

## 8 Steps to Prevent IPO Delays

### Advance Planning Will Significantly Improve Your IPO Process

The process of conducting an initial public offering ("IPO"), from the initial planning until the first sale of shares to the public, is lengthier than many would expect. Companies considering an IPO should begin planning months in advance, as several steps need to be taken well ahead of the completion of the IPO.

This article highlights certain aspects of the IPO process that can result in significant delays or surprises if not managed properly. It is not intended to provide you with an exhaustive or definitive list of the issues facing a company that is considering an IPO in the next few years. Rather, the following tips are intended to give you a better understanding of the IPO process and explain why it is critical to begin considering these issues as far in advance of a proposed IPO as possible.

### Select Auditors and Prepare Financial Statements

Pre-IPO companies whose auditors are not one of the "Big 4" firms are often advised by underwriters to change accounting firms. Due to the cost and time involved, companies may mistakenly seek to delay this transition. However, delays related to the audit process are possibly the biggest and most preventable in the IPO process.

Regardless of prior experience in the relevant industry, new auditors will require time to work their way through a company's financial statements. It usually takes longer to generate public company audited financials than people expect. It may be necessary for the new firm to re-audit prior years, and issues are commonly identified that can result in adjustments or even restated financials.

#### At a glance:

##### 8 Tips to Prevent IPO Delays

- 1 Do not delay retention of new auditors (if change is advised) or underestimate the time needed to prepare audited or interim financial statements.
- 2 Assemble board and management teams prior to launching the IPO process.
- 3 Commence due diligence process with company counsel before IPO kickoff with underwriters.
- 4 Review corporate documents and contracts early to identify and resolve issues.
- 5 Obtain frequent 409A valuations to avoid "cheap stock" issues.
- 6 Start acting like a public company well in advance of launching the IPO.
- 7 Plan for significant developments or transactions that could take place during the IPO process.
- 8 Determine anti-takeover measures that should be adopted before becoming a public company.

Many private companies do not obtain a SAS 100 review of quarterly financials, which can sometimes be as time-consuming as an audit. Eight (or more) quarters of reviewed financials are commonly included in an IPO prospectus. If the issuer has completed acquisitions of a significant nature, the preparation of pro forma financials or financial statements of the acquired businesses can also be a time-consuming process.

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While prompt engagement of a new accounting firm will help keep the work streams above moving as close to the desired timetable as possible, there are other benefits to involving new auditors early in the process. Particularly for leanly staffed companies, auditing firms can provide assistance with preparing certain portions of the prospectus, including the Management's Discussion and Analysis of Financial Condition, or MD&A. Pre-IPO companies often have one or more material weaknesses or significant deficiencies in their internal controls and the auditors can advise on remedial plans that will reassure the underwriters in their due diligence process, as well as prospective investors in the IPO.

## **Assemble a Management Team and Board of Directors**

Many companies will have their post-IPO management team in place far in advance, with clean background checks in hand to ensure no surprises. Others will be lacking individuals for key positions, most commonly a chief financial officer or other principal accounting officer. Delaying the appointment of certain officers in an attempt to reduce costs may result in setbacks that hinder primary objectives. It can take time for new officers to get up to speed, reducing their contribution to the IPO process. Companies are often short on staff in the accounting and internal control areas as

they make the transition to public reporting, but it is important to have the resources in place to ensure that the company is not late in filing its initial periodic report as a public company.

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Likewise, consideration must be given to changes to the board of directors. People typically look for new directors with pertinent industry or accounting expertise, but often have unrealistic expectations of the likelihood of securing desired candidates and underestimate how long the search can take. Although there are transitional periods for compliance with certain NYSE/NASDAQ independence standards, it can be beneficial to create a timeline that will help you meet those requirements on time. Candidates for the audit committee cannot have connections with current or prior auditors that would violate independence tests.

## **Begin the Due Diligence Process**

Many companies wait for the underwriters and their counsel to circulate a due diligence request list following the IPO kickoff meeting to begin organizing a data room. This will often result in surprises materializing while the prospectus is being drafted. The quality of early disclosure drafting can suffer when there is such a reactionary diligence process, and the need to resolve certain issues may lead to delays. It can be much more efficient for a company to have its counsel begin the due diligence process and assist in organizing a data room well in advance of the kickoff meeting. Not only will that provide the underwriters and their counsel materials to begin reviewing immediately upon their engagement, but company counsel may be able to identify and resolve issues earlier in the process. Company counsel will

also have a better understanding of the company and its business, which can improve the quality and precision of initial drafting and allow them to field certain inquiries from underwriters' counsel directly, both of which can save management time.

## Review Corporate Documents and Contracts

A company's capitalization records must, of course, reflect all shares of capital stock that have been issued to date, including issuances of warrants, options or convertible securities and reflecting any exercises, transfers or cancellations. In addition, each of the charter, bylaws and other equity-related documents need to be reviewed to identify parties with special rights, including registration rights, approval rights, voting rights and rights of first refusal—rights that will, at a minimum, require disclosure or otherwise need to be waived or relinquished in order to proceed with the transition to a public company. The conversion terms of any preferred stock need to be reviewed to determine if such conversion is automatic or may require negotiation. Underwriters will require all (or close to all) stockholders and option holders to agree to 180-day "lock-ups" in connection with the IPO, so the existence of market "stand-off" agreements with such holders should be confirmed early on. Revisions to the charter and bylaws are likely to be needed to authorize more shares of common stock and implement other changes to make those documents appropriate for a public company.

Attention should also be paid to the company's material contracts, which will need to be filed as exhibits to the registration statement. There is a process for redacting certain sensitive information in such contracts.

Companies need to be aware of information that they may need to release to ensure that no competitive harm will result. It is also important to note that confidentiality provisions in contracts do not trump disclosure obligations, which can

necessitate discussions with counterparties. Companies should draft confidentiality provisions so they permit disclosure if required by law.

## Avoid Cheap Stock Issues

"Cheap stock" is an issue that gets a lot of attention from the U.S. Securities and Exchange Commission ("SEC"). If the SEC determines in retrospect that a company has issued options or equity grants below the fair value of its stock, it will require the company to take a charge for such deemed expense. Having a dispute with the SEC on past valuations is time consuming, and the financial impact of being required to incur such expenses can hurt a company's appeal to investors. The Internal Revenue Service has also indicated that it may target companies with cheap stock charges disclosed in their public filings for Section 409A enforcement.

To avoid encountering such setbacks, a pre-IPO company should start getting frequent 409A valuations (quarterly or, in certain circumstances, more often) as the IPO approaches and work with its auditors to ensure that the valuations of its equity issuances are acceptable for accounting purposes.

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## Think and Act Like a Public Company

There are many compliance requirements that come into effect when a company becomes public, or even as it enters the IPO process. For those standards that may not yet apply, it can be beneficial for a company to adopt certain changes in advance to essentially learn how to think and act like a public company. New corporate governance policies can be established in advance and communicated to employees. The company's website will need to be reviewed and updated to be consistent with the registration statement. A roadmap for making the

transition to becoming compliant with internal controls testing under Section 404 of the Sarbanes-Oxley Act should be identified, including the engagement of an accounting firm as a consultant if needed. There are rules relating to public communications once a company is in the registration process with the SEC. To ensure that there are no “gun jumping” issues in the middle of the IPO process, company counsel should be asked to advise on publicity guidelines, as well as any interview or public speaking opportunities. The SEC is on alert for potential gun jumping violations, which can result in significant delays or undesired disclosures.

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## Think and act like a public company before you are one.

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## Plan for Material Business Developments

Due to the length of the IPO process and the fact that business does not come to a stop during that time, it is important that companies plan as far ahead as possible regarding major business developments and transactions. For example, consummation of an acquisition of another company or business that exceeds certain materiality thresholds will require that separate audited financial statements for the target be included in the registration statement. If the target does not have audited financial statements available, or is a business within another company and will need to develop “carve-out” financial statements, this will result in a significant delay. If an acquisition opportunity

materializes once the IPO process has begun, management and the board will need to consider the extent of the delay that could result.

The company’s underwriters may advocate the completion of certain actions before launching the IPO, such as release of a new product, entry into a material contract or settlement of material litigation, but such events can pose challenges in terms of the IPO schedule. A new product launch may not have enough performance history for a company to be able to make the types of disclosure the underwriters would prefer in the registration statement. Counterparties to material contracts may object to information being disclosed or contracts being publicly filed. Additionally, parties to legal proceedings may try to leverage knowledge of the IPO process or any initial disclosure that may have been made with respect to reserves for such disputes to extract more favorable terms.

## Consider Anti-Takeover Measures

A company will be more vulnerable to a hostile takeover attempt once it becomes publicly traded. The board of directors and management of the company must decide whether the additional risk makes it worthwhile to adopt certain anti-takeover strategies, which are easier to implement while the company is still privately held. Company counsel can advise on what is typical in this situation.

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## Anti-takeover strategies are easier to implement while the company is still privately held.

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