

# Trends in US IPO registration statements

November 2018

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow chevron shape is positioned above the 'Y'.

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# IPOs strong in US in the first nine months of 2018

Initial public offering (IPO) activity in the US during the first nine months of 2018 was robust with companies completing 166 IPOs and raising \$44.4 billion.<sup>1</sup> That compares with 179 IPOs that raised \$40.4 billion in all of 2017.

Securities and Exchange Commission (SEC or Commission) Chairman Jay Clayton has made capital formation and increasing the attractiveness of US public capital markets a priority.

“For smaller companies to flourish after an IPO,” Mr. Clayton recently noted, “we need to continue to recognize that a one-size regulatory structure for public companies does not fit all.”

Most companies that have gone public since the Jumpstart Our Business Startups Act (JOBS Act)<sup>2</sup> created the category of an emerging growth company (EGC) in 2012 have been EGCs. And most of those EGCs have used most of the Act’s accommodations, which include filing confidentially and providing reduced executive compensation disclosures and only two years of audited financial statements instead of three. EGCs continued to dominate the IPO market in 2018, accounting for 94% of IPOs in the first nine months of the year.

In June 2018, the SEC changed the definition of a smaller reporting company (SRC) to allow more companies to qualify for significant disclosure relief. The new threshold for an IPO registrant to be an SRC is an estimated public float of less than \$250 million, or annual revenue of less than \$100 million and an estimated public float of less than \$700 million. These companies can provide scaled disclosures in their IPO registration statements that go beyond the relief generally available to EGCs.

More than 40 non-EGCs have submitted IPO registration statements for nonpublic review between July 2017, when the SEC began offering this accommodation to all companies, and August 2018, according to Mr. Clayton.

The SEC staff also now allows non-EGCs to omit certain financial information from their IPO registration statements, which has allowed them to avoid the time and expense of preparing and filing interim financial information that will not be needed when the filing becomes publicly available.

Chairman Clayton also has reminded companies that they may request waivers from certain financial reporting requirements under Rule 3-13 of Regulation S-X. Such waivers permit companies to omit certain financial statements or provide alternative information that may be of comparable benefit to investors.

‘Over the last year, the SEC has taken meaningful steps to reduce regulatory burdens on pre-IPO and smaller public companies, while maintaining and, in some cases, enhancing, investor protections. The importance of this focus is highlighted by the significant decline in public companies over the last two decades, particularly amongst emerging companies.’

Chairman Jay Clayton

<sup>1</sup> The term IPO activity refers to IPOs of companies listed on US exchanges. It includes IPOs by foreign companies that list shares on US exchanges but excludes IPOs of special purpose acquisition companies and business development companies.

<sup>2</sup> The JOBS Act is available at [gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf](http://gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf).

# Overview of the US IPO market

The US stock markets hit new records in the first nine months of 2018, prompting more companies to move forward with plans to go public.

Companies conducted 53, or 48%, more IPOs in the first nine months in 2018 than in the same period in 2017, and they raised more than twice as much capital.

AXA Equitable Holdings Inc. was the largest IPO through 30 September 2018, raising \$3.2 billion. It was also the second-largest IPO since 2014, when Alibaba Group Holding Ltd raised \$25 billion.

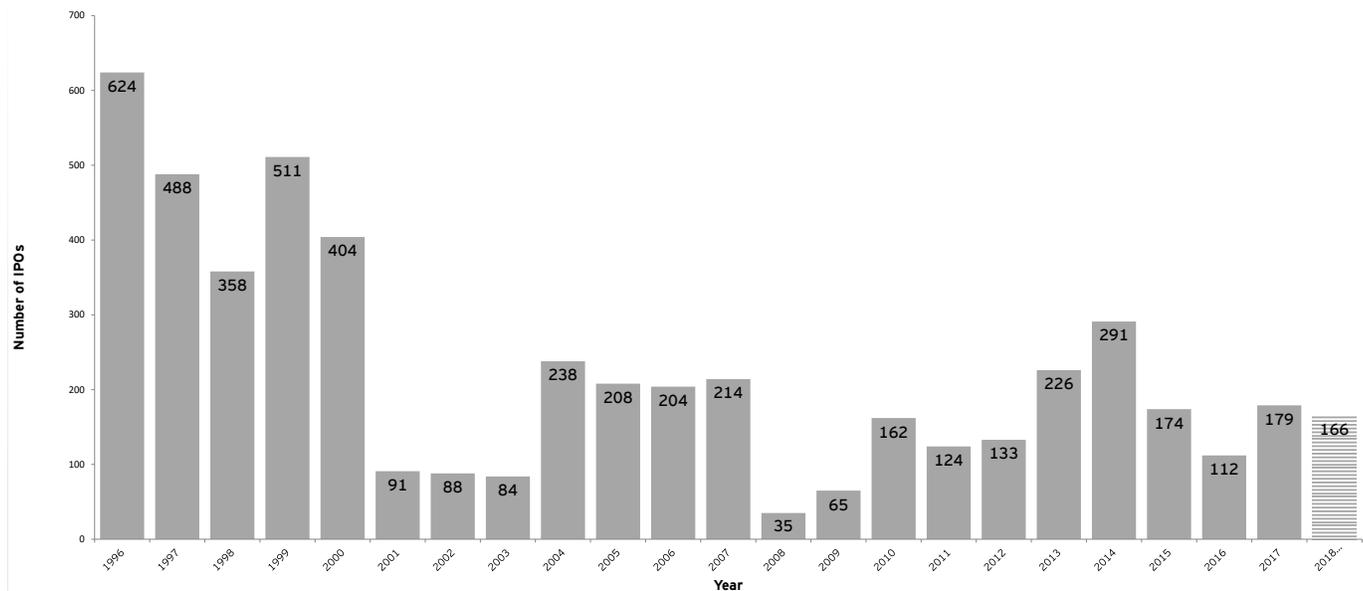
While 2018 will be a more active year for IPOs in US markets than 2017, the IPO market remains below its nearly two-decade peak in 2014.

According to an EY analysis,<sup>3</sup> the long-term decline in US IPOs can largely be attributed to significant changes in the public and private capital markets over the past two decades. For example, private companies today have more access to capital and can grow larger and stay private longer than they could in the past. Companies that have conducted public offerings in recent years have tended to be more mature and have more solid business prospects than the companies that went public in the mid-1990s.

The SEC's Division of Economic and Risk Analysis noted in a report<sup>4</sup> to Congress that companies raised \$2.58 trillion more capital through US private markets than they did through registered offerings in the US from 2010 through 2016.

The number of IPOs backed by financial sponsors such as private equity (PE) firms or venture capital (VC) funds has declined in recent years. Financial sponsor-backed IPOs represented 29% of all IPOs in the first nine months of 2018, the lowest percentage in the last five years.

Number of effective IPOs by year (1996-2018\*)



\* Based on nine-month information for 2018.

<sup>3</sup> Looking behind the declining number of public companies – An analysis of trends in US capital markets (EYG No. 01934-171Gb).

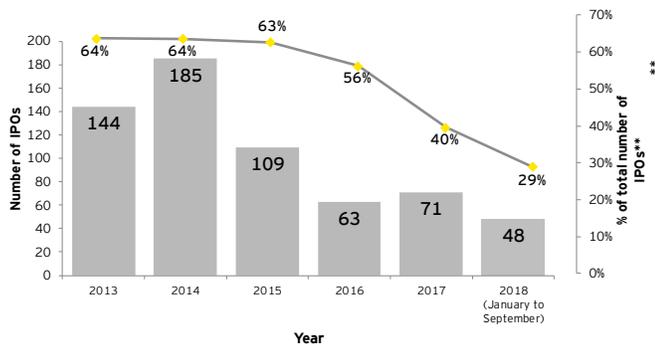
<sup>4</sup> The SEC's Division of Economic and Risk Analysis, Report to Congress – Access to capital and market liquidity.

In the 2018 period, financial sponsor-backed IPOs accounted for approximately 38% of total capital raised in the public market, down from 72% over the previous five years.

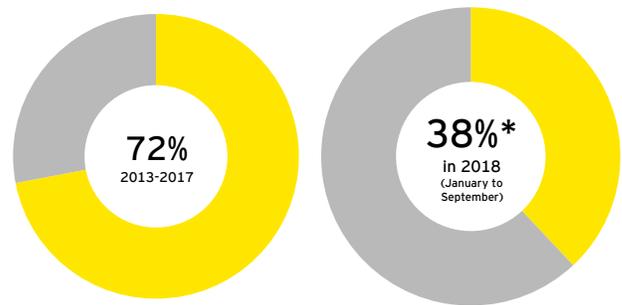
Due to a prolonged period of low interest rates in the US, institutional investors (e.g., mutual funds, hedge funds, corporate venture capital funds, PE firms) in search of higher returns have assumed more risk and have invested in emerging private companies.

This trend has significantly increased the private capital available to emerging private companies, allowing them to stay private longer. The impact of the current interest rate environment on private capital investment is unclear.

### Financial sponsor-backed IPO activity (2013-2018\*)



### Percentage of capital raised in IPOs backed by financial sponsors



\* Based on nine-month information for 2018.

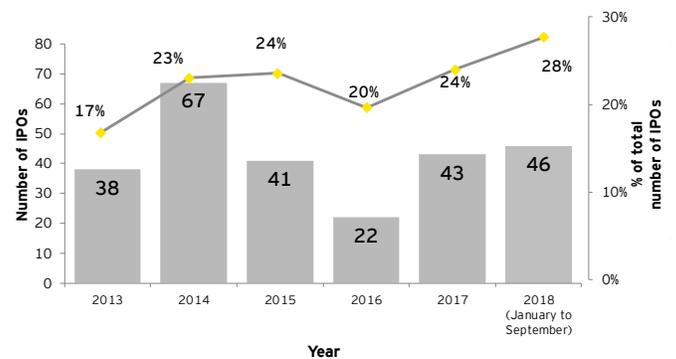
\*\* The fever line above the bars shows the percentage of IPOs backed by financial sponsors.

\* Represents the capital raised by financial sponsor-backed IPOs as a percentage of total capital raised.



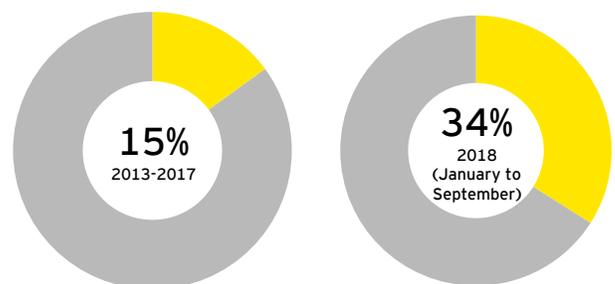
Companies based in foreign jurisdictions that raise capital on US stock exchanges in what are called cross-border offerings have been a significant driver of the IPO market over the past year. The 46 cross-border IPOs in the first nine months of 2018 accounted for 28% of all IPOs and 34% of total capital raised. Companies based in China, Israel, the United Kingdom and Canada accounted for the majority of cross-border IPOs into the US (approximately 60% over the past five years). Cross-border activity accelerated in 2018 as US equity indices reached all-time highs.

### Cross-border IPO activity (2013-2018\*)



\* Based on nine-month information for 2018. The term "cross-border" IPO refers to an offering on a major US stock exchange by a company that is domiciled outside the US.

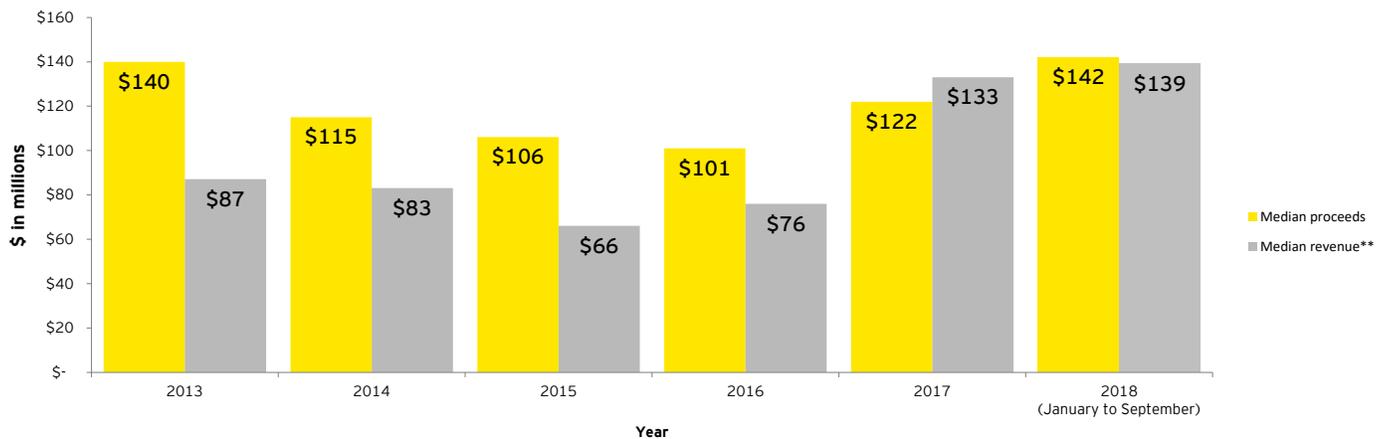
### Capital raised by cross-border IPOs<sup>5</sup>



<sup>5</sup> IPO proceeds exclude the \$25 billion Alibaba IPO (the largest IPO in history) in 2014. If the Alibaba IPO is included, cross-border offerings represented 23% of total IPO proceeds in the years 2013 through 2017.

Excluding biotech and other companies that have not yet generated revenue, the median annual revenue of companies that went public in the first nine months of 2018 was \$139 million compared with a median of \$85 million for the last five years. For the same population of companies, the median IPO proceeds increased to \$142 million during the first nine months in 2018 compared with \$120 million over the last five years.

### Median IPO proceeds and revenue (by year\*)

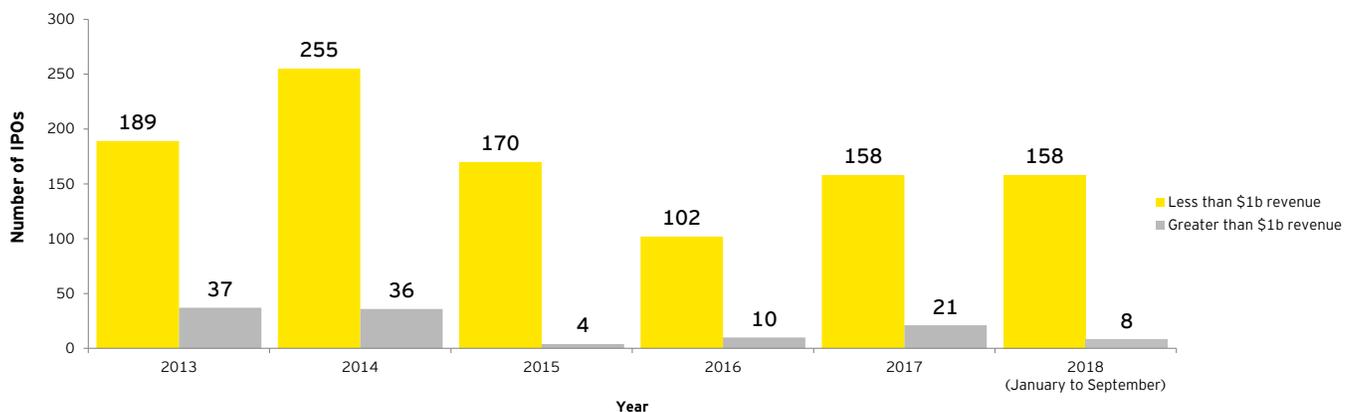


\* This table excludes biotech and other companies without any revenue.

\*\* Median revenue is calculated based on the most recent annual revenues presented in the registration statement.

Roughly 90% of the companies that have gone public since 2013 have been EGCs. (The revenue limit to qualify as an EGC recently rose to \$1.07 billion from \$1 billion in the last audited fiscal year presented in the registration statement.) A number of large private companies known as “unicorns” have chosen to remain private and continue to grow before conducting an IPO.<sup>6</sup>

### IPOs below and above \$1 billion in revenue\* (by year)



\* \$1 billion in revenue refers to revenue in the last audited fiscal year presented in the registration statement.

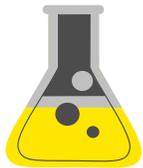
<sup>6</sup> Unicorns are private companies that have an estimated market value of greater than \$1 billion.

# Trends in US IPO registration statements

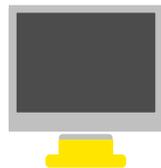
Health care, technology, financial services, real estate, and oil and gas continued to be the top industries for IPOs, accounting for roughly 77% of all IPOs in the US since 2013. Health care remains the most active sector, accounting for 39% of IPOs in the first three quarters in 2018. Health care IPOs raised \$6.2 billion in 2018, which is nearly double the amount raised in the same period in 2017.

Technology continues to be the second most active industry for IPOs, accounting for 28% of IPOs in the first nine months of 2018. Technology IPOs raised \$13.7 billion, more than twice the amount raised during the same period in 2017, driven by the PagSeguro Digital and Farfetch IPOs (i.e., the two largest technology IPOs through 30 September 2018 that raised a total of \$5.8 billion).

## IPOs by top industries during 2018\*



**39%**  
Health care



**28%**  
Technology



**9%**  
Financial services



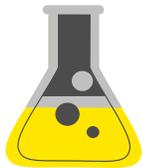
**4%**  
Real estate



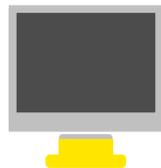
**3%**  
Oil and gas

\* Based on nine-month information for 2018.

## IPOs by top industries during 2013-2017



**34%**  
Health care



**18%**  
Technology



**10%**  
Real estate



**8%**  
Oil and gas



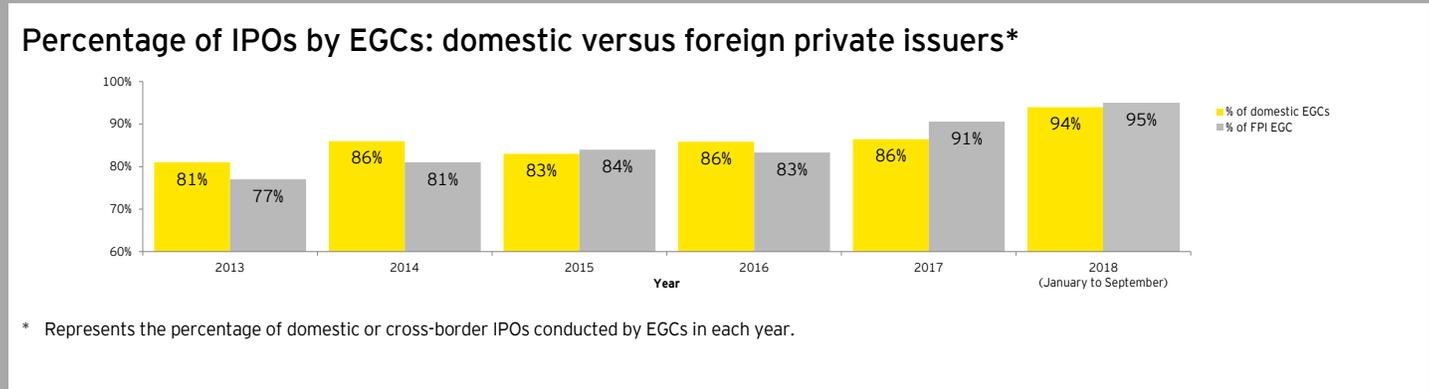
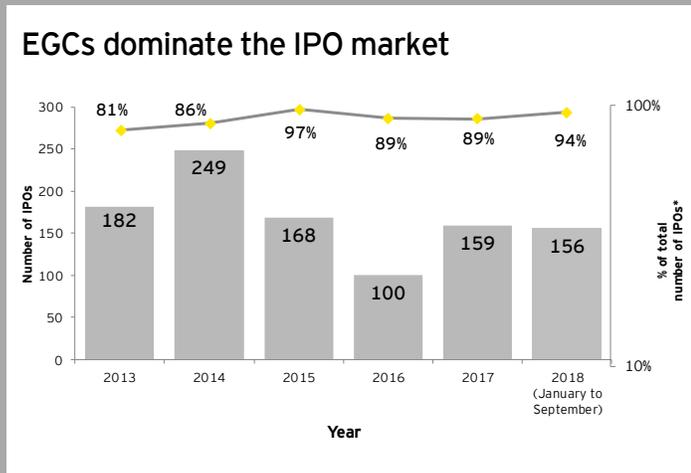
**7%**  
Financial services

In the years since the JOBS Act created a new class of issuer called an “emerging growth company,” hundreds of private companies have gone public using the relief provided by the law. This trend continued in 2018 with 94% of companies filing as EGCs.

An EGC may choose to make certain scaled disclosures in its IPO registration statement and submit its draft registration statement confidentially. Under the JOBS Act, certain regulatory requirements (e.g., obtaining independent auditor attestation of internal control over financial reporting) are phased in for EGCs during a five-year period known as an IPO “on-ramp,” unless a company loses its EGC status earlier.

Of all the companies that went public as EGCs during 2013 through 2017, 36% no longer qualify as EGCs. Another 15% no longer were SEC-reporting companies by 30 September 2018, primarily because they were acquired by other companies.

Unless otherwise noted, the statistics presented in this section are based on an EGC’s initial IPO registration statement publicly filed between January 2013 and September 2018.



<sup>4</sup> SEC staff guidance, including its FAQs about the JOBS Act, is available on the SEC’s website at [sec.gov/divisions/corpfm/cfjobsact.shtml](http://sec.gov/divisions/corpfm/cfjobsact.shtml).

### ***Nonpublic review program***

The SEC staff expanded its nonpublic review program beyond EGCs and certain foreign private issuers (FPIs) to all companies in 2017. Companies can now elect to submit the following draft registration statements for a nonpublic review by the SEC staff:

- ▶ IPO registration statements (e.g., Forms S-1, F-1, S-11)
- ▶ Any Securities Act registration statements prior to an IPO (e.g., registration statements for an exchange offer of debt securities on Form S-4)
- ▶ Registration statements used to list securities on a national exchange pursuant to Section 12(b) of the Exchange Act (e.g., listing securities on the national exchange in a spin-off transaction using Form 10 or 20-F)
- ▶ Registration statements for additional offerings conducted within one year of an IPO

Like EGCs that seek a confidential filing review under the JOBS Act (see description of the confidential filing review process below), companies that seek a nonpublic review have to publicly file IPO or initial registration statements, including all prior draft registration statements, 15 days<sup>7</sup> before a road show or the anticipated effective date. Companies generally price their IPOs within two weeks after launching a road show.

Like EGCs, companies submitting draft registration statements for nonpublic review are not required to have their officers or directors sign the registration statements. Companies also are not required to include the consents of auditors and experts.

Under the nonpublic review program, companies can omit certain financial information from their draft registration statements. EGCs and non-EGCs may omit from draft registration statements annual and interim financial information that they reasonably believe they will not be required to present separately at the time of the contemplated offering (for EGCs) or the initial public filing (for non-EGCs). However, both EGCs and non-EGCs must include all required interim financial statements when they first publicly file their registration statement.

The SEC staff advises companies using the nonpublic review process to include a cover letter describing the anticipated timing of their public filing and effective date and which additional financial statements will be included in the “filed” registration statement. The staff also recommends that the cover letter describe any significant transactions that would have been reflected in the omitted interim financial statements and will be disclosed when subsequent interim or additional annual financial statements are filed, the anticipated accounting treatment and the anticipated disclosures (if known). This will help expedite the filing process because waiting to disclose significant events or transactions until the public filing without notifying the staff in advance could cause delays if the staff has significant comments.

With the exception of financial statements that may be omitted, the SEC staff expects draft registration statements to be substantially complete at the time of submission.

<sup>7</sup> Mandated by the Fixing America's Surface Transportation (FAST) Act of 2015.

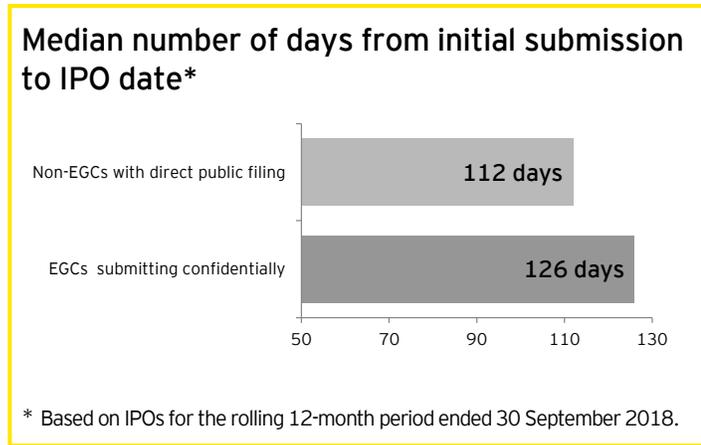
### Confidential IPO registration statement submission

EGCs and FPIs are eligible to use confidential IPO review accommodations. Unlike submissions made under the nonpublic review program, confidential draft submissions cannot be obtained by third parties under the Freedom of Information Act.

Approximately 91% of the EGCs that have filed IPO registration statements since the JOBS Act was enacted have taken advantage of the confidential review accommodation.

The SEC staff reviews draft registration statements using the same process and timetable as it does for publicly filed registration statements. The SEC staff generally has a target of less than 30 days to issue comments on all initial Securities Act filings, including nonpublic and confidentially submitted registration statements. According to the SEC's Annual Performance Report,<sup>8</sup> the SEC staff issued initial comments on Securities Act registration statements within an average of 25.4 days in 2017 and within an average of 25.5 days in 2016.

Many other factors affect the length of time between the initial submission or filing date and the IPO date. They include a company's ability to timely file amendments in response to SEC staff comments, as well as market conditions. That said, on average, it takes longer for EGCs to go public than non-EGCs, particularly if they initially submit their registration statements confidentially.



The median number of days it took EGCs to go public from initial submission to IPO date was roughly the same in 2018 as in 2017, with a slight increase for non-EGCs to 112 days versus 106 days last year.

<sup>8</sup> The FY17 report can be found at [sec.gov/files/secfy19congbudgjust.pdf](https://www.sec.gov/files/secfy19congbudgjust.pdf).



## EGC scaled disclosures during IPO on-ramp period

EGCs may take an “à la carte” approach to using the scaled disclosures allowed by the JOBS Act. Most EGCs have elected to provide reduced executive compensation disclosures in their IPO registration statements, and many EGCs have elected to provide audited financial statements for two years rather than three years.

One big change in 2018 is that 56% of new EGCs chose to adopt new accounting standards using private company effective dates, more than double the percentage that did so in 2017. Otherwise, these companies would have had to adopt the new revenue recognition standard this year to comply with the public company effective date.

### Use of disclosure relief (2013-2018)



**96%**  
Reduced executive compensation disclosures\*



**80%**  
Two years of audited financial statements\*\*



**24%**  
Adoption of new accounting standards using private company effective dates

\* Excludes EGCs that also qualify as a smaller reporting company or a foreign private issuer.

\*\* Excludes EGCs that also qualify as a smaller reporting company or have a reporting history of less than two years.

The following table summarizes some of the scaled disclosures EGCs can choose to make during their IPO on-ramp period:

| Requirements for registrants*  | Scaled disclosures EGCs can choose to make   |
|--|--|
| Follow public company effective dates for new or revised accounting standards  | Follow private company effective dates for new or revised accounting standards   |
| Three years of audited financial statements in common equity IPO registration statement  | Two years of audited financial statements in common equity IPO registration statement <sup>9</sup>   |
| Five years of selected financial data in IPO registration statement, subsequent registration statements and periodic reports   | Two years of selected financial data in IPO registration statement; selected financial data in subsequent registration statements and periodic reports begins with earliest audited period presented in IPO registration statement |
| Compensation, discussion and analysis section and compensation disclosure for five named executive officers in IPO registration statements and subsequent annual reports | No compensation, discussion and analysis section and compensation disclosure for three named executive officers in IPO registration statements and subsequent annual reports   |
| Management assessment and auditor attestation of internal control over financial reporting beginning with second Form 10-K following IPO                                 | Only management assessment of internal control over financial reporting beginning with second Form 10-K following IPO  |

\* Requirements are for registrants other than those that meet the definition of a smaller reporting company or an EGC.

<sup>9</sup> The FAST Act amended the JOBS Act to allow an EGC to omit annual financial statements that at the time of its confidential submission or public filing it reasonably believes will not be required when the registration statement becomes effective. Thus, an EGC might be able to file or submit an IPO registration statement with only one year of audited financial statements if it expects to provide an additional year of audited financial statements in a pre-effective amendment prior to distributing a preliminary prospectus to prospective investors.

### Accounting standards issued after the JOBS Act

The percentage of EGCs electing to utilize private company effective dates for adopting the new or revised accounting standards nearly doubled to 56% in 2018 from 32% in 2017.

With three major new accounting standards on revenue recognition, leases and credit losses becoming effective, EGCs are increasingly taking advantage of this relief that generally gives them one additional year to adopt new standards.

As a result of retaining the transition date relief, a calendar-year EGC can wait to apply the new revenue standard until its annual report for the year ending 31 December 2019 rather than its quarterly report for the interim period ended 31 March 2018. Similarly, that calendar-year EGC can also wait to adopt the new leasing standard until its annual report for the year ending 31 December 2020, rather than its quarterly report for the interim period ended 31 March 2019.

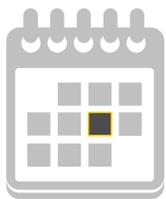
While a majority of EGCs chose this relief in 2018, those EGCs choosing public company effective dates may be trying to assure investors that their financial statements will be comparable to those of other public companies.

Under Section 107(b) of the JOBS Act, an EGC that chooses to follow public company dates must make an irrevocable election to opt in to public company transition and adopt all new or revised accounting standards on the public company dates. The SEC staff has indicated that it will not object if an EGC initially decides to retain the ability to take advantage of the extended transition period but subsequently elects to follow the requirements for public companies.

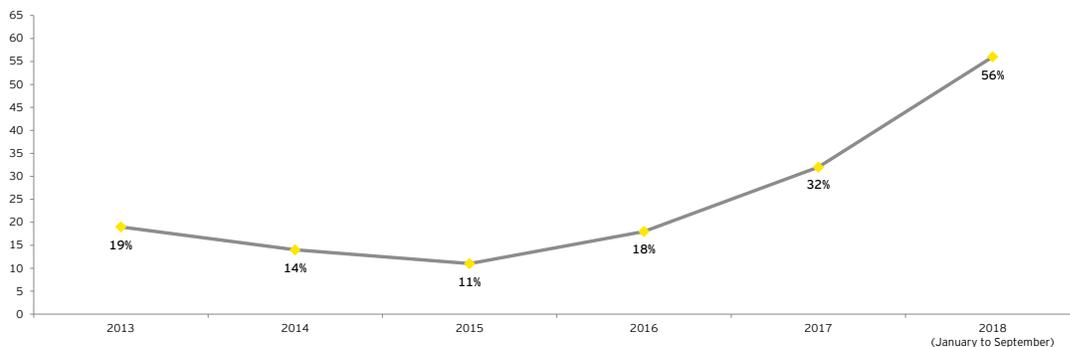
An EGC that elects to follow private company effective dates may early adopt a new or revised accounting standard, if the standard allows early adoption by private companies, without affecting its ability to follow the extended private company transition relief for other new or revised accounting standards.

The SEC staff recently clarified the transition provisions for a company that loses EGC status. For example, a calendar year-end company that loses EGC status on the last day of 2018 and that had elected to retain the private company transition relief will be required to file its audited annual financial statements for 2018 reflecting the adoption of the new revenue recognition standard as of the public company adoption date (1 January 2018).

### Use of relief for adopting new or revised accounting standards by year



Retain ability to use private company effective dates



### How we see it

EGCs that retain the transition date relief should assess whether they have a high likelihood of losing their EGC status before the private company adoption date and plan accordingly to timely adopt any new accounting standards required in filings subsequent to the date they lose EGC status.

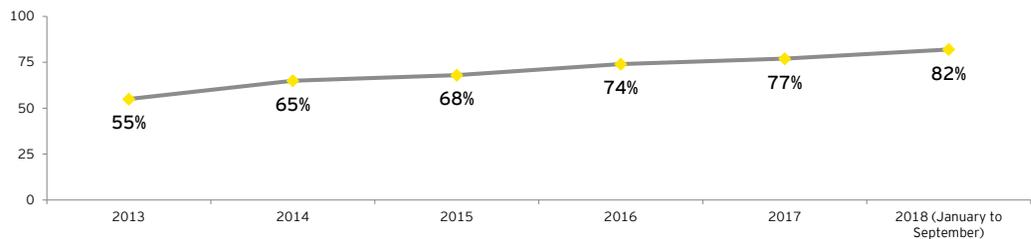
### Number of audited financial statement periods and selected financial data

A substantial majority (i.e., 82%) of EGCs elected to provide two years of audited financial statements and selected financial data in their IPO registration statements in 2018. Many more EGCs have used this relief in recent years than shortly after the enactment of the JOBS Act. Use of this relief is especially popular among smaller EGCs. More than 70% of EGCs electing this relief had revenue of less than \$100 million. The relief is most popular with EGCs in the health care, oil and gas, and real estate sectors.

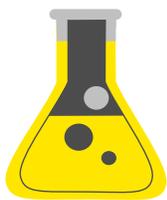
#### Use of relief for number of audited financial statement periods provided\*



Two years of audited financial statements



#### Percentage of EGCs in the top four sectors providing two years of audited financial statements\*



**85%**  
Health care



**85%**  
Oil and gas



**74%**  
Real estate



**55%**  
Financial services

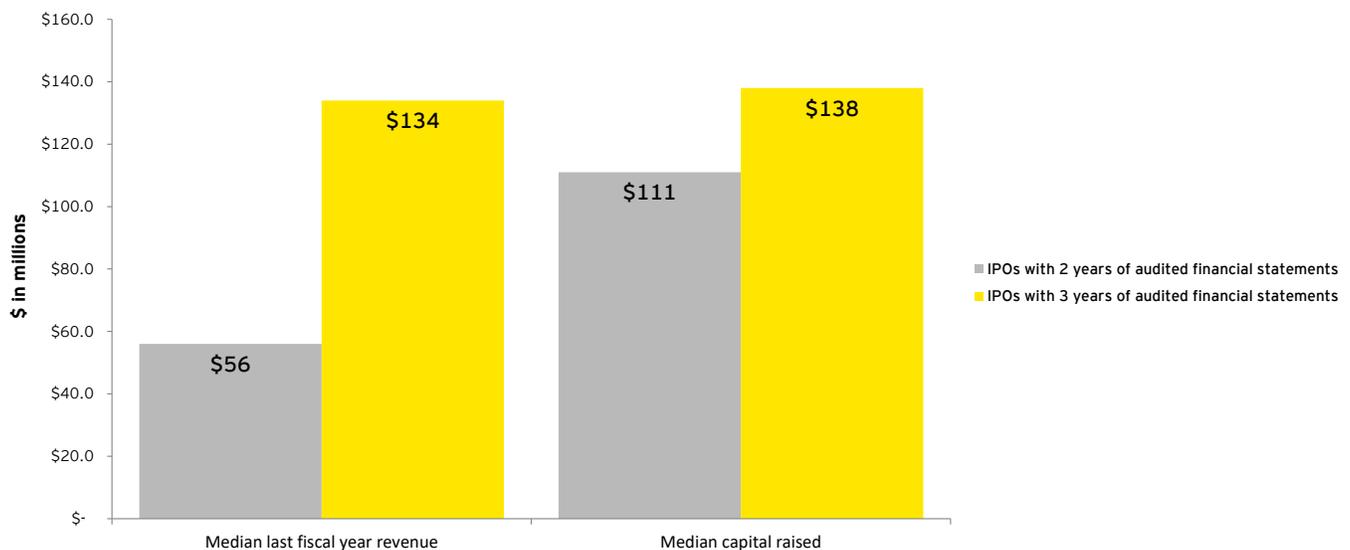
\* Excludes EGCs that also qualify as a smaller reporting company or have a reporting history of less than two years.

In their common equity IPO registration statements, subsequent registration statements and periodic reports, EGCs can provide less selected financial data than other companies. They are not required to include selected financial data for periods before the earliest audited period they present in their IPO registration statements. That means that an EGC that elects to provide audited financial statements for 2017 and 2016 in its IPO registration statement would not be required to provide selected financial data for 2013 through 2015.

The percentage of EGCs that have elected to present reduced selected financial data disclosures has remained steady since 2012, and 89% of EGCs that presented two years of audited financial statements used this relief. Of EGCs that have elected to provide three years of audited financial statements, approximately 73% provided less than five years of selected financial data.

Many factors may influence an EGC's decision to present fewer periods of audited financial statements and selected financial data, including its operating history and whether it believes investors need its historical performance and trend information to understand its current performance and future prospects. Substantially all of the companies that had no revenue when they conducted an IPO chose to report two years of annual audited financial statements in their IPO registration statements.

### Smaller EGCs tend to include two years of audited financial statements rather than three years\*



\* The data covers 2013 to 30 September 2018 and excludes effective IPOs by EGCs that had no revenue and EGCs that also qualify as a smaller reporting company or have a reporting history of less than two years.

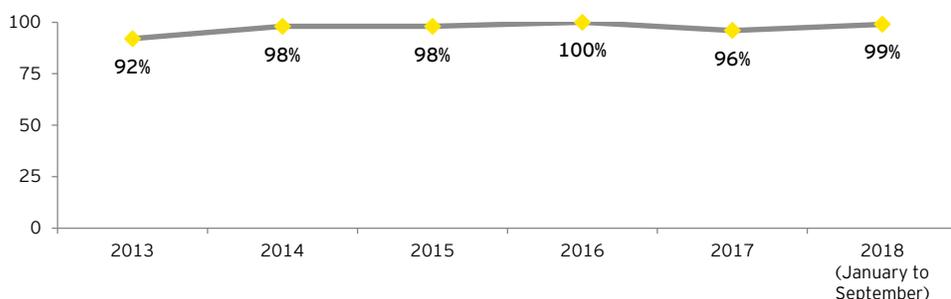
### **Executive compensation disclosures**

An EGC is allowed to provide executive compensation disclosures in a manner consistent with a smaller reporting company. Thus, EGCs are not required to provide a compensation discussion and analysis (CD&A), and most have elected to omit the CD&A from their IPO registration statements. The tabular executive compensation disclosure requirements also are significantly reduced for EGCs. For example, EGCs are required to provide compensation disclosure for only three named executive officers (i.e., the chief executive officer or CEO and the two other highest-paid executives), while non-EGCs are required to provide disclosure for five named executive officers (i.e., the CEO, the chief financial officer and the three other highest-paid executives).

Approximately 99% of EGCs elected to provide reduced executive compensation disclosures in 2018. This is consistent with the overwhelming popularity of this relief among EGCs since it became available.

Once they go public, EGCs also are not required to comply with certain executive compensation requirements mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). EGCs are not subject to the “say-on-pay” provisions of the Dodd-Frank Act, which require companies to hold a shareholder advisory vote on executive compensation and golden parachutes. They also are not subject to the SEC’s “pay ratio” rule. This rule requires most registrants to calculate and disclose the ratio of their principal executive officer’s total annual compensation to that of their median employee.

### **Use of executive compensation disclosure relief by year\***



\* Excludes EGCs that also qualify as a smaller reporting company or a foreign private issuer.

### **Compliance with auditor attestation of internal control over financial reporting**

EGCs are not required to provide an independent auditor attestation report on their internal control over financial reporting (ICFR) under Section 404(b) of the Sarbanes-Oxley Act for as long as they retain their EGC status. Nearly all EGCs have taken advantage of this relief after their IPOs. Only non-accelerated filers (i.e., public companies with a public float of less than \$75 million) are permanently exempt from Section 404(b).

Like other filers, EGCs are required to report their management’s assessment of the effectiveness of their ICFR as required under Section 404(a) of the Sarbanes-Oxley Act generally beginning with their second annual report after becoming a public company.

### **New auditing standard on the independent auditor’s report**

Auditors are not required to discuss critical audit matters in their auditor’s reports for EGCs. This additional information in the auditor’s report is mandated by a Public Company Accounting Oversight Board auditing standard that will be phased in for public company audits, beginning next year for large accelerated filers. If an EGC loses its status because it becomes a large accelerated filer, the provisions of the new auditing standard will apply to auditor’s reports on its financial statements for fiscal years ending after 30 June 2019.

# Common IPO accounting and reporting pitfalls

## ***Submit a substantially complete registration statement***

Companies often run into delays if they submit an incomplete registration statement to the SEC. Companies should be aware that the SEC staff expects registration statements, including those submitted confidentially or on a nonpublic basis, to be substantially complete. At the time of submission, the registration statement should include all disclosures, exhibits, financial statements and financial statement schedules required by the Securities Act of 1933 unless otherwise permitted by the SEC staff.<sup>10</sup>

## ***Pro forma financial information***

Pro forma financial information may be required in an IPO registration statement for various reasons, including showing the effects of significant consummated or probable acquisitions or dispositions. Pro forma adjustments are often a source of significant judgment and an SEC staff focus area. It is important for management to determine whether pro forma financial information will be needed and to allow enough time to prepare such information and make sure it complies with Article 11 of Regulation S-X. In pre-effective amendments companies may use placeholders for pro forma adjustments that are not yet determinable but will be prior to effectiveness.

## ***Predecessor entity determination***

IPO structures in recent years have become more complex, and in transactions such as those involving an “Up-C” structure,<sup>11</sup> a “put together” of multiple entities or a carve-out of operations from another company, the registrant may need to determine whether any entity is a predecessor entity, as defined in Rule 405 of Regulation C, and if so, which entity or entities. In these situations, certain information must be provided for the predecessor (i.e., the same information as for a registrant), including separate schedules, selected financial data, management’s discussion and analysis and other disclosures required under Regulation S-K.

## ***Cheap stock considerations***

The SEC staff continues to challenge the valuation of share-based payment awards issued in the 12 months before an IPO when a security’s fair value was significantly lower than the anticipated IPO price (commonly referred to as cheap stock). Companies should be aware of the AICPA’s Accounting and Valuation Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, which provides a framework and describes best practices for valuing private company securities. Companies contemplating IPOs should obtain contemporaneous valuations from independent valuation specialists to support the fair value of securities issued as compensation in the period leading up to an IPO.

## ***Segment disclosures***

The SEC staff continues to focus on segment disclosures in all filings, including the basic objectives and principles outlined in the segment reporting guidance. For companies going through the IPO process, this means more scrutiny of disclosures they are making for the first time. Companies should carefully evaluate any conclusions they reach on operating segments that are inconsistent with their basic organizational structure and the level of disaggregation used by the chief operating decision maker in making key operating decisions and assessing performance. In addition, companies should consider all public information (e.g., on websites, in press releases) and confirm that their segment conclusions are consistent with both their operations and their public communications.

<sup>10</sup> For example, a draft registration statement may omit annual and interim financial information a company reasonably believes it will not be required to present separately at the time of the contemplated offering (for EGCs) or the initial public filing (for non-EGCs).

<sup>11</sup> A structure that is commonly referred to as an “Up-C” establishes a newly formed holding corporation to conduct an initial public offering and hold an interest in existing pass-through entities (e.g., limited liability companies or partnerships). Such structure allows the existing holders to retain the pass-through tax benefits or exchange their interests for common shares of the registrant and often share in the additional tax benefits resulting from the step-up in tax basis (e.g., by means of a tax receivable agreement).

## Non-GAAP financial measures

The SEC staff continues to issue comments on compliance with the presentation and disclosure requirements for using non-GAAP financial measures. As a reminder, all public companies are prohibited from presenting non-GAAP financial measures in ways that are misleading or give them greater prominence than GAAP measures.

These prohibitions apply to both the order of presentation and the degree of emphasis. In May 2016, the SEC staff updated its guidance on the use of non-GAAP measures and identified certain uses that the staff considers misleading or providing undue prominence.

To avoid staff comments about non-GAAP financial measures, companies planning IPOs should include clear and specific disclosure of why a particular non-GAAP measure is useful for investors and how it is used by management. The statements a company makes about non-GAAP measures during the IPO process may signal how it plans to communicate with investors in the future; therefore, it is important that non-GAAP disclosures in the IPO registration statement be given careful consideration.

### EY resources

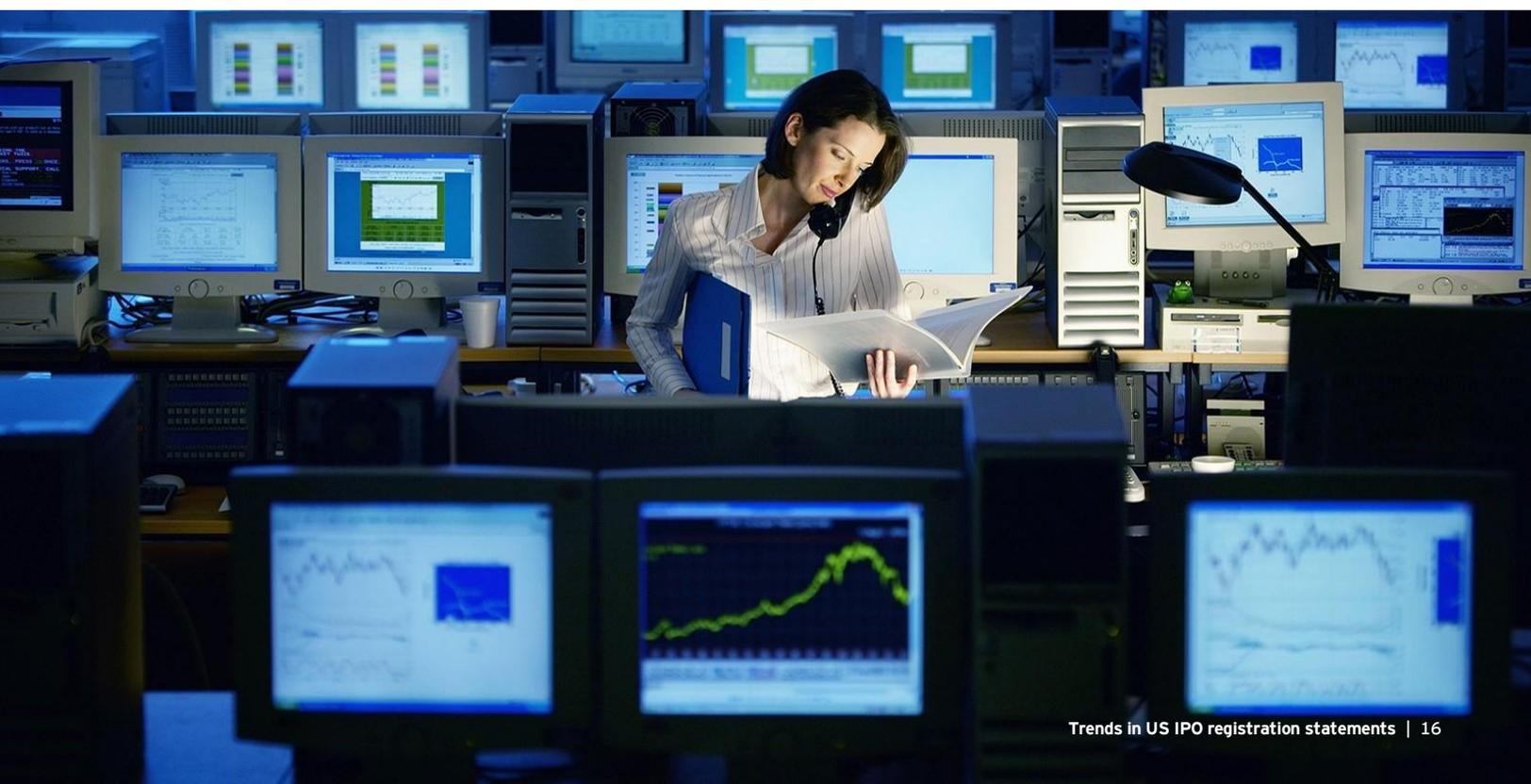
- ▶ Technical Line, *Spotlight on non-GAAP financial measures* (SCORE No. 00785-161US)
- ▶ To the Point, *SEC staff updates guidance on non-GAAP financial measures* (SCORE No. 01108-161US)

## Other SEC comment areas

The SEC staff issues comments on a variety of accounting and reporting issues and requests additional information when it believes that a company planning an IPO may not have complied with SEC disclosure requirements or may have omitted information that may be material to investors. While any comment might cause a major delay, companies planning IPOs should carefully consider their disclosures in the following five most frequent SEC staff comment areas for IPOs.

| Comment area                             | Comment rank for the 12 months ended 30 June |      |
|--|--|------|
|  | 2018   | 2017 |
| Management's discussion and analysis     | 1  | 1    |
| Risk factors                             | 2  | 2    |
| Use of proceeds and dilution disclosures | 3  | 5    |
| Signatures, exhibits and agreements      | 4  | 3    |
| Fair value measurements                  | 5  | *    |

\* This topic wasn't in the top five comment areas in 2017.



## **Management's discussion and analysis**

The SEC staff often requests that registrants explain the results of their operations with greater specificity, including identifying underlying drivers for each material factor that has affected their earnings or that is reasonably likely to have a material effect on future earnings. The SEC staff often questions the significant components of expenses and provisions.

The SEC staff also increased its focus on performance metrics, including whether registrants have disclosed key metrics monitored by management and how those metrics correlate with material changes in the results of operations.

**Risk factors** – Item 503(c) of Regulation S-K requires a registrant to disclose significant risks it faces and how it is affected by each of them. Risk factors should be specific to the registrant's facts and circumstances and should not be general risks that could apply to any registrant. The SEC staff has questioned risk factor disclosures that could apply to any public company. It also may question the completeness of a registrant's risk-factor disclosures based on information included elsewhere in the document or other public information.

**Use of proceeds and dilution disclosures** – Item 504 of Regulation S-K requires registrants to describe the planned uses and amounts of offering proceeds. These disclosures should allow investors to understand the major areas for which the funds will be used, including whether any proceeds will be used to discharge debts, to complete an acquisition or provide working capital. The SEC staff may request that a company provide additional details about how it will use proceeds from the offering, particularly when other disclosures in the filing imply a use omitted from the Item 504 disclosures.

**Signatures, exhibits and agreements** – The SEC staff may question the completeness and adequacy of exhibits, consents, audit reports and management signatures filed by a registrant as required by various rules and regulations. In particular, we often see the SEC staff inquiring about the omission of material contracts that must be filed as exhibits to registration statements.

**Fair value measurements** – In its comments, the SEC staff focuses on disclosures about valuation techniques. Those comments frequently focus on specific inputs to a fair value measurement (e.g., discount rates, selected valuation multiples, cash flow forecasts and discounts/premiums applied). The SEC staff also comments on disclosures about fair value measurements categorized in Level 3 of the fair value hierarchy as set out in Accounting Standards Codification (ASC) 820, *Fair Value Measurement*.

## **Emerging areas of focus**

### **New accounting standards**

**Revenue** – The SEC staff's comments on the application of ASC 606 and ASC 340-40 have focused on areas of judgment. The SEC staff has asked registrants how they identify their performance obligations in contracts with customers. In particular, the SEC staff is interested in how registrants support their conclusions that certain promised goods and services are not separately identifiable. The SEC staff also has asked registrants about their disaggregated revenue disclosures and how the categories for disaggregation were determined in accordance with the disclosure requirements in ASC 606.

**Leases and credit impairment** – With registrants preparing to adopt new standards on leases and credit impairment, SEC officials have continued to emphasize the disclosures registrants should provide to comply with Staff Accounting Bulletin (SAB) Topic 11.M (issued as SAB 74) and the announcement the SEC staff made in 2016 regarding its expectations for disclosures about how companies will be affected when they adopt the new standards.

**Cybersecurity** – Chairman Clayton has asked the Division of Corporation Finance to carefully monitor cybersecurity disclosures. He made the request when the Commission issued new interpretive guidance on cybersecurity in February 2018 that largely incorporates the staff's 2011 cybersecurity disclosure guidance and builds on the previous guidance in important ways. For example, the new guidance helps companies apply the concept of materiality to cybersecurity risks and incidents, and it includes a more comprehensive list of disclosure items for companies to consider. The new guidance also focuses on companies' policies and procedures related to cybersecurity.

### **EY resources**

- ▶ SEC Comments and Trends, *An analysis of current reporting issues, September 2018* (SCORE No. 04321-181US)
- ▶ SEC Reporting Update, *2018 trends in SEC comment letters* (SCORE No. 04322-181US)
- ▶ SEC Reporting Update, *SEC issues guidance on cybersecurity* (SCORE No. 01030-181US)

# Other trends

## ***Trends in restatements during IPO process***

In anticipation of an IPO, companies generally go through a rigorous process to determine whether the financial statements they will include in a registration statement comply with applicable GAAP and the financial statement requirements under Regulation S-X.

In certain cases during the IPO process, companies may become aware of errors in their historical financial statements that may require restated financial statements to be included within an IPO registration statement. Restating financial statements after a registration statement is submitted or filed with the SEC may significantly affect the IPO timeline.

Roughly 6% of the companies that went public during both 2018 (through September) and the last five years reported one or more restatement of their financial statements in their IPO registration statements. The following chart summarizes the top five accounting areas for restatements included in IPO registration statements.

| Ranking | Restatement area                            |
|---------|---|
| 1       | Debt, quasi-debt and warrants               |
| 2       | Revenue recognition                         |
| 3       | Inventory, cost of sales and other expenses |
| 4       | Income tax expenses                         |
| 5       | Income statement classification             |

## ***Trends in voluntary material weakness disclosures***

Companies continue to voluntarily disclose material weaknesses in IPO registration statements. About a quarter of all IPO registration statements during both 2018 (through September) and 2017 included a disclosure of one or more material weaknesses in ICFR.

The SEC defines a material weakness as “a deficiency, or a combination of deficiencies, in ICFR such that there is a reasonable possibility that a material misstatement of the registrant’s annual or interim financial statements will not be prevented or detected on a timely basis.”

While a company going public is not required to disclose an identified material weakness in its registration statement, many do so to avoid any surprises for investors after their IPO that could adversely affect their stock price. In addition, Securities Act Rule 408 requires the IPO registration statement to include any material information necessary to make the required disclosures not misleading in the circumstances.

The following table summarizes the top three areas of material weaknesses reported in IPO registration statements in 2018, which account for the vast majority of instances disclosed. Other less common material weakness areas include debt and equity transactions, income taxes and specific transactions.

| Ranking | Material weakness area  |
|---------|---|
| 1       | Financial statement close process   |
| 2       | Lack of personnel with appropriate experience in US GAAP or SEC reporting |
| 3       | Information technology general controls                                   |

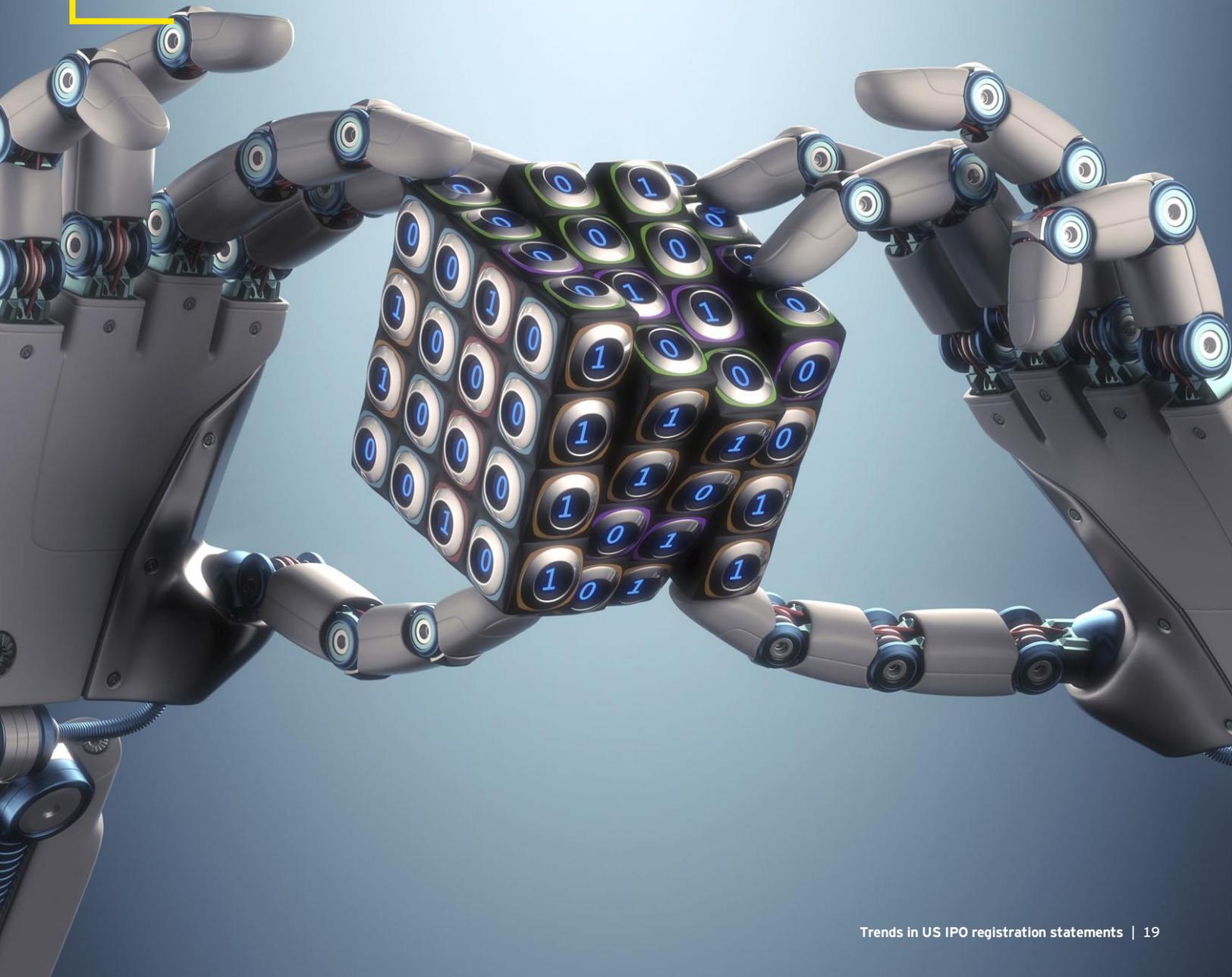
# What's next?

The IPO market will continue to be affected by macroeconomic risks and uncertainties. They include geopolitical tensions, changes in trade policies, rising interest rates and market volatility.

Overall, market conditions remain encouraging, and the US continues to set the pace, having two of the top three globally ranked exchanges by IPO proceeds.

Now that the SEC is back to a full slate of commissioners, we expect it to propose additional rule changes to promote capital formation. For example, we expect the Commission to propose allowing all companies to "test the waters" for an IPO by communicating with certain potential investors before filing an IPO registration statement. Currently, only EGCs can do that.

Chairman Clayton has also said he wants the Commission to review the overall framework for exempt offerings. Any adjustments the Commission makes could affect the relative costs and benefits of an IPO compared to other capital raising options. We expect the SEC to continue to prioritize rulemaking that is intended to make the US public markets more attractive.



# Appendix

## 2019 financial statement staleness dates for IPO registration statements

(For calendar year-end companies)

The tables below provide the dates in 2019 when a calendar year-end company must update its financial statements in an IPO registration statement with more current periods before that IPO registration statement becomes effective. These dates are known as staleness dates.

### *Domestic issuers*

| Staleness date | Which financial statements need to be added?  | Financial statements become stale following: |
|----------------|---|--|
| February 15    | 2018 annual audited financial statements for companies other than SRCs <sup>1</sup> | 45 days after year end                       |
| April 1        | 2018 annual audited financial statements for SRCs                                   | 90 days after year end                       |
| May 15         | Q1 2019 financial statements  | 134 days after year end                      |
| August 13      | Q2 2019 financial statements  | 134 days after the end of the first quarter  |
| November 12    | Q3 2019 financial statements  | 134 days after the end of the second quarter |

### *Foreign private issuers<sup>2</sup>*

| Staleness date | Which financial statements need to be added?  | Financial statements become stale following:                 |
|----------------|---|--|
| April 1*       | 2018 annual audited financial statements  | 15 months from prior audited balance sheet date <sup>3</sup> |
| October 1      | 2019 interim unaudited financial statements for a six-month period at least as recent as 30 June 2019 | Nine months after year end                                   |

\* This date reflects the permitted extension to the next business day when certain financial statements become stale on a weekend or holiday. For instance, 15 months from the prior audited balance sheet date falls on a Sunday (i.e., 31 March 2019) and therefore annual audited financial statements for an FPI do not become stale in an IPO registration statement until the next business day (i.e., 1 April 2019) (Securities Act Rule 417).

<sup>1</sup> In this context, a smaller reporting company is a company with an anticipated public float of less than \$250 million or revenues of less than \$100 million and anticipated public float of less than \$700 million (Exchange Act Rule 12b-2).

<sup>2</sup> An FPI is an issuer incorporated or organized under the laws of a foreign country.

<sup>3</sup> While an FPI's annual audited financial statements included in an IPO registration statement are required to not be older than 12 months at the time the registration statement is filed, the SEC recently codified the accommodation that the 15-month age of annual financial statements that applies to non-IPO registration statements may be used if the FPI can represent that it is not required to comply with the 12-month requirement in any other jurisdiction outside the US. The FPI must also be able to represent that complying with the 12-month requirement is impracticable or involves undue hardship. Our timeline assumes that FPIs meet these conditions (Form 20-F Instruction 2 to Item 8.A.5).



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#### Sources

For purposes of this report, an IPO is defined as a company's first registered offering of equity securities to the public.

This report discusses only IPOs for which the data provider Dealogic offers data on the issue date (the day the offer is priced and allocations are subsequently made), the trading date (the date on which the security first trades) and proceeds (funds raised, including any over-allotment sold). Companies with the following Standard Industrial Classification codes also are excluded from our study:

- ▶ 6091: Financial companies that conduct trust, fiduciary and custody activities
- ▶ 6371: Asset management companies such as health and welfare funds, pension funds and their third-party administration as well as other financial vehicles
- ▶ 6722: Companies that are open-end investment funds
- ▶ 6726: Companies that are other financial vehicles
- ▶ 6732: Companies that are grant-making foundations
- ▶ 6733: Asset management companies that deal with trusts, estates and agency accounts
- ▶ 6799: Special purpose acquisition companies

We have included only IPOs on the three major US exchanges: New York Stock Exchange (NYSE), NASDAQ and NYSE MKT.