Avoiding IPO Pitfalls: The Top 5 Challenges Organizations Face and How to Avoid Them

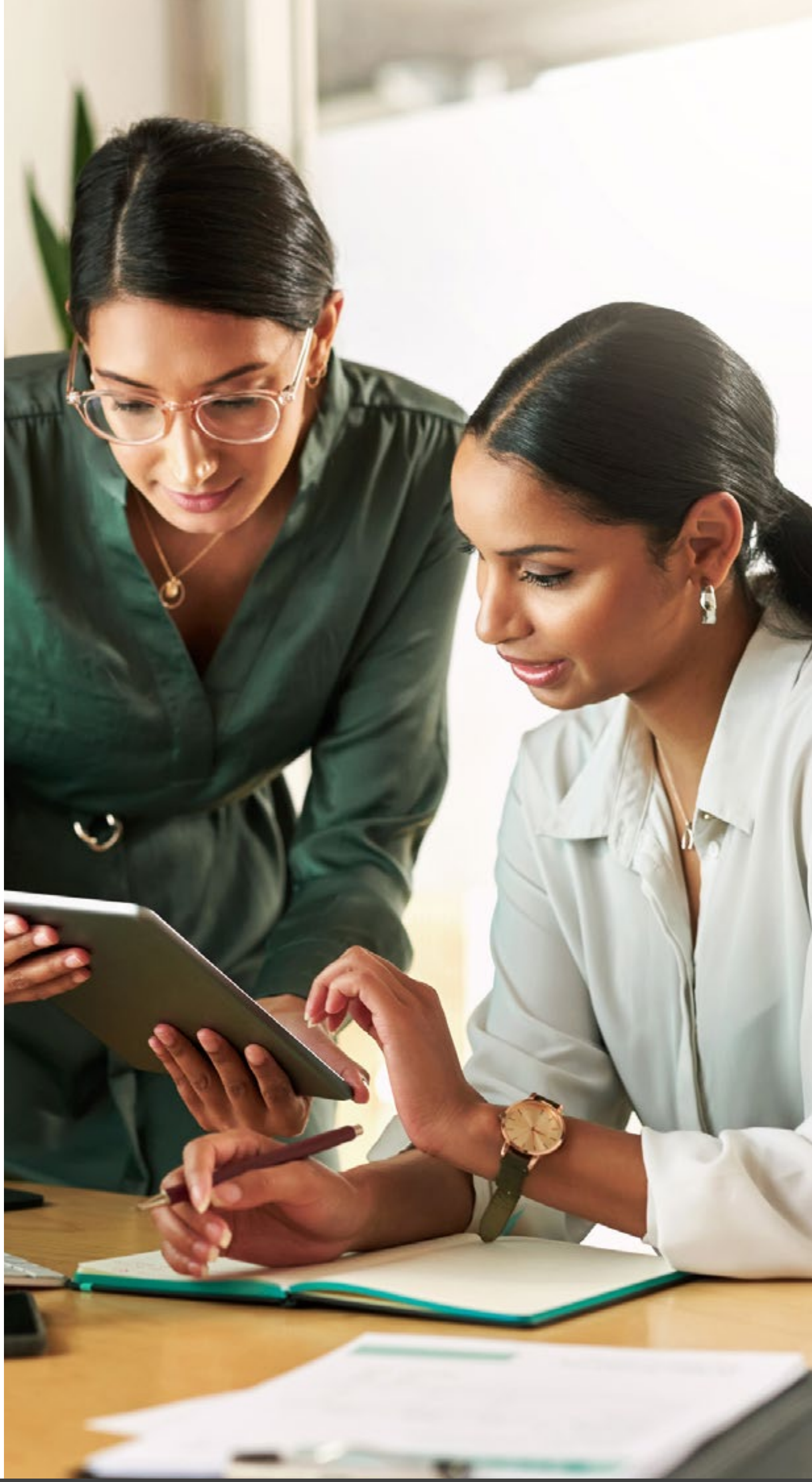
Introduction

Taking a company public means more than adhering to heightened compliance and regulatory standards. A successful initial public offering (IPO) calls for significant planning and investments by a leadership team with experience in public company operations, controls and auditing standards — and that's only the beginning. IPO readiness is a holistic process that requires insight and oversight across your entire organization. Internal teams must manage day-to-day operations while preparing to operate as a public company. There are many pitfalls companies must avoid on the road to going public, including:

1. Poor Planning
2. Under-resourced Accounting
3. Inexperienced Leadership and Governance Oversight
4. Weak Internal Controls
5. No Trial Run

The good news? BDO's **IPO Readiness Team** is here to help your company prepare for public life. We bring multidisciplinary and industry-specific experience to guide you through the IPO process. Our team includes consultants and former C-suite leaders who have facilitated hundreds of successful IPOs and Special Purpose Acquisition Company (SPAC) transactions. We work side-by-side with your professionals to assess IPO readiness, mitigate risk and meet critical milestones, while building the foundation for success as a public company.

Read on to learn more about these common pitfalls and how we've helped our clients avoid them.



Pitfall #1: Poor Planning

While the IPO process can generally take between 18-24 months, not all IPOs will fall within this window, allowing your company ample time to prepare. In many instances, IPO timelines are compressed due to a myriad of factors. And while most organizations want to be able to time the market, if they hold off on preparing until the IPO window is open, they could risk a lower valuation, or worse, a failed IPO. BDO's IPO readiness assessment can help you evaluate gaps, opportunities and risks across your enterprise, including:

- Does your company's leadership team have experience with operating and reporting a public company
- Whether your financial audits and accounting and reporting standards meet SEC and PCAOB requirements
- Whether your internal controls, processes and technology are up to the standards required of public companies
- Whether your current teams have the capabilities and capacity to operate as a public company or making the determination that some level of third-party assistance will be needed during and after the IPO
- When your company will be ready for the administrative needs of a public company
- If you have established a board of directors and standing committees with requisite experience in overseeing strategic execution of a public entity

These evaluations are key to making the IPO process as smooth and seamless as possible, minimizing operational distractions all while trying to maximize the value of your IPO. Process inefficiencies, poor integration of disparate systems and technology, leadership gaps—these shortcomings not only heighten the risk of incomplete data and misstatements, they also take time and resources to consolidate. Fixing these problems will bolster your business and show added value to investors and ensure confidence in management's ability to report accurate and relevant information.

BDO Case Study: Getting IPO-Ready Six Months Post-Acquisition

Summary

A national care provider was acquired for $1.3 billion by a private equity (PE) firm. The PE firm wanted to initiate an IPO within six months of acquisition, but the organization lacked effective leadership and in-house technical expertise. Its finance and controls also did not meet SEC standards.

Strategy

- We developed an IPO strategy to identify and remedy resource, technical accounting and financial reporting gaps.
- We provided interim finance and accounting resources for core stabilization projects across multiple teams, including accounts payable and payroll.
- Our team led the S-1 filing process and technical correspondence with the SEC to request relief from some reporting obligations.
- BDO worked collaboratively with various outside vendors and advisors to ensure a smooth and successful path towards IPO.
- We stood up an enterprise software solution to drive process improvement and standardize the chart of accounts.

Impact

- We helped the client file its initial S-1 on a condensed timeline, meeting the six-month window required by its PE firm.
- Our transformation of the finance department greatly reduced third-party co-sourcing requirements.
- We ran the overall IPO program and managed five other vendors, enabling our client to focus on running their business.

Pitfall #2: Under-resourced Accounting

The IPO process is long and expensive, driving many organizations to look for cost-saving opportunities in administrative work. However, the accounting function is one administrative area that typically needs more investment, not less, to meet the speed, scrutiny and complexity of public accounting standards.

Many organizations overestimate their finance and accounting (F&A) team's ability to handle the volume and technical complexity of preparing for an IPO in addition to their regular workflow—not to mention the significantly increased workload post-IPO. While your IPO roadmap likely accounts for this long-term shift, your short-term approach to accounting must also change.

When assessing your company's accounting resources and capabilities, you should consider whether:

- You need a larger team, greater technical expertise and/or new processes to prepare disclosures for your IPO registration statement and handle the administration of public company accounting standards
- Your business information system(s) (BIS) enable your organization to close the books in 10 business days and the various systems support the same data and messaging
- You're adequately prepared for your first public company audit – which generally includes three years of financial information

It is critical to ensure your F&A team is ready for a significantly larger workload with faster timelines. The incremental increases in workload start well before you file the S-1.

BDO Case Study: Correcting Accounting Issues and Errors for Reverse Merger IPO

Summary

A biotechnology company with cash flow issues planned to strengthen its market position through a reverse merger with a publicly traded company. An investor provided $160 million to fund a portion of the acquisition and development of the combined businesses, but this financing was contingent on a successful registration statement filing within six months. To meet this aggressive timeline, the company needed to fill resource gaps, rectify historical errors in its records and gain new capabilities for complex transactions.

Strategy

- Our team created an IPO roadmap and provided project management and audit support.
- We tapped BDO's valuation and tax teams to help file the client's Form S-4 and prepare Regulation S-X compliant financial statements.
- Our team supported the implementation of new lease accounting standards (ASC 842) and delivered technical accounting memos for multiple complex accounting matters.

Impact

- Our work helped make the company eligible for investor capital by filing all necessary SEC documents correctly and on time.
- We lifted the company's financial statements to meet PCAOB standards.
- Our team identified and corrected previously unknown errors in the company's accounting records.

Pitfall #3: Inexperienced Leadership and Governance

Building a leadership team including executives with prior IPO experience is critical to avoiding costly missteps both before and after the IPO. Ask yourself early: Do you have the right management team to operate as a public company? The road to going public is smoothest when guided by executives that have traveled this road before.

The SEC and listing exchanges (e.g., NYSE and NASDAQ) require public companies to have a certain number of independent board members. This requirement includes the establishment of an audit committee with all independent members who are financially literate and have at least one member designated as an audit committee financial expert. If you don't have a qualified financial expert, or if your current board members have conflicts of interest, you will need to start recruiting.

Audit committee financial expert must have the following attributes:

1. An understanding of generally accepted accounting principles (GAAP) and financial statements (F/S);
2. experience in: (a) preparation or auditing of F/S of generally comparable issuers; and (b) the application of such principles in connection with the accounting for estimates, accruals, and reserves;
3. experience with internal accounting controls; AND
4. an understanding of audit committee functions.

Such attributes shall have been acquired through:

- Education and experience as a principal financial officer, principal accounting officer, controller, public accountant or auditor or experience in one or more positions that involve the performance of similar functions:
- Experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor or person performing similar functions;
- Experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing or evaluation of F/S; OR
- Other relevant experience.

For more information, refer to **BDO's Audit Committee Requirements Practice Aid**.

Other standing committees of a public board, as required by listing the exchanges, include the Compensation Committee and a Nomination & Governance Committee that also are required to be comprised of independent directors with certain exceptions. Other committees of the board may be required - e.g., mandatory risk committees for certain financial institutions.

Many companies underestimate how long it can take to fill management team gaps and recruit qualified independent board members. Finding the right people isn't a box-checking exercise: Not only do you need to vet executives' backgrounds, but you also need to ensure their vision for the organization aligns with yours.

Ideally, you want these experienced leaders to start well before your public debut. Inexperience in the IPO process can lead to inadequate preparation, mismanagement of stakeholders or poor strategic decisions—and ultimately, delays and costly mistakes.

BDO Case Study: Helping an Inexperienced Leadership Team Prepare to IPO

Summary

An aerospace and defense engineering company planned to go public through an IPO. Privately held for more than three decades, the company was recently relaunched under a new name as a PE-backed portfolio company. The new company's leadership team lacked IPO experience. They sought a partner to conduct an IPO readiness assessment.

Strategy

- We conducted an IPO readiness assessment across financial planning and analysis, accounting, SEC reporting, tax, people, technology, risk and operations.
- Our team identified critical gaps and opportunities to mitigate risk and create value in processes, capabilities and reporting.
- We educated executive leadership on how to plan and execute the IPO process.

Impact

- Our readiness assessment laid the groundwork for the company to go public.
- Our holistic approach — showing the client how systems, technologies, accounting and tax interconnect throughout the IPO process — helped shift the CFO's understanding of the necessary steps to prepare for an IPO.

Pitfall #4: Weak Internal Controls

Under SOX 404 requirements, public companies are required to implement a system of internal controls over financial reporting and evaluate their effectiveness. Newly public companies are granted a one-year grace period to become 404 compliant, however the amount of time to comply with 404 may vary depending on the type and size of the transaction. Because they are not required to have their internal controls audited right away, deficiencies may be overlooked and unaddressed in the runup to the IPO.

Delaying SOX compliance until after the IPO is a mistake. Insufficient controls increase the risk of financial misstatements, fraud and errors. Disclosing an issue after filing a report with the SEC can harm your company's stock price and jeopardize investor confidence, not to mention incurring supplementary audit, legal and advisory costs.

On the flip side, demonstrating strong internal controls from the outset has significant upside. Whether you have an in-house internal audit (IA) function, outsourced or a hybrid IA function, early SOX compliance serves as a signal of your commitment to financial integrity, builds credibility with investors, and streamlines compliance in future filings.

BDO Case Study: A Risk-Based Approach for SOX Compliance Post-IPO

Summary

A fintech company with multiple subsidiaries went public. The company's business sectors — institutional, wholesale and retail — were each supported by unique IT infrastructures that served a variety of clients with disparate revenue streams and no existing process documentation. The company, which also lacked a global process to govern business practices in each sector, needed help determining the root cause of audit findings and assessing whether existing controls were sufficient to detect and prevent future shortcomings.

Following the company's IPO, BDO was engaged to evaluate the design of their internal controls framework and readiness to comply with SOX.

Strategy

- We worked with process owners to draft the process flow and document controls, risks and assertions.
- Our team used transaction testing to detect design and operating gaps and determine the effectiveness of existing controls.
- We took a risk-based approach, using our SOX knowledge to remediate issues and recommend process improvements.
- Our team worked with the process owners to develop and implement internal controls, assessment methodologies and best practices.

Impact

- Our work enabled the company to eliminate material weaknesses and achieve SOX compliance.
- Our process improvement and educational support increased the external auditors' confidence in management's ability to assess the company's financial reporting controls.
- We prepared the company for ongoing compliance by educating management, finance and business teams on their roles in SOX documentation and reporting.

Pitfall #5: No Trial Run

Private companies are subject to far less regulation and scrutiny than their public counterparts. To meet these heightened requirements, companies must implement all necessary changes before they go public, allowing time for internal teams to practice functioning as a public entity. Company leadership may not realize gaps and inadequacies until they apply their current processes to meet the new standards.

These are some questions to consider as your organization prepares to go public:

- Is your organization SOX compliant?
- Can your teams meet reporting deadlines without risk of misstatements?
- Do you have uniform controls and reporting policies?
- Does your organization have two or more enterprise resource planning (ERP) systems? Would consolidating these systems help streamline data and reporting?

The more time you allocate to this organizational "dress rehearsal," the better prepared your company will be to go public. This exercise will help your finance leaders understand the new expectations for controls, reporting and compliance post-IPO. It will also test the accuracy of your forecasting models and projections to uncover any needed improvements to your financial planning and analysis (FP&A) function. Most importantly, the sooner you begin practicing as a public company, the more time your organization will have to remediate any gaps in your current operations.

BDO Case Study: Consolidating Financials for Insurtech Merger with SPAC

Summary

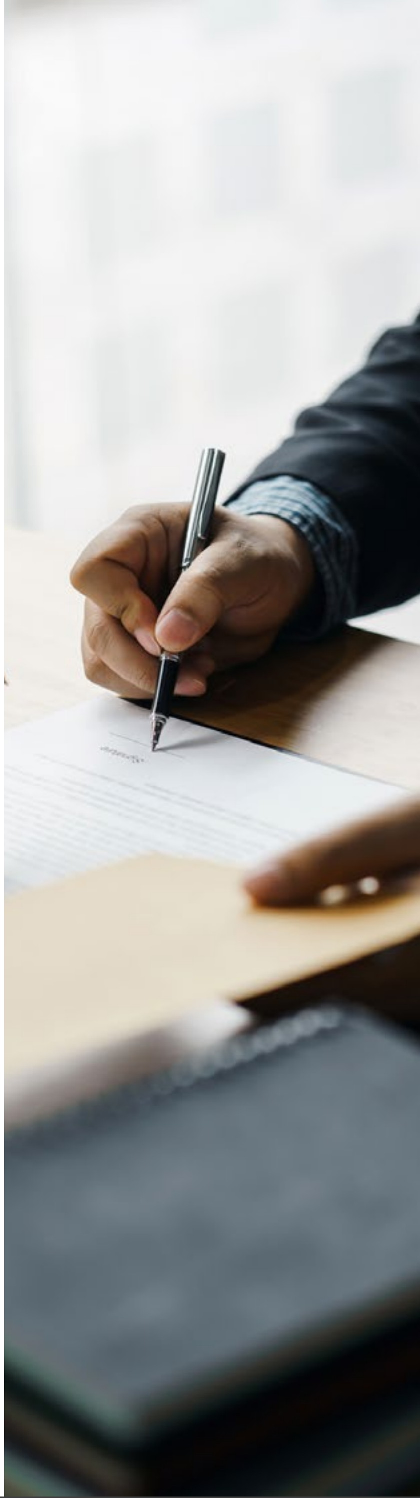
A $20 million insurtech startup was preparing to merge with a SPAC, but had only completed a stub period year-end audit for the prior year. Because the insurtech company was operating as an insurance agency, it did not consolidate its insurance carrier during the stub period, which would have eliminated most of its core revenue and earned agency commission. As a result, the insurtech company and SPAC needed to consolidate their carrier and financial reporting to operate as an insurance carrier post-merger.

Strategy

- Our team provided a technical accounting evaluation and prepared a white paper to guide the consolidation.
- We determined the company's valuation by evaluating debt versus equity accounting for preferred stock, debt modification versus extinguishment, warrants, segments and earnings per share.
- We helped both companies consolidate their core financial statements and disclosures and update them with current data.

Impact

- Our work enabled the insurtech startup and SPAC to successfully file the initial S-4 and requisite amendments, including updated financial statements, MD&A and pro forma and SEC comment letter responses.
- Consolidating the startup agency's insurance carrier enables the organization to operate as an insurance carrier.



The Bottom Line

BDO's IPO Readiness Solution is designed to help you avoid pitfalls throughout the IPO process. The path to going public is challenging and can hold surprises for even an experienced team. Our team will help you understand the process, address your gaps and opportunities, and foster your long-term growth as a public company. From conducting an initial readiness assessment to executing an IPO roadmap and providing public company training and best practices for boards and committees, our multidisciplinary team has the experience and knowledge to help your organization through your public company journey and support your post-IPO needs.

Planning an IPO? Get in touch with a BDO professional today to discuss your readiness and path to becoming public.

CONTACT US TO FIND OUT HOW WE CAN HELP ▶