



3

Role of the accountants

Scott Gehsmann, John Coffey, Mike Dillon and Shafiq Ahmed,
PricewaterhouseCoopers LLP

**PricewaterhouseCoopers LLP outlines the important role played by
the accountant in a public offering**

Another important set of professional advisors involved in a public offering are the accountants. These include independent auditors and may also include an additional accounting firm employed to provide financial reporting advisory services.

This chapter outlines the accountants' role in a public offering and the accounting-related requirements of a registration statement. It also addresses ongoing reporting requirements for a public company.

The decision to go public

Why go public?

Going public is a monumental decision for any company as it permanently changes how a company goes about doing business.

A company usually begins to think about going public when the funding required to meet its business expansion goals begins to exceed its ability to raise additional private/venture capital or debt, or when its ability to compete in attracting and retaining qualified employees is adversely affected. However, going public is not always the best move when a company needs to raise capital. The market must also perceive the company as an attractive investment candidate with a capable and committed management team and good market timing.

Pros, cons and expenses of going public

Even if all indicators are positive, selling equity represents a permanent forfeiture of a portion of the returns associated with corporate growth, some loss of privacy and a potential loss of

some control over corporate decisions. Raising equity capital in the public markets also entails incurring substantial costs on an initial and ongoing basis. To make the right decision, a company must carefully consider the pros, cons and expenses associated with going public. Some of the pros and cons of going public are summarized below and should be considered prior to engaging in a transaction.

Pros

These include:

- cash/long-term capital;
- increased share liquidity and market value;
- access to additional equity;
- prestige/reputation;
- ability to offer employee share incentives;
- ability to attract talented employees; and
- stock-facilitated acquisitions.

Cons

These include:

- loss of control;
- loss of privacy;
- pressure regarding short-term performance;
- restrictions on insider sales;
- public company reporting obligations;
- higher ongoing cost of compliance for financial reporting under the Exchange Act and the Sarbanes-Oxley Act;
- scrutiny of regulators and risk of litigation;
- the high cost associated with an initial public offering (IPO); and
- higher ongoing costs of corporate governance and investor relations.

Common financial reporting challenges faced during an IPO process

Common challenges faced include:

- audit of historical financial statements by an independent registered public accounting firm;
- preparing for compliance with Sarbanes-Oxley requirements, including internal controls over financial reporting in accordance with Section 404;
- determining the appropriate enterprise value and related 'cheap stock' issues;
- revenue recognition issues;
- preparation of a five-year summary of selected financial data and management discussion and analysis (MD&A);
- Securities and Exchange Commission (SEC) comment letter process; and
- comfort letter process.

The resolution of these items can be challenging and time consuming, requiring the proactive involvement of management with their accountants and advisors in order to resolve them in a timely and satisfactory manner.

Choosing a stock market

Each stock market has specific entry requirements, which generally concern profit history, shareholders' equity, market capitalization, number of expected shareholders and corporate governance. To help a company choose the right stock market, its banking advisors can furnish in-depth

information on the investor base in each market and its likely appetite for the company's shares. In addition to having a new economy focus, NASDAQ's minimum quantitative entry requirements are generally less stringent than those of the New York Stock Exchange. A company and its advisors should approach the stock market early in the capital-raising process to ensure the smoothest possible transaction.

The accountants' role in a public offering

The independent registered public accounting firm

As strategic and technical advisors, a company's independent auditors will play a key role throughout the registration process. Therefore, at the start of the IPO process a company will need to ensure that it has selected an audit firm that is registered with the Public Company Accounting Oversight Board. Selection of an auditing firm should also be based on:

- its experience with public company financial reporting;
- expertise in generally accepted accounting principles (GAAP) and the auditing standards of the board;
- the firm's reputation and experience with IPOs and other capital markets transactions; and
- the firm's ability to continue to service the company appropriately through its growth and global expansion.

Other factors to consider are the size of the firm's local and global resources and its experience in the company's industry. Some of the specific services the independent auditor will provide include:

- strategic advice in the planning stage of the process to establish a realistic plan to enter the capital markets;
- requisite technical expertise in US GAAP and SEC requirements so it can advise a company on preparing the registration statement and obtaining SEC clearance – guidance on the identification of potentially sensitive or problematic accounting issues (e.g., cheap stock considerations), financial disclosure issues and the overall transparency of financial reporting is particularly important;
- audits of the financial statements – the process of auditing multiple years of financial statements and related disclosure requirements for public offerings can be extensive. An established relationship with an auditor which knows a company's business well, coupled with thorough preparation on the company's part, should enable it to complete the process faster and more effectively, which can be crucial to the success of the offering;
- a comfort letter to assist the underwriter in its due diligence efforts – this letter details certain procedures that the company's external auditor performed at the request of the underwriter, along with other representations the auditor made

concerning the financial statements or other information contained in the prospectus; and

- review of the prospectus and assistance in responding to the SEC comment letter process.

Advisory accountant

The post-Sarbanes-Oxley regulatory environment has raised the bar on the amount of advance preparation and careful planning necessary to complete a successful IPO in the US capital markets. The initial and ongoing Section 404 internal control over financial reporting structure documentation, testing and reporting requirements is substantial. The risks and consequences of failed execution or a breakdown of internal controls or external financial reporting are significant. For these reasons, companies often seek transaction support and advisory services from a second accounting firm that is not restricted by professional and statutory independence standards.

An advisory accountant can offer assistance to organizations with limited experience in IPOs and executing capital markets transactions by providing an independent view of the critical issues involved in accessing a particular capital market. Some of the principal ways in which an advisory accountant can assist a company going through a capital-raising transaction include:

- project management – companies must define the transaction requirements and the roles and responsibilities of management and their advisors at the outset. Failure to do so early can jeopardize control and effective management of the transaction;
- strategic advice in the planning stage of the process to evaluate alternative approaches and establish a realistic plan to enter the capital markets;
- assistance from the advisory accountant regarding the design, documentation and testing of internal controls over financial reporting to ensure compliance with Section 404 of Sarbanes-Oxley;
- issue resolution – the advisory accountant can assist with complex financial reporting and deal execution matters, and can facilitate communication among the key players in the process. Recent regulatory developments have placed more emphasis on the role of the audit, forcing audit teams to focus heavily on assurance and risk management at a time when companies need solutions that support the timely execution of the deal;
- technical advisory – the advisory accountant can and should have extensive experience with complex capital markets transactions; and
- post-transaction services – a knowledgeable advisory accountant can provide advisory assistance with:
 - implementing new financial reporting protocols necessary to meet public

company reporting requirements, along with ongoing technical advice on these requirements;

- corporate governance;
- the adoption of new accounting, reporting and disclosure standards;
- training of accounting and finance staff; and
- ongoing Sarbanes-Oxley Section 404 compliance.

Accounting and reporting requirements of a public offering

Registration statement form

Determining which SEC form to use for registration purposes is a legal decision that a company must make after consulting with its underwriter and legal counsel.

Form S-1 is the basic registration form for a US company IPO. Canadian registration forms are also discussed below.

Preparing the registration statement

The process of preparing and filing a registration statement is complicated, time consuming and technical. Furnishing the requisite information and complying with all applicable SEC rules in an efficient manner demands substantial planning and coordination. The company's management team, lawyers and accountants will expend a great deal of effort to achieve appropriate transparency in reporting historical financial results and to balance both positive and negative factors.

It is during the preparation process that the scheduled timetable for going public can fall asunder, causing a delay in the anticipated filing date. It is therefore imperative that the entire team:

- be thoroughly familiar with the registration statement requirements;
- be cognizant of the deadlines set;
- regularly assess the status of the various sections of the registration statement; and
- ensure that reviews of each section are completed in a timely manner.

The registration statement (Form S-1) consists of two parts. Part I contains the essential facts regarding the company's business operations, financial condition and management which must be included in the prospectus, along with the company's financial statements. Part II presents additional information not required for the prospectus. The prospectus should be a comprehensible narrative document prepared in plain English that tells the story of the company and gives investors a balanced view of why they should invest, along with the associated risks of investing.

The Form S-1 filing

Information required for Form S-1 includes, but is not limited to, the following.

Part I – information required in the prospectus

Prospectus summary: This appears at the beginning of the prospectus and is a short

summary describing the company, its business, the type of securities being offered, the amount of estimated proceeds, the intended use of the proceeds and the complete mailing addresses and telephone numbers of the company's principal executive offices. It may also include certain summary financial information and the company's internet address.

Risks associated with the business and industry:

A company must disclose any factors that make its offering speculative or risky. These may include one or more of the following:

- recent adverse developments or a history of operating losses;
- any need for additional financing;
- dilution to public investors;
- industry trends or seasonal factors that could affect performance;
- presence of significant competition;
- dependence on a few customers, suppliers or key members of management;
- information regarding significant contracts or licenses;
- impact of current or proposed legislation (e.g., communications, healthcare);
- technological change;
- effectiveness of internal control structure; and
- litigation.

Use of proceeds: A company must disclose and discuss the planned use of the proceeds from

the offering. This section of the registration statement should be carefully drafted because the SEC requires disclosure of the actual disposition of the proceeds after the offering is completed. It may be necessary to revise this section of the registration statement on the effective date if the company's plans for using the proceeds change after the initial filing date. Typical uses might include debt reduction, acquisitions, corporation distributions, research and development expenditures and marketing expenses.

Dividend policy and restrictions: A company must disclose its current dividend policy, any anticipated changes to that policy and any restrictions on its ability to pay dividends. For example, many new public companies do not pay dividends, but instead retain earnings to finance operations and expansion. Restrictions might be based on debt, contractual agreements or the regulatory environment in which the company operates.

Capitalization: Although not specifically required, the capital structure of a company, both prior to the offering and after all securities offered are sold, is usually presented in a tabular format.

Dilution: When a disparity exists between the IPO price and the net book value per share of tangible assets, dilution results. The effects of any material dilution to prospective investors must be disclosed; this is usually presented in a dilution table.

Underwriting and distributing securities:

A company must provide information concerning:

- the price of the securities being offered;
- the members of the underwriting syndicate;
- the type of underwriting; and
- any relationship between the company and any of the underwriters.

Information about the company's business: The company must make extensive disclosures about its business, including:

- its business plan, particularly if it has less than three years' operating results;
- a description of its business's properties;
- information relating to foreign operations, if any;
- research and development expenditures;
- regulations affecting the company and its industry;
- pending or threatened legal proceedings; and
- revenues, profits, assets, products and services, product development, major customers, order backlog, inventory, patents, suppliers and the competitive position of each major industry and geographic segment of the company.

Financial information: The SEC has specific and sometimes complex rules regarding the content and age of the financial statements that must be presented in a registration statement, and a company's accountants can be invaluable in helping to

interpret these rules. In a Form S-1 registration statement, a company must generally present the following items:

- audited balance sheets as of the end of the two most recent fiscal years;
- audited statements of income, cash flows and changes in stockholders' equity for each of the past three fiscal years;
- selected financial information (typically summarized from the company's financial statements) for the past five fiscal years;
- separate financial statements of businesses that have been or are probable, as defined, of being acquired and that meet certain significance requirements. Depending on the significance, the company may be required to present one to three years of audited financial statements;
- interim financial statements (also referred to as stub-period financial statements), if the fiscal year-end financial statements are more than 134 days old at the expected effective date of the registration statement. Interim financial statements can be presented in a condensed format and generally are not audited; however, they are required to be reviewed by the independent registered public accountant. Interim financial statements include a balance sheet as of the end of the most recent interim fiscal quarter, statements of income and cash flows for the period between the latest audited balance sheet and interim balance sheet and corresponding period of the preceding year

and changes in stockholders' equity. The latest audited financial statements cannot be more than one year and 45 days old at the date on which the registration statement becomes effective;

- *pro forma* financial information (i.e., financial statements or financial information along with appropriate disclosure of all significant assumptions) prepared as though certain transactions had already occurred. While the need for *pro forma* financial information most frequently occurs with respect to business combinations, the rule also applies to other events, such as the disposition of a significant portion of a business or other events or transactions where the *pro forma* information is material to investors, including situations where:
 - the registrant's financial statements are not indicative of the ongoing entity (e.g., tax or cost-sharing agreements will be eliminated);
 - the registrant has declared dividends after the balance sheet date;
 - redeemable preferred stock or debt converts to common stock at either the effective or closing date of an IPO;
 - other changes in capitalization occur at or prior to the closing date of an IPO; and/or
 - an issuer was formerly a Subchapter S corporation, a partnership or a similar tax-exempt enterprise.

Background and compensation of officers, directors and principal shareholders: Form S-1 requires that a company identify and describe:

- the business experience of its executive officers and directors;
- their compensation (including information on stock options, bonuses, profit-sharing plans and other benefits);
- the security holdings of directors and principal shareholders;
- transactions with and indebtedness of officers, directors and principal shareholders; and
- information regarding transactions with, and compensation paid to, its promoters.

Transparent disclosure of all compensation and financial relationships with management and directors has been a focus of regulators in recent years and is essential to good corporate governance. Recently the SEC made significant changes to its disclosure requirements regarding:

- executive and director compensation;
- related-person transactions;
- director independence and other corporate governance matters; and
- security ownership of officers and directors.

The executive and director compensation disclosures have received particular attention. Accordingly, such SEC disclosure requirements are intended to ensure that investors and other parties receive clear, comprehensive

and transparent disclosures regarding executive and director compensation and related matters. The rules are meant to ensure that companies disclose relevant information so that investors and other parties can readily determine the total amount of compensation that is actually awarded to executive officers.

The key components of the rules and their impact on registrants include:

- expanded disclosure related to named executive officers, automatic inclusion of the principal executive officer (CEO) and principal financial officer (CFO), a new definition of the term ‘named executive officer’ (NEO), and a different method of determining which officers are the three most highly compensated;
- a compensation discussion and analysis section which requires extensive discussion of the methodologies and rationales used, as well as the roles of management and the compensation committee in making underlying compensation decisions;
- a summary compensation table, accompanied by six new supplemental tables, to disclose compensation components relating to salary, bonus, stock awards, option awards, non-equity incentive plan compensation, pensions, non-qualified deferred compensation and all other compensation (including perquisites);
- expanded disclosure related to amounts payable to NEOs upon termination of employment, and separately, upon a

termination of employment following a change in corporate control; and

- enhanced related-person disclosures, including disclosure of the policies for the review, approval or ratification of transactions with related persons.

A key consideration for management when preparing such executive compensation disclosures is the transparency provided to shareholders and the general public with certain types of compensation information and decisions.

In addition, the specific requirements on preparation of such disclosures will require companies to broaden their level of involvement beyond the company's human resources and legal departments and accordingly involve their accountants, tax professionals and actuaries in the disclosure drafting process.

MD&A: In this section, management provides its assessment of the company's financial condition, operating results, liquidity and capital resources, with particular emphasis on the company's prospects for the future. The SEC continues to focus on MD&A when reviewing registration statements and this inevitably results in comments (particularly the lack of forward-looking information required in each of the major sections of the MD&A). It is therefore imperative that this section be carefully drafted. The goal in drafting the MD&A is

to prepare a narrative that is clear, comprehensible and complete, and written from the point of view of management. Best practice MD&A reporting includes:

- contextual information that enables a more complete understanding of current and prospective financial results;
- expanded information on both financial and non-financial performance;
- forward-looking information for assessing prospective performance; and
- information on key performance indicators that companies use to manage their business (with appropriate non-GAAP disclosures).

Required MD&A disclosures include the following:

- Operating results – a comparison of the income statement amounts for each period presented and the reasons behind any material changes. The MD&A should also discuss reasons for any recent positive or negative trends, as well as the quality of the company's earnings. Any known trends or uncertainties that have had or are expected to have a material impact on the company should also be analyzed. Changes in significant balance-sheet items must be discussed. The objective of this section is to analyze and explain results qualitatively, not simply to present quantitative changes in financial statement line items. The discussion should focus on relevant reportable segments or other

subdivisions of the business that have materially impacted results.

- Liquidity – a list of any known trends, demands, commitments, events or uncertainties that either will or are reasonably certain to result in a material increase or decrease in the company's liquidity. Any course of action that the company has taken or proposes to take to remedy any deficiencies should be indicated. In addition, the internal and external sources of liquidity should be described and any material unused sources of liquid assets should be briefly discussed. This section should include a thorough analysis of operating, investing and financing cash flows.
- Capital resources – a description of the registrant's material commitments for capital expenditures, the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments should be included in the MD&A. Further, any known material trends, favorable or unfavorable, in the company's capital resources should be disclosed.
- Off-balance sheet arrangements, aggregate contractual obligations, and other matters – among other things, this section should explain off-balance sheet transactions and arrangements, including the company's relationships with unconsolidated entities or other persons that have or are reasonably likely to have a current or future material

effect on the company's financial condition, changes in its financial condition, revenues or expenses, results of operations, liquidity or capital resources.

- Critical accounting policies and estimates – this section should provide greater insight into the quality and variability of the company's financial condition and operating performance resulting from key accounting policies, assumptions and estimates. It should supplement, not duplicate, the description of significant accounting policies in the notes to the financial statements and include quantitative and qualitative disclosures, a sensitivity analysis and critical estimates by segment if necessary.
- Specific industry information – the SEC staff requires specific industry disclosures in the MD&A for oil and gas, mining, banking, insurance and real estate companies. Such disclosures include the discussion of oil reserves for oil and gas companies and loss development tables for certain insurance companies. To provide a more complete understanding of the business, companies must also present the above information on the basis of multiple segments, as defined by the accounting rules.
- Other disclosures – other disclosures that are required in a registration statement include (but are not limited to):
 - principal and selling stockholders;
 - description of capital stock;
 - shares eligible for future sale;
 - legal proceedings, if any;

- interests of named experts and counsel; and
- certain relationships and related transactions.

Part II - information not required in the prospectus

This part includes:

- disclosures regarding the expenses associated with the issuance and distribution of the securities;
- indemnification of directors and officers acting for the company;
- any sales of unregistered securities within the last three years;
- a company's representations acknowledging that it will keep the registration statement and prospectus current;
- various exhibits (e.g., certain material contracts involving the company, articles of incorporation and bylaws, underwriting agreements); and
- various required financial statement schedules.

Sources of SEC technical requirements

The following SEC rules, regulations and interpretations specify the form and content of registration statements, including the requirements for most financial statements and other financial information to be included:

- Regulation S-X – this is the SEC's principal accounting regulation, which specifies the financial statements to include in SEC filings

and provides rules and guidance on their form and content.

- Regulation S-K – this regulation contains SEC disclosure requirements for the non-financial statement portion of filings (including the industry guides) and non-GAAP financial and performance measures, otherwise referred to as the ‘forepart’ of the document.
- Financial reporting releases – these are designed to communicate the SEC’s positions on accounting and auditing principles and practices. They are used to adopt, amend or interpret rules and regulations relating to accounting and auditing issues or financial statement disclosures.
- Staff accounting bulletins – the interpretations and practices that the SEC follows are generally required to be followed by registrants, even though the SEC commissioners have not formally approved them.
- Regulation S-T – this governs the preparation and submission of documents filed via the SEC’s Electronic Data Gathering, Analysis and Retrieval (EDGAR) system.
- Regulation G – this regulation governs the disclosure of certain financial information that is calculated and presented on the basis of methodologies other than in accordance with GAAP. The regulation requires public companies that disclose or release non-GAAP financial measures to include, with that disclosure or release, a statement

disclosing the reasons why management believes that presentation of the non-GAAP financial measure provides useful information to investors and a presentation of the most directly comparable GAAP financial measure and a reconciliation of the disclosed non-GAAP financial measure to the most directly comparable GAAP financial measure.

Registration and reporting requirements for certain Canadian issuers

Canadian companies looking to make a US public offering may be subject to different requirements than US domiciled entities. Canadian incorporated companies that qualify as ‘foreign private issuers’ under SEC rules are entitled to use the Securities Act of 1933 registration statement forms and Securities Exchange Act of 1934 reporting forms for foreign private issuers. Foreign private issuers are allowed to file their annual reports on Form 20-F and do not have quarterly SEC filing requirements. In general, any material information that the company provides or is required to provide locally or to a stock market, including any interim financial information, is required to be furnished to the SEC on Form 6-K. Registration statements filed by Canadian foreign private issuers under the Securities Act generally contain the same content as those filed by a US domestic entity; however, the forms are F forms as opposed to the domestic equivalent of S forms.

In addition, a Canadian foreign private issuer may qualify to use the multi-jurisdictional disclosure system, which reduces the efforts required of eligible Canadian issuers by allowing them to use documents prepared largely in accordance with Canadian regulations. The main differences between the multi-jurisdictional disclosure system and the non-multi-jurisdictional disclosure system filing processes are as follows:

- Required financial statements – the financial statements included in the multi-jurisdictional disclosure system forms are based on the requirements in Canada. Financial statements of significant acquired businesses and equity investees that would be required by SEC rules for non-multi-jurisdictional disclosure system filers are not applicable. However, if financial statements of such businesses or investees are required to be included in the document in Canada, they are included in the filing on the multi-jurisdictional disclosure system form.
- Certain non-financial information, such as industry guide data and market risk disclosures, is not applicable to multi-jurisdictional disclosure system filings; whereas US domiciled companies and non-multi-jurisdictional disclosure system foreign private issuers are subject to all such regulations.

Canadian companies filing on multi-jurisdictional disclosure system forms may have their financial statements audited only in

accordance with Canadian generally accepted auditing standards. However, when a Canadian company is also required to include in the multi-jurisdictional disclosure system filing an auditor's attestation report on internal control over financial reporting in accordance with Section 404 of Sarbanes-Oxley, and such audit of internal control over financial reporting is performed in connection with the audit of the financial statements of the Canadian company filing on multi-jurisdictional disclosure system forms, both audits must be performed in accordance with the standards established by the Public Company Accounting Oversight Board, with such indication being made in the auditor's report. Auditor independence in accordance with SEC rules must be maintained with respect to Canadian companies filing on MJDS forms, except that the rules do not apply to periods prior to the most recent fiscal year for which financial statements are included in the initial registration statement under the 1933 Act or Form 40-F under the Exchange Act.

The Securities Act allows a multi-jurisdictional disclosure system company to use five different multi-jurisdictional disclosure system forms when registering securities under the system. A company's legal advisor should select the appropriate form.

Reconciliation to US GAAP not required: The Securities Act provides the following forms for Canadian issuers filing under the multi-jurisdictional disclosure system: F-7, F-8, F-9 and F-80. Certain requirements have to be met

in order to qualify to use these various forms. For example, not every exchange offer or business combination would qualify to use either Form F-8 or Form F-80. The company should consult its legal counsel with regard to such matters. Registering securities using these forms requires no extra effort because they are similar to the relevant Canadian disclosure document and a reconciliation of Canadian GAAP to US GAAP is not required. The general purpose of each form is as follows:

- Form F-7 – rights offerings;
- Form F-8 – certain securities issued in an exchange offer or a business combination;
- Form F-9 – investment-grade debt and preferred stock which are non-convertible or are convertible only after one year from the date of issuance; and
- Form F-80 – certain securities issued in an exchange offer or a business combination.

Reconciliation to US GAAP required: Multi-jurisdictional disclosure system filers seeking to register security offerings that do not qualify to use any of the system forms above may use Form F-10. Like the other system forms, F-10 is a wraparound for the relevant Canadian disclosure document. However, Form F-10 requires that all financial statements included in the Canadian disclosure document be reconciled to US GAAP. This reconciliation must discuss and quantify all the differences between Canadian GAAP and US GAAP, and provide all disclosures required under US

GAAP and SEC regulations that are not included in the Canadian financial statements. Quantifying these differences can be difficult depending on the industry and it is important that a company involves its advisory accountants and auditors at an early stage.

Performing due diligence procedures

Throughout the registration statement preparation process, the entire IPO team will perform the necessary procedures to provide a reasonable ground for belief that, as of the effective date, the registration statement contains no significant untrue or misleading information and no material information has been omitted. These procedures are referred to as due diligence and are performed primarily in response to the Securities Act, which will hold all parties participating in the registration liable for any material misstatements or omissions in the registration statement. (Due diligence serves as the primary defense in any actions brought against the parties, other than the issuer, under the Securities Act.)

Due diligence procedures entail reviews by the company's attorneys and underwriters and its management including, but not limited to:

- visiting facility sites and reviewing significant agreements and contracts;
- financial statements, tax returns and board of directors' and shareholders' meeting minutes; and
- performing various analyses of the company and the industry in which it operates.

A company's attorneys and the attorneys for the underwriters will also typically distribute questionnaires to the directors and officers of the company requesting them to review, verify and comment on the information contained in the draft registration statement. In addition, the directors and officers may be interviewed by the attorneys.

Furthermore, 'keeping current' procedures are performed by the independent auditors to ascertain whether anything has occurred up to the effective date of the registration statement with respect to the company's financial position or operations that would have a material effect on the audited financial statements included in the registration statement. Due diligence also encompasses the reading of the entire registration statement by all parties involved in its preparation to ensure that there exist no material misstatements, omissions or inconsistencies.

In addition, as part of the due diligence procedures, the underwriters request comfort letters from the company's independent auditors with respect to information that appears in its registration statement outside the financial statements and on events subsequent to the date of the accountants' report.

In general, the more information the underwriters seek comfort on, the more expensive the process becomes. In light of this, and to avoid any misunderstandings and undue time delays, a company, its auditors, the underwriters and the attorney for the

underwriters should agree during the early stages of the registration process (ideally before the initial Form S-1 registration statement is filed) on the information on which the auditors will be providing comfort.

Generally, two comfort letters are issued to the underwriters: one at the time that the underwriting agreement is signed (generally the pricing date) and an updated letter on the closing date (often called a 'bring-down' letter). After the registration statement is filed, but before it becomes effective, the principal underwriter holds a due diligence meeting. The due diligence meeting is attended by the principal underwriter and often by members of the underwriting group, as well as by the company's principal officers and its counsel, in addition to counsel for the underwriter. At this meeting, the members of the underwriting group are afforded the opportunity to exercise due diligence as to the proposed offering and may ask any questions concerning the company and its business, products, competitive position, recent developments in finance, marketing, operations and other areas and future prospects.

SEC comment letter process

Filing and SEC review: Upon completion of the draft registration statement, it is sent to the printer. This draft should be somewhat final, so as to avoid unnecessary reprinting/amending costs at the printing stage. However, it is common for several lengthy drafting sessions to occur during the printing stage. When the

registration statement has been completed the document, including exhibits, is filed with the SEC by electronic transmission through EDGAR. The registration statement must contain appropriate signatures in typed form; each signatory must manually sign a signature page acknowledging inclusion of his or her typed signature in the electronic filing. This signature page must be retained by the company for a period of five years.

Once filed with the SEC, registration statements become public information and are processed and reviewed by the staff of the Division of Corporation Finance, generally consisting of an attorney, an accountant and/or a financial analyst. The group may also consult with other staff members familiar with a particular industry (e.g., mining or petroleum engineers). The SEC reviews the documents to determine whether there is full and fair disclosure, particularly to determine whether the document contains misstatements or omissions of material facts. However, review by the SEC staff cannot be relied upon to ensure the accuracy or completeness of the data.

The review of financial data is performed by a staff accountant who reads the entire prospectus and the remainder of the registration statement to become familiar with the company and its business. The staff accountant may also refer to published annual and interim reports, newspaper articles, the company's website and other internet resources for information regarding the

company and its industry. This review is primarily directed at the financial statements, other financial data and the independent registered public accountant's report. Its purpose is to determine whether the data complies with SEC regulations and all applicable authoritative accounting literature, as well as with various SEC staff interpretations and policies dealing with accounting and auditing issues.

Although securities law contemplates a review of registration statements filed with the SEC, it does not prescribe the specific review procedures. The SEC has developed and adopted review procedures that provide for issuance of comments to registrants (and permit necessary registration statement revisions to be made) without formal proceedings. The informal comment technique has proved to be an effective method of communicating and resolving questions and defects before permitting a registration statement to become effective.

Maintaining open communication with the SEC serves to expedite the registration process. To save time, company counsel generally maintains close telephone contact with the SEC while the registration statement is being reviewed.

Registration statements should be complete at the time the document is filed. At times, the SEC has received incomplete registration statements in an attempt to 'get in line' for the review process. In general, it will

not review incomplete registration statements. If a registrant believes there are extenuating circumstances and the SEC should review an incomplete filing, the matter should be approved by the SEC prior to submission.

Responding to the SEC letter of comment and preparing the amended registration statement:

After review of the registration statement, the staff typically issues a letter that sets forth questions, possible deficiencies and suggested revisions. The letter, referred to as a comment letter, is generally mailed or faxed to the company's legal counsel.

Submission of a carefully prepared registration statement usually limits SEC comment. While differences of opinion sometimes exist as to the propriety of a particular comment or request, most of the comments and suggestions made by the SEC prove to be constructive.

Each comment in the SEC's letter of comment must be addressed and resolved in writing before the registration statement can become effective. If revisions are necessary, they are made in an amended registration statement which is also filed via EDGAR. The independent auditor is required to perform keeping-current procedures in connection with each amendment in order to issue its consent for the inclusion of its audit report in the amended registration statement. As part of the SEC's intent to expand the transparency of the comment process and to disseminate this information

to a broader audience, upon satisfactory completion and effectiveness of the registration statement all SEC comment letters and related company responses are made publicly available by the SEC via EDGAR. A company should consult with its legal counsel when requesting that certain information not be made public because it is deemed to be proprietary in nature and may competitively harm the company.

In addition, significant developments often occur during the period subsequent to filing of the initial registration statement and prior to final SEC approval, and these must be reported. For example, if a development is materially adverse it would obviously affect the offering's attractiveness. Conversely, a positive development, such as the favorable settlement of a major pending lawsuit, might remove any uncertainty about a company and its future. In other words, any interim developments that materially affect a company and its prospects must be disclosed via amendments to the initial registration statement.

It generally takes approximately 30 calendar days from the time the registration statement is filed with the SEC for it to complete its initial review and furnish comments.

In addition to filing the registration statement with the SEC, filings must be made in the states in which the company intends to offer the securities, as well as with the National Association of Securities Dealers.

Life as a public company

It is generally recommended that a company should begin acting like a public company as early as two years before the IPO. This means getting comfortable with the rhythm of quarterly and annual reporting requirements, their content and costs, including quarterly certification requirements; and preparing for the demands of complying with Section 404 of Sarbanes-Oxley. It also means actively managing the company's reputation through regular communication with analysts, investors and the financial media to ensure that its story is accurately reported.

The public's perception of a company has a direct effect on the value of its stock. Do not underestimate it.

Under the Exchange Act and Sarbanes-Oxley, the SEC requires public companies to file certain periodic reports such as Form 10-K and Form 10-Q, which keep the investing public informed. This requirement will continue as long as investor and asset tests are met. In fact, the company should have discussed its obligations under the various regulations with its attorneys and accountants, even before beginning the going-public process, to be certain that these obligations can be met. A company should consult its legal counsel to confirm SEC requirements concerning the form, content and timing of specific reports. A financial public relations firm can assist with furnishing the company's annual reports to its shareholders. Table 1

Table 1 SEC reporting requirements for public companies based on their designated accelerated filer status

Form	Description	Due date based on designation
Form 10-K	This is the annual report to stockholders (conforming to SEC specifications), and it discloses, in detail, information about the company's activities, risks, financial condition and results of operations. It also contains the company's audited annual financial statements which includes the external auditor's opinion on financial statements and Section 404 of Sarbanes-Oxley	Large accelerated filer - 60 days after fiscal year end Accelerated filer - 75 days after fiscal year end Non-accelerated filer - 90 days after fiscal year end Newly public company - 90 days after fiscal year end
Form 10-Q	This is the quarterly report required for each of the first three quarters of the fiscal year. It includes condensed financial data and information on significant events. In addition, SEC rules require that the interim financial information included in the quarterly report be subject to a review by an independent accountant prior to filing	Large accelerated filer - 40 days after fiscal quarter end Accelerated filer - 40 days after fiscal quarter end Non-accelerated filer - 45 days after fiscal quarter end Newly public company - 45 days after fiscal quarter end
Form 8-K	This is a report filed for significant events such as an acquisition or disposal of assets; a change in control; bankruptcy; a change in independent accountants; resignation of directors because of disagreement with the registrant; the entry into a material definitive agreement; creation of direct obligations or obligations under off-balance sheet arrangements; a commitment to a plan involving exit or disposal activities; and asset impairments. A new Form 8-K reporting requirement was added in 2004 to be used when a company concludes or is advised by its independent accountants that previously issued financial statements should no longer be relied on	Due within four days of event
Proxy or information	This contains data furnished to shareholders so they can decide how to assign their statements proxies (votes)	Due dates vary

Table 2

Compliance dates

US domestic issuers	Management reporting	Auditor reporting*
Large accelerated filer	Already effective	Already effective
Accelerated filer	Already effective	Already effective
Non-accelerated filer	Years ending on or after December 15 2007	Years ending on or after December 15 2008
Canadian issuers	Management reporting	Auditor reporting*
Large accelerated filer	Already effective	Already effective
Accelerated filer	Already effective	Years ending on or after July 15 2007
Non-accelerated filer	Years ending on or after December 15 2007	Years ending on or after December 15 2008
Newly public company**	Management reporting	Auditor reporting*
Second annual report	Second annual report	

* At the time of writing the SEC was considering an amendment to defer the requirement to provide an auditor attestation report on internal control over financial reporting for non-accelerated filers until annual reports covering fiscal years ending on or after December 15 2009. Companies should consult their accountant or attorney regarding the outcome of this proposed deferral.

**A voluntary filer or debt-only issuer that completes an equity IPO is not considered a newly public company for purposes of evaluating Section 404 transition.

includes an overview of the basic SEC reporting requirements for public companies based on their designated filer status.

SEC-designated filer status

The SEC designates companies into three categories of filers in order to determine the companies' filing deadlines for Forms 10-K and 10-Q, as identified in Table 1.

In addition, effective February 2008 the SEC added a 'smaller reporting company' filer option. The distinction among the different categories is based on the non-affiliated market capitalization (also known as 'public float') of companies as of the last business day of the company's most recently completed second fiscal quarter, as follows.

Large accelerated filer

This is a company with non-affiliates holding a common public equity float valued at \$700 million or more as of the last business day of the company's most recently completed second fiscal quarter.

Accelerated filer

This is a company with non-affiliates holding a common public equity float valued at \$75 million or more, but less than \$700 million, as of the last business day of the company's most recently completed second fiscal quarter.

In addition to the market capitalization requirements, in order to be designated as a large accelerated filer or an accelerated filer a company needs to meet the following conditions as of the end of its fiscal year:

- The company has been subject to SEC reporting requirements (specifically Section 13(a) or 15(d) of the Exchange Act) for a period of at least 12 calendar months;
- The company has previously filed at least one annual report pursuant to Sections 13(a) and 15(d); and
- The company is not eligible to use the requirements for smaller reporting companies for its annual and quarterly reports.

Non-accelerated filer

Companies that are neither large accelerated filers nor accelerated filers are considered non-accelerated filers.

Accelerated filer status must be considered at each year-end to determine

Table 3
SEC reporting requirements for certain Canadian issuers

Form	Description	Due date
Form 20-F	This is an annual report of a foreign private issuer. It includes the issuer's audited financial statements, generally for the latest three fiscal years, reconciled to US GAAP. Significant other information about the company's activities, including MD&A, is required	Within six months of the end of the fiscal year covered in the report
Form 40-F	This is the annual report to stockholders for a Canadian company that qualifies as a foreign private issuer and is a multi-jurisdictional disclosure system filer. The report includes the issuer's annual information form and audited annual financial statements with accompanying MD&A, all prepared in accordance with Canadian requirements. A reconciliation to US GAAP is required in connection with any Form 40-F filed, unless the obligation to file arises because of registration on Form F-7, F-8, F-9 or F-80, or the Form 40-F is filed with respect to securities that could have been registered under the Securities Act on Form F-9. In such cases, no reconciliation is required	Same day as information is made public in Canada. If information comprising the Form 40-F is publicly filed in different parts on different dates, companies should seek legal counsel advice as to the approach to filing Form 40-F
Form 6-K	This is used for information furnished to the SEC that the issuer makes or is required to make public in its home jurisdiction, files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange, or distributes or is required to be distributed to its security holders	Promptly after information is made public by the issuer, filed with the stock market or distributed to the company's shareholders

This designation will allow such companies to qualify for the disclosure requirements that are scaled to reflect the characteristics and needs of smaller companies and their investors. In most cases the revised rules did not change the substance of the disclosure requirements applicable to smaller reporting companies. Rather, the requirements were reorganized through the elimination of Regulation S-B, which relocated the scaled disclosure requirements into Regulation S-X (financial statement requirements) and Regulation S-K (non-financial statement disclosure requirements) to make it easier and less costly for smaller reporting companies to comply with the scaled disclosure requirements. The new rules became effective in February 2008.

The SEC has leveraged the accelerated filer status to determine the transition requirements relating to internal control over financial reporting under Section 404 of Sarbanes-Oxley. The transition requirements are summarized in Table 2.

Canadian reporting requirements

Table 3 presents an overview of the basic SEC reporting requirements for Canadian issuers that qualify as foreign private issuers or multi-jurisdictional disclosure system filers.

Sarbanes-Oxley

Enacted on July 30 2002 in response to several major corporate accounting scandals, Sarbanes-Oxley significantly reformed securities laws in the United States and

whether the designated filer status has changed.

Smaller reporting company

In 2007 the SEC made substantial changes to its registration and reporting system for smaller reporting companies in order to streamline and simplify the disclosure requirements. Under

the new rules, companies qualify as 'smaller reporting companies' if they:

- have a common equity float of less than \$75 million;
- are unable to calculate their public float; and
- have annual revenues of \$50 million or less, upon entering the system.

prescribed fundamental changes in how audit committees, management and auditors interact and carry out their responsibilities.

Sarbanes-Oxley has had a profound impact on public companies, affecting financial reporting in two important ways. Sections 302 and 906 require that the chief executive officer and the chief financial officer of a public company certify the company's financial statements. Section 404 requires the management of a public company to test internally and issue a report on its assessment of the effectiveness of internal control over financial reporting. The company's external auditor must then independently test and issue an opinion on both management's assessment and the company's effectiveness of internal controls, in addition to the opinion on the fair presentation of the financial statements.

Certification by management under Section 302

Section 302 requires the chief executive officer and the chief financial officer of a public entity to certify that, based on his or her knowledge:

- the annual and quarterly reports contain no untrue statement of a material fact or omit any material fact which would make the statements in the annual or quarterly reports misleading in light of the circumstances under which they were made;
- the financial statements and other financial information included in the report fairly present, in all material respects, the financial

condition and operating results of the issuer as of and for the periods presented in the report; and

- the chief executive officer and the chief financial officer are responsible for designing and maintaining disclosure controls and procedures and internal control over financial reporting, and disclosing any changes or deficiencies in those controls to the auditors and the audit committee of the board of directors.

The certification under Section 302 is filed as an exhibit (generally Exhibits 31.1 and 31.2) to the annual or quarterly report to which it relates.

Certification under Section 906

Section 906 mandates that any annual or quarterly public company report that contains financial statements filed with the SEC be accompanied by a written statement by the issuer's chief executive officer and chief financial officer (or the equivalent thereof), certifying that:

- the report fully complies with the related requirements of the Exchange Act; and
- the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

Section 906 expressly creates new criminal penalties for a knowingly or willfully false certification.

Section 906 certifications are to be filed as an exhibit (generally Exhibits 32.1 and 32.2) to the report to which they relate.

Reporting under Section 404

Section 404 - management assessment of internal controls - may be the most challenging aspect of Sarbanes-Oxley and requires most publicly registered companies and their external auditors to report on the effectiveness of the company's internal control over financial reporting. A company's internal control report must contain the following information and be included in its annual report on Form 10-K:

- a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company;
- management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year;
- a statement identifying the framework management used to evaluate the effectiveness of the company's internal control over financial reporting (e.g., the internal control integrated framework issued by the committee of sponsoring organizations); and
- a statement that the independent registered public accounting firm that audited the company's financial statements included in the annual report has issued an attestation report on the effectiveness of the company's internal control over financial reporting.

The process of documenting, management testing and auditing a company's internal control is time consuming and detailed. Appropriate planning prior to a company's registration with the SEC is a key to success. A company's external auditors are a good source of information regarding the Section 404 requirements.

In 2007 the Public Company Accounting Oversight Board issued and the SEC approved Auditing Standard 5 - an audit of internal control over financial reporting that is integrated with an audit of financial statements, which replaces previous guidance issued under Auditing Standard 2. The new guidance is designed to be a principles-based standard and sets forth an approach by which management and the auditors can conduct a

top-down, risk-based evaluation of internal control over financial reporting. Auditing Standard 5 is intended to simplify the requirements and make them easier to apply, while retaining core principles necessary for an effective audit of internal control. Although such guidance provides for flexibility to tailor the process to an individual company's facts and circumstances, the overall process is still detailed and time consuming and requires considerable effort by management, their auditors and advisory accountants.

Conclusion

Like any other major strategic undertaking, taking a company public requires careful planning to ensure success. This process requires careful thought around two main

facets of becoming public and operating as a public company. First, the company must prepare its management team and business units to begin acting and functioning as a public company, both internally and externally, in advance of entering the capital markets. Second, it must identify the key advisors on the going-public team, from the experts it will hire to the staff members who will help to prepare the registration statement. The accountants play an important role in assisting in the navigation of the complex lifecycle of the capital market transaction from the identification of an entry strategy, assisting with the public registration process and through continuous support in dealing with the complexities of ongoing public company financial reporting obligations.

how to manage the challenge of going public without taking your eye off the business.*

As you deal with the challenges of managing your business during the IPO process, we can help you avoid unanticipated delays that may erode confidence in management and damage your company's reputation.

PricewaterhouseCoopers' Transaction Services Capital Markets practice brings deep knowledge of the financial reporting requirements relevant to companies seeking to raise capital in US public markets. We can help you anticipate and resolve the kinds of technical accounting and SEC registration process issues that could derail your offering or cause you to incur costly delays. For more information, contact:

Scott Gehsmann
646.471.8310
scott.j.gehsmann@us.pwc.com

Mike Dillon
415.498.8234
mike.dillon@us.pwc.com

John Coffey
617.530.6171
john.j.coffey@us.pwc.com

*connectedthinking

PRICEWATERHOUSECOOPERS 