FIVE REASONS PRIVATE COMPANIES SHOULD ADOPT PUBLIC COMPANY CONTROLS

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Often viewed as a "public company problem," private organizations may want to consider implementation of internal controls similar to Sarbanes-Oxley (SOX) Section 404 requirements. The inherent benefits of a strong control environment may be of significant value to a private company by providing: enhanced accountability throughout the organization, reduced risk of fraud, improved processes and financial reporting, and more effective inclusion of the Board of Directors.

Private organizations, while not always smaller, often have limited resources in specialty areas, including accounting for income tax. This resource constraint—the work being done outside the core accounting team—combined with the complexity of the issues, means private companies are ideal candidates for, and can achieve significant benefit from, internal controls enhancements. Thinking beyond the present, the following are five reasons private companies may want to adopt public-company-level controls:

1. **Future Initial Public Offering (IPO)** - Walk before you run! If the company believes an IPO may be in its future, it's better to "practice" before the company is required to be SOX compliant. A phased approach to implementation can drive important changes in company culture as it prepares to become a public organization. Recently published reports analyzing IPO activity reveal that material weaknesses reported by public companies were disproportionately attributable to recent IPO companies. Making a rapid change to SOX compliance can place a heavy burden on a newly public company.
2. **Private Equity (PE) Buyer** - If the possibility of the company being sold to a PE buyer exists, enhanced financial reporting controls can provide the potential buyer with an added layer of security or comfort regarding the financial position of the company. Further, if the PE firm has an exit strategy that involves an IPO, the requirement for strong internal controls may be on the horizon.
3. **Rapid Growth** - Private companies that are growing rapidly, either organically or through acquisition, are susceptible to errors and fraud. The sophistication of these organizations often outpaces the skills and capacity of their support functions, including accounting, finance, and tax. Standard processes with preventive and detective controls can mitigate the risk that comes with rapid growth.
4. **Assurance for Private Investors and Banks** - Many users other than public shareholders may rely on financial information. The added security and accountability of having controls in place is a benefit to these users, as the enhanced credibility may impact the cost of borrowing for the organization.

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5. **Peer-focused Industries** - While not all industries are peer-focused, some place significant weight on the leading practices of their peers. Further, some industries require enhanced levels of security and control. For example, utility companies, industries with sensitive customer data (financial or medical), and tech companies that handle customer data often look to their peer group for leading practices, including their control environment. When the peer group is a mix of public and private companies, the private company can benefit from keeping pace with the leading practices of their public peers.

Private companies are not immune from the intense scrutiny of numerous stakeholders over accountability and risk. Companies with a clear understanding of the inherent risks that come from negligible accounting practices demonstrate their ability to think beyond the present, and to be better prepared for future growth or change in ownership.

CONTACT

MICHAEL WILLIAMS
Income Tax Provision Services (ASC 740) Partner & National Practice Leader
617-239-4174
mwilliams@bdo.com

DANIEL NEWTON
National Tax Office Partner
617-239-7026
dnewton@bdo.com

KRISTI PINDELL
Tax Partner and Income Tax Accounting Atlantic Regional Leader
704-887-4134
kpindell@bdo.com

ELLIOT BINDER
Tax Office Managing Partner and Income Tax Accounting West Regional Co-Leader
408-352-3524
ebinder@bdo.com

JOHN WOODWARD
Tax Partner and Income Tax Accounting Central Regional Leader
312-856-9100
jwoodward@bdo.com

WILLIAM CONNOLLY
National Tax Office Tax Managing Director
617-239-4127
wconnolly@bdo.com

KENNETH SMITH
Tax Office Managing Partner and Income Tax Accounting Southeast Regional Leader
404-979-7126
ksmith@bdo.com

CHING LUN
Income Tax Accounting Partner and Southwest Regional Leader
713-548-0901
clun@bdo.com

BRIAN KO
Tax Partner and Income Tax Accounting West Regional Co-Leader
310-557-7578
bko@bdo.com

VICKY GREGORCYK
Risk Advisory Services Partner and National Leader
713-407-3955
vgregorcyk@bdo.com