets the requirements for EGC status at the time it submits its confidential registration statement. That is, it must have total annual gross revenues of less than $1.235 billion during its most recently completed fiscal year. As previously noted, EGCs are exempt from certain requirements provided for by the JOBS Act. The scaled disclosures afforded to EGCs generally allow for temporary relief. The scaled disclosures and exemptions available to EGCs include the following:

- An EGC is not required to provide more than two years of audited financial statements in its IPO registration statement. However, an EGC that is not a smaller reporting company (SRC) is required to provide three years of financial statements in its post-IPO annual reports.
- An EGC may provide scaled executive compensation disclosures required by Regulation S-K and is not required to include a Compensation Discussion and Analysis.
- An EGC is provided a deferral of the requirement to have an independent auditor assess the EGC's ICFR under Section 404(b) of the Sarbanes-Oxley Act (although the EGC's management is still required to assess its ICFR under Section 404(a) of the Sarbanes-Oxley Act, generally beginning with the second annual report on Form 10-K).
- An EGC is not required to adopt new or revised accounting standards following public company effective dates if nonpublic companies have a delayed effective date. Instead, the nonpublic company effective date can be applied to an EGC that doesn't elect to follow public company effective dates (however, most standards would allow a company to elect to early adopt on the public company timeline if desired).

An EGC is not required to follow all the scaled disclosure provisions. It may instead take an "à la carte" approach and decide to comply with some EGC-scaled disclosure requirements and other full SEC disclosure requirements, except for the transition period provision for new or amended accounting standards.

For example, if an EGC decides to take advantage of the extended transition periods for new or revised accounting standards in the IPO registration statement, such election is irrevocable and applies to all new or revised accounting standards. An EGC's choice to early adopt a new or revised accounting standard (when early adoption is permitted for nonpublic companies) does not violate an election to utilize the extended transition periods.

Smaller reporting companies

Regulation S-K Item 10(f)(1) defines an SRC as an issuer, excluding an investment company, an asset-backed issuer or a majority-owned subsidiary whose parent is not an SRC, that meets either of the following conditions after performing its initial qualification test (e.g., upon filing an initial registration statement for common equity):

- Public float[5] is below $250 million.
- Annual revenue for the most recently completed fiscal year is less than $100 million, and public float is less than $700 million (including no public float).

A company filing an initial registration statement for shares of its common equity should determine its estimated public float as of a date within 30 days of the date the registration statement is filed and then finalize its public float calculation at the time the IPO is completed and the common share price at IPO is known.

An issuer that determines it does not qualify for SRC status because it exceeded one or more of the conditions in the initial qualification test will remain unqualified unless it meets certain thresholds when making its annual determination.

SRCs may choose to comply with either the scaled reporting and disclosure requirements in Regulation S-X and Regulation S-K for SRCs or the more rigorous disclosure requirements for larger public companies on an item-by-item basis in each filing, as long as the selection is applied consistently and allows for period-to-period comparative financial information.

Refer to our Technical Line, ***Reminders on reporting and filer status considerations for SEC registrants***, for further guidance on EGC and SRC considerations.

Financial statements of the registrant

Annual financial statements requirements

Consolidated annual financial statements must be included in the registration statement. The required financial statements include the balance sheets as of the two most recent fiscal year ends and statements of income, comprehensive income, changes in shareholders' equity,[6] and cash flows for each of the three years (two years for SRCs and EGCs) preceding the most recent audited balance sheet.

Consolidated annual financial statements of companies undertaking an IPO must be audited in accordance with PCAOB auditing standards.

Interim financial statements requirements

Depending on the age of the most recent balance sheet presented, a registrant may also have to include consolidated interim financial statements in the registration statement.

Depending on the age of the most recent balance sheet presented (as discussed in the *Age of financial statements* section below), a registrant may also have to include consolidated interim financial statements (i.e., balance sheets and statements of income, comprehensive income, changes in shareholders' equity, and cash flows) in the registration statement. Consolidated interim financial statements and related footnotes are typically presented separately from those for annual periods (i.e., on different pages of the registration statement) to facilitate any updates to the interim financial statements when there is a delay between the registration statement filing and effective date.

The consolidated interim financial statements may be presented in a condensed format as allowed by Article 10 of Regulation S-X. When interim financial information includes more than one quarter, information for the separate quarters generally is not required to be presented in the registration statement (i.e., only the year-to-date interim period is required).

Consolidated interim financial statements may be unaudited. Although there is no requirement for an auditor to perform interim review procedures over an IPO issuer's interim financial statements, such a review is often performed when a comfort letter is being issued by the auditor.

Predecessor entities

The registration statement includes the financial statements of the entity that is the registrant (i.e., the legal entity issuing the securities being registered) and any predecessor entities, as defined in Rule 405 of Regulation C. Predecessor financial statements are required because without them the ability of the financial statement users to evaluate the historical operating results of the continuing business would be limited. Annual and interim financial statements for the registrant and its predecessor should collectively be as of all dates and for all periods required (as discussed below). The financial statement and disclosure requirements discussed in this publication are applicable for a predecessor entity, as well as the registrant.

In certain cases, the IPO registrant may be a newly formed entity, or Newco, which has no significant activities but will acquire a business considered the predecessor entity when or before an IPO becomes effective. The determination of whether an acquired business comprises a predecessor is a matter of judgment and is based on whether the acquired business will constitute the primary business or operations of the combined entities.

Although the definition of "predecessor" is very broad, the SEC staff generally does not require an acquired business to be designated as a predecessor, except when a registrant succeeds to substantially all the business (or separately identifiable line of business) of another entity (or group of entities), and the registrant's own operations before the succession appear insignificant relative to the operations assumed or acquired. In limited situations, a registrant may conclude that more than one predecessor entity exists.

Each situation must be evaluated based upon the facts and circumstances. An acquired business that is not determined to be a predecessor would generally be evaluated under Rule 3-05, as discussed further below.

In IPO filings, the financial statements of Newco (i.e., the successor) before its acquisition of the predecessor are generally required with certain exceptions.[7] The financial statements will typically include an audited balance sheet as of the date of incorporation reflecting the initial capitalization (i.e., a "seed" balance sheet). However, the date of the balance sheet must be less than 135 days before the initial filing date. Statements of operations, comprehensive income and cash flows may be omitted if there are no transactions other than the organization of Newco.

In addition, the financial information of the predecessor, prepared in accordance with Regulation S-X, is required for all periods before the date of succession, with no gaps in audited information (i.e., the financial statements are presented with a predecessor stub period from the beginning of the fiscal year through the acquisition or succession date and a successor stub period from the acquisition or succession date through the end of the fiscal year).

Any stub period of the predecessor prior to being subsumed by the registrant should be audited when audited financial statements for the period after the acquisition are presented. The presentation of a comparative period for a stub period is not necessary.

Illustration 1 — Predecessor and successor financial statement periods

A shell company (Newco) formed on 14 March 20X4 acquires an operating company (Opco) on 20 May 20 20X4. The acquisition is not a common control transaction. Newco is determined to be the accounting acquirer, and Opco is determined to be Newco's predecessor. Newco subsequently files an IPO registration statement in September 20X5. Newco does not qualify for EGC or SRC accommodations.

The IPO registration statement must include audited financial statements of the predecessor (i.e., Opco) for the years ended 31 December 20X2 and 20X3 and the stub period from 1 January 20X4 to 19 May 20X4. Financial statements of the predecessor for the period 1 January 20X3 to 19 May 20X3 are not required.

Newco, the registrant, must provide audited financial statements for the period from inception (14 March 20X4) through 31 December 20X4 and unaudited interim financial statements for the six months ending 30 June 30 20X5 and inception (14 March 20X4) through 30 June 30 20X4.

Separate schedules, management's discussion and analysis (MD&A) of financial condition and results of operations and other disclosures required under Regulation S-K must be provided for each predecessor as well.

Age of financial statements

In an IPO, the latest balance sheet presented, whether annual or interim, must be as of a date less than 135 days before the effective date of the registration statement, except for the third quarter, which will be considered timely through the 45th day after the most recent fiscal year end. This age requirement can result in the need to update financial statements that have gone "stale" in the period between the initial submission and the effective date of the Form S-1. Thus, the SEC staff will not declare a registration statement effective later than the 134th day after the latest balance sheet date, except that third quarter data is timely through the 45th day after the most recent fiscal year end, after which that fiscal year's audited financial statements must be included in the registration statement.

The annual audited financial statements in an initial registration statement for an SRC may not be required for up to 90 days after year end (i.e., third quarter interim data is timely through the 90th day after the most recent fiscal year) if the issuer expects to report pre-tax income in the current year and has reported pre-tax income in at least one of the two previous years.

When the last day of the age-of-financial-statement period (e.g., the 134th day after the first quarter end) falls on a Saturday, Sunday or holiday, the registration statement may be filed and made effective on the next business day without updating the financial statements.

Additionally, the SEC staff generally will not commence review of a registration statement unless it complies fully with the rules for the age of financial statements at the date of the submission.

Financial statements that may be omitted

A registrant may, in certain circumstances, omit financial information for historical periods that are reasonably expected not to be required in the Form S-1. The SEC staff issued two Compliance and Disclosure Interpretations (C&DIs)[8] that clarify when EGCs and non-EGCs may omit from draft registration statements annual and interim financial information that they reasonably believe won't need to be presented separately at the time of the contemplated offering (for EGCs) or the initial public filing (for non-EGCs).

Financial statements	EGCs	Non-EGCs
Annual audited financial statements	May be omitted from a confidential submission and a public filing if not expected to be required at the time of the **contemplated offering**	May be omitted from a nonpublic submission if not expected to be required at time of the first public **filing** of the registration statement
Interim financial statements	May be omitted from a confidential submission if not expected to be required at the time of the **contemplated offering**	May be omitted from a nonpublic submission if not expected to be required at the time of the first public **filing**

The difference between EGCs and non-EGCs is that EGCs have to anticipate the financial statement requirements at time of the contemplated offering (that is, when the preliminary prospectus is first distributed to investors, generally the start of the road show) to determine what annual and interim periods are required at each registration statement stage, while non-EGCs have to anticipate the financial statement requirements at the time of the first public filing of the registration statement. For example, a calendar-year EGC that confidentially submits a draft registration statement in November 20X7 and reasonably believes that it will commence an offering in April 20X8 or a non-EGC that will publicly file a registration statement in April 20X8 may omit the audited financial statements for the earliest year that will not be required for an April 20X8 offering or public filing (i.e., 20X5 for EGCs and 20X4 for non-EGCs), as well as interim financial information for 20X7 and 20X6. However, this interim financial information would be required in the confidential or nonpublic submissions by an EGC or a non-EGC if the first public filing is anticipated to occur in January 20X8 (before the full-year audited financial statements for 20X7 are available).

For EGCs, this accommodation extends to financial information of other entities (e.g., those required by Regulation S-X Rules 3-05 and 3-09). However, EGCs must include all required financial information before distributing a preliminary prospectus to investors.

How we see it

We believe the relief allowing certain financial information of a non-EGC registrant to be omitted from nonpublic submissions also would apply to financial statements of other entities required to be included (e.g., acquired businesses under Regulation S-X Rule 3-05 and equity method investees under Regulation S-X Rule 3-09 as discussed further below), similar to the accommodations for IPOs of EGCs.

Financial statements of businesses acquired or to be acquired

Rule 3-05 under Regulation S-X also requires registrants to provide financial statements (i.e., balance sheets and statements of income, comprehensive income, shareholders equity, and cash flows) for a significant acquired or to be acquired businesses based on the SEC's definition of a business in Rule 11-01(d) of Regulation S-X.

Article 11 under Regulation S-X requires registrants to also provide pro forma financial information for such acquired businesses. Significance is expressed as a percentage and is measured using the asset test, the investment test and the income test described in Rule 1-02(w) of Regulation S-X to compare the acquired business with the registrant.

- **Asset test**: Compare the registrant's proportionate share of the acquired business's total assets to its consolidated total assets after intercompany eliminations (using the most recent preacquisition annual financial statements included in the registration statement).
- **Investment test**: Compare the registrant's investments in and advances to the acquired business to its consolidated total assets in the most recent preacquisition annual financial statements. Once an entity completes its IPO, it should use aggregate worldwide market value (instead of total assets) when performing the investment test.
- **Income test:** Determine the income and revenue component using the most recent preacquisition annual financial statements of each entity, using the lower result of the two components to measure significance:
  - Compare the registrant's proportionate share of the acquired business's pre-tax income or loss from continuing operations, after intercompany eliminations and net of amounts attributable to any noncontrolling interest, to that of the registrant.
  - Compare the registrant's proportionate share of the acquired business's most recent annual consolidated revenue from continuing operations after intercompany eliminations to that of the registrant.

Acquisitions of related businesses are treated as a single acquisition for purposes of the significance tests. In addition, pro forma financial information may be used to measure significance for acquisitions consummated in the most recent fiscal year, if the required Regulation S-X Rule 3-05 financial statements and Article 11 pro forma financial information for the acquired businesses are included in the registration statement.

The table below summarizes when Rule 3-05 financial statements are required and for what financial statement periods based on the significance thresholds.

Scenarios	Significance level	Annual and interim periods
Individual consummated acquisition, including multiple consummated acquisitions of related businesses (treated as a single acquisition)	20% or less	No separate financial statements needed
	Greater than 20% but not than 40%	Most recent fiscal year and most recent year-to-date interim period
	Greater than 40%	Two most recent fiscal years and most recent year-to-date interim period with a comparative prior period
Individual probable acquisition	50% or less	No separate financial statements needed
	Greater than 50%	Two most recent fiscal years and most recent year-to-date interim period

Registrants must determine financial statement requirements for individually insignificant acquisitions that are significant in the aggregate.

Rule 3-05 financial statements and pro formas for a completed acquisition that is more than 20% significant but no more than 50% significant are not required in a registration statement that becomes effective no more than 74 days after consummation. However, registrants must consider the aggregate significance of these financial statements along with acquisitions that do not individually trigger a requirement to provide Rule 3-05 financial statements, which include (1) acquisitions consummated after the registrant's most recent audited balance sheet date that are 20% or less significant and (2) probable acquisitions that are 50% or less significant.

When the aggregate significance of these individually insignificant acquisitions exceeds 50%, financial statements (covering the most recent fiscal year and interim period) for any of these acquisitions that exceed 20% in significance must also be included with pro formas that depict the aggregate effect of all of the individually insignificant acquisitions in all material respects.

Rule 3-05 financial statements may be omitted from a registration statement for (1) a business that is more than 20% significant but not more than 40% significant if it has been included in the audited results for at least nine months or (2) a business that exceeds 40% significance and has been included in the registrant's audited results for a full fiscal year.

Rule 3-05 does not address whether separate Rule 3-05 financial statements are required for recent acquisitions made by an acquiree (i.e., a second-tier acquisition). The SEC staff has indicated that neither are required, unless their omission would render the acquiree's financial statements misleading or substantially incomplete.

The age determinations for registration statements can also result in a registrant updating the Rule 3-05 financial statements and the related pro formas between the filing and effective dates of a registration statement. See further discussion below of the pro forma requirements.

Refer to our Technical Line, ***Applying the SEC's requirements for significant acquired businesses***, for further guidance on applying Rule 3-05.

How we see it

When planning an IPO, companies should consider the complexity in determining the financial statements for acquired businesses required in the registration statement and the effort required to obtain audited financial information for an acquired or to-be-acquired business or real estate operation (discussed further below).

A company that believes the significance tests require financial information beyond that reasonably necessary to inform investors in the IPO registration statement may make a written request for a waiver to the Office of Chief Accountant in the SEC's Division of Corporation Finance. The staff considers the facts and circumstances when evaluating such requests and grants waivers only in certain situations.

Form of the Rule 3-05 financial statements

While Rule 3-05 financial statements must comply with US GAAP, Regulation S-X and applicable SEC Staff Accounting Bulletin (SAB) topics, as further discussed below, disclosure requirements applicable only to issuers are not required. However, a significant acquired business that is not a registrant but whose financial statements are included in an SEC filing under Rule 3-05 meets the definition of a public business entity in US GAAP and, therefore, cannot elect Private Company Council (PCC) accounting alternatives in its Rule 3-05 financials. Rule 3-05 financial statements are not required to be audited in accordance with PCAOB standards. Further, interim period financial statements provided under Rule 3-05 are not required to be audited or reviewed. However, interim reviews are often performed when a comfort letter is issued by the auditor.

Financial statements of real estate operations acquired or to be acquired

Rule 3-14 under Regulation S-X requires registrants to provide income statements for the most recent fiscal year (audited) and the most recent year-to-date interim period (unaudited) before the acquisition of a real estate operation, along with certain footnote disclosures.

Rule 3-14 defines a real estate operation as a business that generates substantially all of its revenue through the leasing of real property. It requires a registrant to calculate the significance of an acquisition using the investment test defined in Rule 1-02(w) of Regulation S-X (described above). Generally, a registrant is required to provide Rule 3-14 financial statements and pro formas if a consummated acquisition exceeds 20% significance. However, a registrant may also have to provide Rule 3-14 financial statements and pro formas for certain probable and/or individually insignificant but significant-in-the-aggregate acquisitions in a manner similar to Rule 3-05.

Refer to our Technical Line, ***How to apply the amended S-X Rule 3-14 to real estate acquisitions***, for further guidance on Rule 3-14 financial statements.

Financial information of equity method investees

Registrants with investments in equity method investees (including those accounted for using the fair value option) must assess their significance to determine whether the investee's separate financial statements must be included in the registration statement. In addition, the registrant may be required to provide certain summarized financial information. The significance of equity method investments is determined based on Rule 1-02(w) of Regulation S-X, as discussed in the Financial statements of businesses acquired or to be acquired section above, subject to certain caveats (e.g., the asset test applies to determine whether summarized financial information is required under Rule 4-08(g) but not to determine whether separate financial statements are required to be provided under Rule 3-09):

Separate financial statements

Rule 3-09 of Regulation S-X requires that registration statements include separate financial statements (i.e., balance sheets and statements of income, comprehensive income, shareholders' equity, and cash flows) and schedules prepared in accordance with Regulation S-X for equity method investees (including those accounted for using the fair value option) when such entities are individually significant based on the investment or income test.

Generally, the separate Rule 3-09 financial statements should be as of the same dates, and for the same periods, as the audited annual consolidated financial statements of the registrant. However, the separate financial statements are only required to be audited for those fiscal years in which the investee is individually significant (applying the income and investment test). Separate financial statements of significant equity method investees are not required for interim periods.

Rule 3-09 applies to all investees, regardless of whether the investment is held by the IPO issuer, a subsidiary or another investee. Accordingly, separate financial statements are required for any lower-tier investee in which the IPO issuer's proportionate share of such investee meets the 20% test relative to the consolidated financial statements of the issuer.

SRCs are not required to present separate Rule 3-09 financial statements in their registration statements.

Summarized financial information

Rule 4-08(g) of Regulation S-X requires disclosure of summarized financial information about equity method investees in the notes to the annual financial statements if, individually or in the aggregate, the investees exceed 10% significance based on any of the three significance tests.

Registrants must present certain summarized financial information (i.e., balance sheet and income statement items) of the investee(s) for the same annual periods as the audited consolidated financial statements included in the registration statement. No explanatory notes need to accompany the summarized information. If interim financial statements are included in the registration statement, summarized income statement information would be required for those equity method investees that meet either the investment test or the income test at the 20% level.

SRCs are required to provide summarized financial data for significant equity investees that individually or in the aggregate represent 20% or more of their consolidated assets, equity or income from continuing operations attributable to the registrant in both annual and interim financial statements.

Refer to sections 6 and 3 of our SEC Financial Reporting Series publications, ***SEC annual reports — Form 10-K*** and ***SEC quarterly reports — Form 10-Q***, respectively, for further discussion of Rule 3-09 separate financial statements and summarized financial information.

Pro forma financial information

Article 11 of Regulation S-X describes the requirements for registrants to provide pro forma financial information, which may be required in an IPO registration statement for various reasons. It may reflect a significant business combination that has been consummated or is probable. It may show the use of proceeds for a particular transaction or show the registrant as an autonomous entity when it previously was part of another entity and such presentation is necessary to reflect the operations and financial position of the registrant.

Pro formas are intended to show how a transaction or a group of transactions might have affected historical financial statements to illustrate the scope of the change in the registrant's financial position and results of operations.

Article 11 pro formas generally consist of an introductory section, a pro forma condensed balance sheet, pro forma condensed statements of comprehensive income and explanatory notes.

A pro forma balance sheet must be presented as if the transaction occurred as of the date of the latest balance sheet in the filing. A company generally must file pro forma income statements for the most recent fiscal year and for any subsequent interim period to the date of the latest interim balance sheet presented. The pro forma income statements should be prepared as if the transaction occurred at the beginning of the full fiscal year presented. A pro forma income statement for the corresponding interim period of the preceding fiscal year is optional. Once the transaction has been reflected in a registrant's results for an entire period required to be presented in the pro formas, that period is not required and should not be presented.

Historically, the SEC staff has required companies to present additional pro forma disclosures in or alongside the historical financial statements in their IPO registration statements. However, Rule 11-02(a)(12) states that registrants cannot present pro forma financial information on the face of their historical financial statements or in the accompanying notes, except when such presentation is required by the applicable accounting principles. As a result, we believe registrants should continue to determine whether additional pro forma information is material and evaluate the appropriate location for such disclosures. Examples of additional pro forma disclosures that may need to be presented include:

- A significant planned distribution to owners or promoters that is not reflected in the latest historical balance sheet
- Distributions in excess of earnings
- Changes in capitalization
- Changes in tax status

The age of pro formas included in a registration statement is based on the age of the registrant's financial statements required by Rule 3-12 (or Rule 8-08 for SRCs) of Regulation S-X at the date the registration statement is filed, as well as when it becomes effective. The ages of the pro forma balance sheet and income statements are determined at the filing and effective date of a registration statement. The pro forma income statements must be kept current in new or amended registration statements until the registrant can omit the historical financial statements of the acquired business required by Rule 3-05 from the registration statement. The pro forma balance sheet must also be updated until the transaction is reflected in the registrant's latest balance sheet filed with the SEC.

In the comment letter process, the SEC staff may seek details about the nature of specific pro forma adjustments. In addition, the SEC staff may question how a registrant concluded that separate financial statements and pro forma financial information were not required under Rule 3-05 or Rule 3-14 and Article 11, respectively.

Refer to our SEC Financial Reporting Series publication, ***Pro forma financial information: A guide for applying Article 11 of Regulation S-X***, for further guidance and considerations when applying the pro forma rules.

Financial statement schedules

The financial statement schedule requirements related to form, applicability and periods to be included in the registration statement are set forth in Articles 5 and 12 of Regulation S-X. Financial statement schedules provide detailed information about certain captions in the annual financial statements. Some schedules are filed for the most recent balance sheet, while others are filed for each period for which an income statement is required.

Schedules are required for each set of financial statements required by Article 3 of Regulation S-X, other than for those required by Regulation S-X Rule 3-05 in relation to businesses acquired or to be acquired. For example, if financial statements are filed for equity method investees under Rule 3-09, schedules supporting those financial statements are also required. However, the required schedule information may be presented in a single schedule with the information shown separately for each set of financial statements filed.

Individual schedules may be omitted when they are not applicable or the amounts are immaterial (as defined by specific materiality standards for each schedule and the general materiality standard of Rule 4-02 of Regulation S-X). Further, if the information required by any schedule is shown in the related financial statements or the notes thereto, the schedule may be omitted. Schedules are required to be audited if the related financial statements are required to be audited. SRCs are not required to present financial statement schedules in their registration statements.

Accounting matters

A company that previously elected to apply any of the PCC accounting alternatives must retrospectively revise its financial statements to apply public company accounting standards in the IPO filing.

The SEC generally requires domestic public companies to follow US GAAP as established by the Financial Accounting Standards Board (FASB), along with certain accounting and disclosure requirements for public companies under SEC rules and regulations. In addition, the SEC's Division of Corporation Finance and OCA publish written accounting interpretations reflecting positions of the SEC staff that should be applied by public companies, including companies undertaking IPOs. While these SABs do not have the same authority as SEC rules, the accounting positions taken by the SEC staff can exert significant influence on the form and content of financial statements.

Public entity definitions

The FASB defined a public business entity in Accounting Standards Update 2013-12, *Definition of a Public Business Entity*, and uses the definition to clarify which entities may elect accounting alternatives developed by the PCC and use relief the FASB provides to private companies on effective dates, transition requirements and disclosure requirements in new standards. Other US GAAP standards (e.g., earnings per share, segment reporting) define a public entity differently.

A company filing an IPO registration statement would be considered a public business entity under any of these definitions. Therefore, a company that previously elected to apply any of the PCC accounting alternatives (e.g., the goodwill amortization accounting alternative) would need to retrospectively revise its financial statements to apply public company accounting standards in the IPO filing. In addition, the company must consider other public company accounting and disclosure requirements, such as those on earnings per share and segment reporting.

A company becomes an SEC filer once its IPO registration statement is effective. The FASB uses the term SEC filer distinctly in certain accounting standards (e.g., subsequent events) and, in some cases, when establishing transition periods for new standards.

Public versus nonpublic company transition periods

New accounting standards often contain different transition provisions for public and nonpublic companies. Nonpublic companies generally have more time to adopt new standards than public companies. Except for EGCs, nonpublic companies that file with the SEC to become public must apply all accounting standards, including new standards, as if they have always been public.

The SEC staff expects an EGC that elects to use nonpublic company transition to disclose an additional risk factor explaining that the election allows it to delay the adoption of new or revised accounting standards that have different transition dates for public and nonpublic companies, and as a result, the company's financial statements may not be comparable to those of companies that comply with public company effective dates.

Earnings per share

Accounting Standards Codification (ASC) 260, *Earnings Per Share*, requires public companies to present earnings per share (EPS) in their annual and interim financial statements, including those in the IPO registration statement, for each period a statement of income is presented. Computing EPS is often complicated, particularly for companies with complex capital structures that have issued several types of equity. ASC 260 requires public entities to disclose two EPS calculations:

- Basic EPS, which is calculated by dividing income available to common stockholders (i.e., net income or loss attributable to the parent entity adjusted for preferred stock dividends declared or accumulated, income attributable to noncontrolling interests, and other relevant adjustments) by the weighted average number of common shares outstanding
- Diluted EPS, which is calculated by taking basic EPS and adjusting for the assumed issuance of all potential common shares that were dilutive and outstanding during the period (e.g., options, warrants, unvested share-based payment awards, convertible securities)

Contingently issuable shares (i.e., shares issuable for little or no cash consideration upon the satisfaction of certain conditions pursuant to a contingent stock arrangement) are included in diluted EPS if all necessary conditions have been satisfied by the end of the period (i.e., the events have occurred). If all necessary conditions have not been satisfied by the end of the period, the number of contingently issuable shares included in diluted EPS is based on the number of shares, if any, that would be issuable as of the end of the reporting period, assuming the end of the reporting period was also the end of the contingency period and the result would be dilutive.

In some cases, IPOs are structured to issue a second class of common stock. Under ASC 260, entities that have multiple classes of common stock or have issued securities other than common stock that participate in dividends with the common stock (i.e., participating securities) are required to apply the two-class method to compute EPS. Under this earnings allocation method, EPS is calculated for each class of common stock and participating security considering both dividends declared (or accumulated) and participation rights in undistributed earnings, as if all such earnings had been distributed during the period.

In addition, as discussed above, full pro forma financial information pursuant to Article 11 of Regulation S-X may be required to reflect certain transactions or events that have occurred or are probable of occurring. It should be noted that the presentation of pro forma EPS data does not change the calculation or presentation of historical EPS under ASC 260. Specifically, transactions that have not yet occurred (e.g., conversions, distributions), but will occur in connection with the IPO, do not affect historical EPS before their occurrence unless specific provisions in ASC 260 provide otherwise (e.g., stock splits, rights issues).

Refer to our Financial reporting developments (FRD) publication, ***Earnings per share***, and our SEC Financial Reporting Series publication, ***Pro forma financial information: A guide for applying Article 11 of Regulation S-X***, for detailed considerations and guidance.

Segment reporting

ASC 280, *Segment Reporting*, requires public companies to disclose certain information about reportable operating segments in complete sets of financial statements of the entity and in condensed financial statements of interim periods. It also requires public entities to present certain entity-wide information, including revenues related to products and services and geographic areas in which they operate. Information about major customers also is required.

A public company is required to present disaggregated information by segment using the management approach, which requires segment information to be reported based on how management internally evaluates the operating performance of the company's business units or segments (i.e., its management reporting structure).

Segment disclosures continue to be a frequent area of emphasis in SEC staff comment letters. In its reviews, the SEC staff continues to focus on how companies identify and aggregate operating segments and whether companies have inappropriately included non-GAAP measures in their segment disclosures. Companies also are frequently asked about the adequacy of their entity-wide disclosures with respect to products and services, revenues attributable to individual foreign countries and revenues from major customers.

How we see it

Companies should challenge any conclusions they reach on operating segments that are inconsistent with their basic organizational structure, and the level of disaggregation used by the chief operating decision-maker (CODM) in making key operating decisions. Other factors to consider include the basis on which budgets and forecasts are prepared, and on which executive compensation is determined.

Further, determining a company's reportable segments requires careful consideration of the facts and circumstances. ASC 280 allows, but does not require, a registrant to aggregate operating segments for reporting purposes. To be eligible to aggregate operating segments, companies must consider whether operating segments are similar in all of the criteria in ASC 280. This area is often challenged by the SEC staff.

In addition, companies should consider all public information (e.g., registrant websites, earnings calls, industry or analyst presentations) and confirm that their segment conclusions are consistent with both their operations and their public communications.

Refer to our FRD publication, ***Segment reporting***, for detailed considerations and guidance.

Share-based compensation

Many companies completing an IPO have share-based compensation strategies for their key executives, board members and other employees, such as stock options and grants of non-vested stock that vest over several years. ASC 718, *Compensation — Stock Compensation*, and SAB Topic 14, *Share-Based Payment*, specify accounting considerations for nonpublic companies entering the public markets and for financial reporting subsequent to the IPO.

This section provides an overview of certain accounting issues related to share-based compensation that are common in IPO transactions. Refer to our FRD publication, ***Share-based payment***, for detailed considerations and guidance.

Equity award fair value and related expense

One of the key accounting issues for an entity that is planning an IPO is the valuation of equity securities, including options, issued as compensation under ASC 718 while the entity is privately held. A key financial reporting concern is often referred to as "cheap stock" (i.e., when the value of the underlying stock at the grant date is significantly less than the estimated IPO price).

The SEC staff generally believes that the publicly traded price of an entity at the time of its IPO provides the best indication of fair value as of the transaction date, and there should be a rational correlation between the value of the awards issued before the transaction and the estimated IPO price (or range). The SEC staff often challenges the valuation of share-based payment awards issued in the period before a transaction that is significantly lower than the estimated IPO price. When an entity grants share-based payment awards, management needs to support its judgments and estimates about the fair value of the entity's securities and should retain documentation about such estimates.

The SEC staff expects entities that plan to enter the public markets to apply the valuation guidance in the AICPA Accounting and Valuation Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation* (the Guide), when valuing share-based payments (and other equity instruments) they grant in the period before the transaction.

How we see it

An entity's compliance with the Guide may not prevent it from receiving SEC staff questions about the valuation of share-based payment awards issued in the period before entering the public markets. The staff may challenge both the appropriateness of the valuation methodology considering the circumstances and the underlying assumptions used to value share-based payment awards granted in the period before the entity enters the public market. However, the Guide includes a framework that, when appropriately applied, should yield a credible valuation that the SEC staff likely would not object to.

The staff of the SEC's Division of Corporation Finance states in Section 9520, *Share-based Compensation in IPOs*, of its Financial Reporting Manual (FRM)[9] that companies should disclose the following information about share-based payments issued in the periods before becoming a public entity as part of their critical accounting estimates disclosures in MD&A:

- The methods used to determine the fair value of the entity's shares and the nature of material assumptions used in determining the fair value
- The extent to which such estimates are highly complex and subjective
- The fact that estimates won't be necessary for new awards once the shares begin trading

Based on this guidance, entities should focus on describing the methodology and judgments they use and the extent to which the estimates are complex and subjective. That is, they do not need to quantify each assumption or explain how the assumptions changed over time, although this information should be maintained in an entity's internal documentation and may need to be provided when responding to an SEC staff comment letter.

How we see it

If a company receives a comment letter from the SEC staff, management should first determine whether the staff is seeking additional disclosure or requesting evidence of milestones and significant events to support the changes in fair value at each grant date leading up to the IPO (i.e., support for the contemporaneous valuations).

To more efficiently resolve questions about the valuations, companies should contemporaneously document their considerations and reasons for changes in fair value that occur between valuation dates and the determination of a price range for the IPO, including third-party transactions and key milestones.

After an entity files its initial registration statement, liability-classified share-based payment awards previously measured using intrinsic value are required to be measured at fair value determined in accordance with ASC 718.

Equity and liability awards valuation models

ASC 718 requires both public and nonpublic entities to value the equity instruments exchanged for goods or services based on the fair value of those instruments (i.e., the fair value-based method). However, it provides an exception for nonpublic entities that cannot estimate the fair value of equity instruments issued to employees and nonemployees because it is not practicable to estimate the expected volatility of the entity's share price. In that case, a nonpublic entity may use the historical volatility of an appropriate industry sector index (i.e., the calculated-value method).

How we see it

ASC 718 is clear that a nonpublic entity may be able to estimate its share price volatility by considering the historical, implied or expected share price volatility of similar public entities.

We expect that in many cases, a nonpublic entity that can identify an appropriate industry sector index for purposes of using the calculated-value method would be able to identify similar entities in that index on which to base an estimate of its own share price volatility, and therefore, it would be required to use the fair value-based method.

Further, entities are required to evaluate whether share-based payment awards should be liability-classified. Although public entities are required to measure liability-classified awards at fair value, nonpublic entities may elect to measure liability-classified awards at fair value or at intrinsic value.[10]

Once an entity files (or submits for confidential or nonpublic review) its initial registration statement in connection with an IPO of equity securities, liability-classified share-based payment awards previously measured using intrinsic value are required to be measured at fair value, as determined in accordance with ASC 718, in the first reporting period ending after the filing (or submission) of the initial registration statement. All share-based payments granted after the filing (or submission) date are also required to be measured at fair value.

An entity that is required to modify its accounting policy from intrinsic value to fair value because it becomes a public entity should disclose the change in accounting policy that will be required by ASC 718 and the reasonably likely material future effects. The IPO registration statement should include the disclosures, within management's discussion and analysis of financial condition and results of operations, for example. In subsequent filings, such as Forms 10-K and 10-Q, a new public company should provide financial statement disclosure of the effects of the changes in accounting policy (i.e., disclosures required by ASC 250).

Redeemable equity securities

Although they are issued in the form of equity, certain redeemable equity instruments are required to be distinguished from permanent capital. The guidance listed below includes the positions of the SEC and its staff on the accounting for certain redeemable equity instruments. The guidance has been codified in ASC 480-10-S99, *SEC Materials*, and applies to all financial statements filed with the SEC, including those in an IPO registration statement.

- Financial Reporting Releases and Codifications 211, *Redeemable Preferred Stock*
- Staff Accounting Bulletin No. 64 Topic 3.C, *Redeemable Preferred Stock*
- Emerging Issues Task Force Topic D-98, Classification and Measurement of Redeemable Securities

If the redemption of the equity instrument is certain to occur, the instrument is generally classified as a liability pursuant to ASC 480. Instruments that are not otherwise required to be classified as liabilities pursuant to ASC 480 and for which redemption could be required (1) at a fixed or determinable date, (2) at the option of the holder or (3) upon the occurrence of certain contingent events (e.g., an IPO, change in control, liquidation event or achievement of a performance condition) not solely within the control of the issuer are in the scope of the above guidance.

The guidance applies to all redeemable equity instruments, including common stock, preferred stock, noncontrolling interests and equity components of certain financial instruments, such as convertible debt. It's important to note that the SEC staff does not consider probability in determining whether the instrument will become redeemable under the redeemable equity guidance.

The SEC requires instruments that are in the scope of this guidance to be classified on the balance sheet as temporary (or mezzanine) equity between liabilities and stockholders' equity to highlight the future cash obligations attached to these types of securities and thus distinguish them from permanent equity. Instruments classified as temporary equity cannot be included in any subtotals that imply it is considered equity.

While certain exceptions exist, the initial carrying amount of a redeemable equity security should generally be its fair value on the date of issuance. However, the subsequent measurement varies based on whether the instrument is currently redeemable or is probable of becoming redeemable.

Changes to the carrying amount of a redeemable security are generally treated in the same manner as dividends on nonredeemable stock. The impact to EPS depends on the type of security (preferred or common), the basis for the redemption amount (i.e., fair value, fixed amount or formulaic amount) and whether the security represents a noncontrolling interest.

How we see it

Although ASC 480-10-S99 applies only to financial statements prepared in accordance with Regulation S-X, many nonpublic companies also apply this guidance. While nonpublic companies are not required to apply this guidance (when their financial statements are not included in SEC filings), we generally believe that its application is preferable and may provide for an easier transition to an IPO.

Refer to our FRD publication, ***Issuer's accounting for debt and equity financings***, for detailed considerations and guidance.

Stock splits

SAB Topic 4.C, *Change in Capital Structure*, codified in ASC 505-10-S99-4, discusses the accounting for a change in capital structure from a stock dividend, stock split or reverse split that occurs after the date of the last reported balance sheet but before the release of the financial statements or the effective date of a registration statement, whichever is later. The SEC staff has indicated that such changes in capital structure are required to be reflected retroactively in the pre-stock split balance sheet, with appropriate footnote disclosure.

In some cases, a stock split may not occur until immediately before the effectiveness of the registration statement. The SEC staff may accept the inclusion of a draft or "legended" audit report in earlier registration statement submissions or filings before the transaction can be reported under US GAAP. Such draft includes (1) an unsigned audit report in the form that it will be included in the registration statement after the transaction closes but before effectiveness and (2) a signed legend at the end of the unsigned audit report. Before the SEC staff will declare the registration statement effective, the transaction must occur, the legend must be removed, and the audit report must be signed.

Offering costs

SAB Topic 5.A, *Expenses of Offering*, codified in ASC 340-10-S99-1, notes that specific incremental costs directly attributable to a proposed or actual offering of securities may properly be deferred and applied to the gross proceeds of the offering through additional paid-in capital. However, management salaries and other general and administrative expenses may not be allocated as costs of the offering. The SEC staff has noted that it would object to registrants deferring costs related to financial statement preparation and audits because they are not directly attributable to the offering.

Deferred costs of an aborted offering, which would include a postponement of 90 days or greater, should be expensed.

How we see it

A company must use judgment to determine whether expenses are incremental and directly attributable to an offering, rather than the costs of being a public company. In addition, a company often may need to apply judgment when determining whether an offering was aborted. We believe the duration of the postponement should be considered in relation to the company's IPO activities, rather than the period when a company last submitted its IPO registration statement.

Other public company disclosures

A public company's financial statements, including those in the IPO registration statement, require more disclosures on the face of the financial statements and in the notes to the financial statements for various other ASC topics and SEC rules, including:

- Income taxes, such as a reconciliation of income tax expense (benefit) from continuing operations to the amount that would result from applying the domestic federal statutory rate to pretax income (loss) from continuing operations
- Fair value measurements, such as a narrative description of the uncertainty of Level 3 fair value measurements from the use of significant unobservable inputs if those inputs reasonably could have been different at the reporting date
- Business combinations, such as supplemental pro forma disclosures in the footnotes
- Balance sheet disclosure of equity securities (e.g., number of shares of common stock issued and outstanding on the face of the balance sheet) and amounts related to related parties (e.g., amounts receivable from and payable to related parties)

Nonfinancial statement disclosures

A registration statement is also required to include disclosures outside the financial statements in accordance with Regulation S-K. Regulation S-K comprises subparts organized by "Items" that contain specific nonfinancial statement disclosure requirements, including:

- Item 101, Description of business
- Item 105, Risk factors
- Item 303, Management's discussion and analysis of financial condition and results of operations
- Item 404, Transactions with related persons, promoters and certain control persons
- Item 504, Use of proceeds
- Item 601, Exhibits

As discussed above, SRCs and EGCs are not subject to all the Regulation S-K disclosure requirements or may have reduced nonfinancial statement disclosure requirements. In these cases, Regulation S-K specifies the applicable requirements for an SRC or EGC.

SEC comment letters

Many of the areas that the SEC staff comments on during the IPO process relate to disclosures outside the financial statements. Such comments address areas where the staff believes the company has not complied with SEC requirements. Some of the more frequent areas for comment are summarized below.

Risk factors — The SEC staff commonly questions risk factor disclosures that could apply to any public company and are not specific to the registrant's facts and circumstances. The SEC staff also may question the completeness of a registrant's risk factor disclosures based on information included elsewhere in the document or other public information.

MD&A — While SEC staff comments address various aspects of MD&A disclosure sections, the majority of comments are focused on disclosures about results of operations. Many comments relate to a lack of sufficiently detailed disclosures about the reasons for material period-to-period changes in a registrant's financial statement line items, including the need to disclose material changes in quantitative and qualitative terms for each factor contributing to the change. The SEC staff also asks registrants to focus their MD&A discussion of critical accounting estimates[11] on the quality and variability of management's most significant judgments and assumptions. In addition, the SEC staff may request enhanced disclosures in the liquidity and capital resources section of MD&A, particularly when there are trends or uncertainties affecting liquidity.

Non-GAAP financial measures — The SEC staff often comments on registrants' presentation and disclosure of non-GAAP financial measures and their compliance with (1) the requirements of Regulation G and Item 10(e) of Regulation S-K and (2) the views in the staff's Compliance and Disclosure Interpretations (C&DIs) on non-GAAP measures. Refer to our Technical Line, ***Navigating the requirements for non-GAAP financial measures***, for further guidance on non-GAAP financial measures.

Related party disclosures — The SEC staff may request that registrants clarify or expand their disclosures about related party transactions, as required by Item 404 of Regulation S-K. The SEC staff expects the description of a related party transaction to summarize the nature of the transaction in quantitative and qualitative terms and to include any other material information. The SEC staff often questions the completeness of Item 404 disclosures based on the registrant's disclosures elsewhere in the filing (e.g., related party disclosures in the financial statements). The SEC staff also questions whether the registrant has included in the registration statement required exhibits that are relevant to the Item 404 disclosures (e.g., material related party agreements).

Use of proceeds — Item 504 of Regulation S-K requires registrants to describe the planned uses and amounts of offering proceeds. These disclosures should give users the ability to understand the major areas for which the funds will be used, including whether any proceeds will be used to discharge debts or complete an acquisition, or for working capital. The SEC staff may request that a company provide additional details about how it will use the proceeds from the offering, particularly when other disclosures in the filing (e.g., pro forma financial information) imply that a use has been omitted from or is inconsistent with the Item 504 disclosures.

Signatures, exhibits and agreements — The SEC staff may question the completeness and adequacy of exhibits, consents, audit reports and management signatures filed by a registrant as required by various rules and regulations. The SEC staff often inquires about the omission of material agreements that must be filed as exhibits to registration statements.

Post-IPO considerations

Periodic reporting requirements

Once an issuer has completed its IPO, it will generally be required to file annual reports on Form 10-K and quarterly reports on Form 10-Q with the SEC. After a registrant's first registration statement is declared effective, a Form 10-Q is due the later of 45 days after the effective date of the registration statement or the date the Form 10-Q would otherwise be due. The report would include the quarter following the latest period for which financial statements were included in the registration statement.

When the effective date of a registrant's initial registration statement on Form S-1 is within 45 days (90 days for an SRC) of its fiscal year end, but the registration statement does not include audited financial statements of the recently completed fiscal year, the registrant will generally be required to file a complete annual report on Form 10-K within 90 days of its fiscal year end (i.e., the post-IPO accommodation for Form 10-Q is not available for Form 10-K).

Filer status

A registrant's filer status (i.e., non-accelerated, accelerated or large accelerated filer status) primarily affects the deadline for filing periodic reports with the SEC and the requirement to obtain auditor attestation on ICFR subsequent to the IPO.

A company that conducts an IPO would not meet the definition of an accelerated filer or large accelerated filer at the end of the fiscal year in which it went public.

Rule 12b-2 of the Exchange Act provides definitions of a large accelerated filer and an accelerated filer. The conditions for both definitions include the registrant having periodic reporting obligations for at least 12 months.

A company that conducts an IPO would not meet the definition of an accelerated filer or large accelerated filer at the end of the fiscal year in which it went public because it would not have had periodic reporting obligations for at least 12 months. Instead, it would be considered a non-accelerated filer[12] for purposes of its first annual report on Form 10-K following its IPO, even if its public float were to exceed the thresholds in the accelerated or large accelerated filer definitions.

Registrants need to verify their filing status every year to determine the deadline for filing their periodic reports and the disclosure relief for which they are eligible. For example, a registrant that has been a public company for a complete fiscal year, subject to the other status determination criteria, may meet the definition of an accelerated filer, which would cause the due dates of its Form 10-K and Form 10-Q to be earlier than if the registrant had remained a non-accelerated filer (e.g., Form 10-Q would be due within 40 days of quarter-end, rather than within 45 days).

Registrants will also need to determine whether they qualify as EGCs and/or SRCs on an annual basis. EGCs and SRCs may lose their status based on the redetermination tests discussed in our Technical Line, ***Reminders on reporting and filer status considerations for SEC registrants***. At the latest, an EGC will permanently lose its status on the last day of the fiscal year of its IPO's fifth anniversary.

XBRL

The SEC requires filers to use extensible Inline Business Reporting Language (XBRL) tags for all primary financial statements, notes and financial statement schedules, as well as certain other information, filed with the SEC, beginning with the first quarterly report filed by a newly public company.

For additional details and considerations on periodic reporting requirements, refer to our SEC Financial Reporting Series publications, ***SEC annual reports — Form 10-K*** and ***SEC quarterly reports — Form 10-Q***. In addition, refer to our SEC Reporting Update, ***Highlights of trends in SEC staff comment letters***, for themes in comment letters issued with respect to periodic filings.

Current reporting requirements

The purpose of current reports on Form 8-K is to provide investors with timely disclosure of important corporate events (e.g., entry into material definitive agreement, completion of an acquisition or a disposition of assets, results of operations and financial condition, change in auditor, election of directors, submission of matters to a vote, Regulation FD disclosure).

A Form 8-K report is required to be filed within four business days after the occurrence of most reportable events. The reported information is considered "filed" under the Exchange Act, except for information provided under Items 2.02 Results of Operations and Financial Condition and 7.01 Regulation FD Disclosure.

Assessment of disclosure controls and procedures and ICFR

Issuers are required to comply with Item 307 of Regulation S-K regarding management's assessment of disclosure controls and procedures and with Item 308 of Regulation S-K regarding management's assessment and independent auditor attestation over the effectiveness of ICFR as required by Sections 302 and 404 of the Sarbanes-Oxley Act.

Disclosure controls and procedures

Exchange Act Rules 13a-15(b) and 15d-15(b) require an issuer's management, with the participation of its principal executive and principal financial officers, or persons performing similar functions, to evaluate the effectiveness of the issuer's disclosure controls and procedures as of the end of each fiscal quarter. Based on that evaluation, Item 307 of Regulation S-K requires each Form 10-Q and, for the fourth quarter, the Form 10-K, to disclose the conclusions of the registrant's principal executive and principal financial officers, or persons performing similar functions, regarding the effectiveness of the registrant's disclosure controls and procedures as of the end of the period covered by the report. These disclosures are required to be filed beginning with the issuer's first periodic report.

Internal control over financial reporting

Item 308(a) of Regulation S-K requires each Form 10-K, beginning with a registrant's second annual report on Form 10-K, to include management's report assessing the effectiveness of the company's ICFR.

Item 308(b) of Regulation S-K requires each Form 10-K of an accelerated filer or a large accelerated filer, beginning with a registrant's second annual report on Form 10-K, to include an attestation report from the registrant's registered public accounting firm on the registrant's ICFR. Non-accelerated filers and EGCs are exempt from this requirement.

Item 308(c) of Regulation S-K requires disclosure of material changes in ICFR that occurred during a fiscal quarter. The SEC staff clarified that it would not object if a registrant does not disclose changes or improvements to controls made in preparation of management's first report assessing the effectiveness of the company's ICFR (e.g., between its IPO and second Form 10-K report date). However, the SEC has stated, "a company will have to determine, on a facts and circumstances basis, whether the reasons for the change, or other information about the circumstances surrounding the change, constitute material information necessary to make the disclosure about the change not misleading."

How we see it

Although a registrant is not required to provide Item 308 disclosures in its first year as a public company, it will be better positioned to comply with the requirements and maintain an appropriate control environment by documenting and evaluating ICFR as part of the IPO readiness process. Further, some companies may identify material weaknesses that may warrant disclosure in the risk factor or other sections of the IPO registration statement. Companies should consult with their advisers and legal counsel regarding such disclosures.

Endnotes:

[1] On 6 March 2024 the SEC adopted rules that will require registrants to provide climate-related disclosures in annual reports and registration statements, including Form S-1. On 4 April 2024, the SEC voluntarily stayed the rules pending judicial review by the US Court of Appeals for the Eighth Circuit of consolidated challenges to the rules. Pending the stay, a nonpublic entity will be required to comply with the disclosure requirements for fiscal years beginning 2027. See our Technical Line, ***A closer look at the SEC's climate-related disclosure requirements***, for additional information about the disclosure requirements.

[2] The OCA has published protocols and requirements for pre-filing submissions, which are available on the SEC's website at **https://www.sec.gov/page/oca-form-delivery-and-content-correspondence-oca-consultations**.

[3] Requests to the Office of Chief Accountant at the Division of Corporation Finance for no-action, interpretive, exemptive and waiver letters should be submitted on the SEC website at **https://www.sec.gov/forms/corp_fin_noaction?#no-back**.

[4] Therefore, in its response letters to the SEC staff on its confidential or nonpublic submission, an issuer should identify the information for which it intends to seek confidential treatment pursuant to SEC Rule 83 (17 CFR 200.83). This rule allows a company to request confidential treatment for some portions of a written response to an SEC staff comment letter if there is an appropriate basis for making such a request.

[5] Public float is determined by multiplying the aggregate number of voting and non-voting common shares held by non-affiliates by the price at which the common shares were last sold, or the average of the bid and asked prices, in the principal market for the registrant's common shares. Thus, the determination of public float is premised on the existence of a public trading market for the issuer's common equity securities. This is different from the definition of market capitalization, which is an amount equal to the total number of issued and outstanding shares of the issuer's common equity securities. Calculating a registrant's public float may involve judgment and legal interpretations and analysis, including determining affiliate status based on the facts and circumstances. Registrants should consult with their legal counsel.

[6] The changes in shareholders' equity and noncontrolling interests generally may be presented in a separate statement or a note to the financial statements.

[7] The financial statements of Newco may be omitted if Newco is only capitalized nominally before the registration statement's effective date or if it is a "business combination related shell company" as defined under Rule 405 of Regulation C.

[8] See Securities Act Forms, C&DIs 101.04 and 101.05 at **https://www.sec.gov/corpfin/securities-act-forms.html**.

[9] The Division of Corporation Finance Financial Reporting Manual is available at **https://www.sec.gov/files/cf-frm.pdf**.

[10] All entities, both public and nonpublic, must measure awards that are granted to customers in conjunction with a revenue arrangement and are not issued in exchange for a distinct good or service at fair value. That is, a nonpublic entity's policy election to value liability-classified awards at intrinsic value does not apply.

[11] Critical accounting estimates, as defined by Item 303(b)(3), are those that involve a significant level of estimation uncertainty and have had, or are reasonably likely to have, a material impact on the registrant's financial condition or results of operations.

[12] The SEC said an issuer that does not meet the definition of an accelerated filer or a large accelerated filer is considered a non-accelerated filer. However, the term "non-accelerated filer" is not defined in Rule 12b-2 or elsewhere in the SEC's rules.