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THE CFO'S 10-STEP GUIDE TO SLEEPING THE FIRST YEAR AFTER RINGING THE BELL

By Peter Bardwick, John Dunican and Jeremy Sucharski

All CFOs who aspire to take their companies public recognize the process as expensive and time-consuming. Best in class organizations use 12-24 months to ramp up and put the right people and systems in place.

But it isn't unusual to fly somewhat blindly into IPO preparation, crushing staff, external advisors, and budgets with the weight of a six-month schedule. And in this process, fast-growing companies create unintended risks that may only appear once public.

We take a contrarian view and suggest high-growth entities should view IPO readiness not as a single, defining event, but as the CFO's opportunity to create additional value in the company lifecycle. Companies that consciously create a path to liquidity – whether that path is going public or being acquired – will have a smoother exit.

Even in the absence of an immediate timeline for going public, managing the issues faced by pre-IPO companies provides the benefit of visibility to internal processes that in many cases are inefficient, risky, and not well understood. Beginning to think and act like a public company with ongoing progress toward rapid and accurate financial and accounting processes, SOX compliance, and enterprise risk management systems in place can reduce risk, enhance efficiency, and reduce total costs. Moreover, given that the IPO path is statistically less likely than a sale, having one's accounting and regulatory house in order can enhance valuation in a sale and streamline M&A integration.

As with many complex undertakings, the answer to exactly what to do, and when to do it, is "it all depends." Starting with an inventory of the team's knowledge and expertise, prior public company experience, the quality of and predictability of revenues, earnings, and key operating metrics, and the robustness of the financial and reporting tools provides a roadmap for focus areas.

EXECUTIVE SUMMARY:

This paper will define the Top 10 Avoidable IPO Preparation Challenges, offering an outline of the risks your company faces along the path to an exit. A detailed analysis provides solutions to the challenges with an estimated return on investment for each.

Completing an IPO is the most significant financing event a company can achieve. It also represents the weaving together of multiple complex threads to create the foundation required for long term success. For high growth companies heavily focused on creating product and customer traction, the IPO preparation process is often analogous to the big bang, with too much to do in too little time. The result is costly, exhausting, and risky.

What are the goals of effective preparation to become public? At a very high level, they can be broken down into two areas: first, operational improvements which reduce risk and enhance transparency; second, changes that are mandated by regulators, primarily SOX compliance and governance. While it's a rare executive that relishes regulatory to-do lists, the plain English version of this to-do list has significant focus on understanding who has access to data and systems, creating repeatable procedures which enhance internal visibility, and thinking systematically about risk.

Before digging into a better way to prepare for an IPO, let's consider the upside of a more controlled approach to IPO preparation. First, and it is impossible to fully appreciate this unless you have been there, the last six months of preparing to go public are ludicrously busy. So any front-end loading creates room for better IPO and business execution and allows the team to begin public life relatively rested.

Starting dress rehearsals for rapid and accurate closes and stress testing rolling forecasts early will surface weaknesses in both people and systems. Addressing those vulnerabilities gives the entire executive team confidence in the underlying mechanisms. The financial operations of a public company should run smoothly with a zero defect approach--nonetheless, many companies go into their first quarter as a public company with real uncertainty and anxiety.

A typical big bang approach involves starting all parts of the multi-threaded IPO preparation process more or less simultaneously; often less than a year before a target IPO date. As a result, most fast-growing organizations have no option other than to hire people and bring on consulting resources in an unbudgeted scramble. We argue that deliberately staging some of financial operations and SOX compliance issues earlier in your company's lifecycle mitigates risk, and creates space to undertake some of the deal-related tasks (selecting bankers and completing the S-1) closer to the IPO date in a more controlled way.

	Stage			
	Series A	Series B	Series C	IPO / $50M+ Private Round
Accounting & Financing Staff	Outside Bookkeeper / AP & AR clerk	Startup accountant (may be doing finance and facilities as well)	VP Finance, first CPA, Director or VP People, Possibly IT separates from Engineering	CFO, possible FP&A, GC
Core Tasks	Keep the books	More frequent reporting, tightened up HR policies and procedures, audit, actual to budget quarterly	HR, legal, and IP risk management, rolling forecast, actual to budget monthly w/ department heads	Big 4 audit, quarterly reviews and annual audit completed timely, quarterly board meetings with committee reports, earnings call prep
Software / Systems	QuickBooks + Excel	QuickBooks + Excel + initial CRM implementation	QuickBooks or Intacct or NetSuite + Excel + Deeper CRM integration	Intacct or Microsoft Dynamics AX or NetSuite AX + CRM + BI + Contract Mgmt. + Budgeting/Forecasting Integration

TOP 10 AVOIDABLE IPO PREPARATION CHALLENGES

01.

INABILITY TO FILE S-1 IN DESIRIED TIMEFRAME

The risk of "missing the market" because your organization didn't have the proper ERP system and strong technical accounting team in place is one of the most visible threats to a pre-IPO company. Private companies, even those with Big 4 audits, are not required to create the complex financial information of an S-1.

Building out a finance organization with the right balance of the skills and expertise needed to operate as a public company is crucial. When hiring the finance team and advisors, CFOs need to think strategically and add staff that will supplement their existing skillsets. A Controller with strong technical accounting skills and previous public company experience may eliminate the need for an in-house SEC expert; thus, a company can focus on hiring an FP&A (Financial Planning and Analysis) manager who will be critical in identifying company growth drivers. Conversely, if your controller's strengths lie in budgeting and forecasting, look to hire a senior finance team member who has public company experience.

IPO preparation should be practice for life as a public company—and it may be that not everyone will make the cut. While these are always difficult decisions, the team that built the company might not be right going forward and it's much better to make the changes before beginning life as a public company.

While the risk of not being ready to "hit the IPO window" has been lessened by the JOBS Act, which allows companies to file an S-1 registration statement confidentially, completing the filing process for a confidential filing remains a significant piece of work and one that will be enhanced through proper staffing.

02.

INABILITY TO FILE 10-K OR 10-Q ON TIME

Public companies work under a “no excuses” mantra when it comes to meeting all reporting requirements. Those who fail to file 10-K or 10-Q reports on time are subject to SEC penalties, stock price declines and lawsuits. Non-compliant CFOs should also start looking for a new job, because the fallout from such missed deadlines will rest on their shoulders. The pressure of timely filing of financial statements is surely a key reason for the frequency of restatements.

As with many of the other challenges described herein, the solution is rigorous dress rehearsals, having the right people and the right tools in place, and starting early.

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03.

FINANCIAL STATEMENT RESTATEMENT

Once publicly on file and then as a public company, one of the surprisingly common risks is that of a financial statement restatement. Of the 1,800 companies that have gone public since 2004, fully one-third have filed restatements. While some of these will be immaterial, others will be significant, and no CFO or board wants a restatement on their records. A material restatement which results in stock price volatility can lead to lawsuits or even end a CFO's career. Putting in place the qualified team described above is half the answer – the other half is implementing solutions that are automated, easily integrated and scalable for future company growth.

A quality enterprise resource planning (ERP) system implementation will significantly enhance the process. The Aberdeen Group's research revealed that companies with a current ERP system realize a 16 percent profit margin gain over their competitors.[1]

[1] Aberdeen Group, "The Value of Upgrading ERP, Maintaining Modern Technology," 2014

The following finance tools are the four pillars of a CFO's ideal financial infrastructure:

ENTERPRISE RESOURCE PLANNING (ERP)

Process and validate accounting data from various silos to provide a real-time view of business resources and commitments, while allowing for built-in workflow and internal control processes to streamline new reporting requirements.

CUSTOMER RELATIONSHIP MANAGEMENT (CRM)

Roll out a CRM and ERP system at the same time to allow for a comprehensive view of the business—from the accounting side (ERP) as well as the sales, marketing and customer service side (CRM).

FINANCIAL REPORTING, BUDGETING AND FORECASTING

Process and validate accounting data from various silos to provide a real-time view of business resources and commitments, while allowing for built-in workflow and internal control processes to streamline new reporting requirements.

BUSINESS INTELLIGENCE (BI)

Allow the C-Suite, board and others to visualize real-time data, accelerate decision making and increase data usage without adding to the finance team's workload. This is often Excel in earlier stage companies and therefore prone to error.

Utilizing these powerful software tools pre-IPO, particularly the ERP solution, will allow the finance organization to focus its energy on the additional data analysis and reporting demands of the SEC, leaving manual data entry for special situations that don't fit within their standard processes.

04.

ENTERPRISE RISK MANAGEMENT (ERM) CONDUCTED LATE OR INADEQUATELY

First, let's dispense with the term "Enterprise Risk Management" because it is confusing to most business managers. Instead, let's focus in on what the exercise of risk assessment and control can accomplish for a company. This exercise allows the management team to look at the company comprehensively and strike a balance between risk and reward.

A fast-growing company that hasn't taken the time to conduct this multifaceted review sets itself up for two pre-IPO challenges. First, the company lacks the data necessary to run the business during times of crisis or natural disaster. Second, it may be operating with overly manual processes that cannot scale.

The key to value creation over the lifespan of a company in the process is to focus on meeting regulatory requirements in a way that enhances instead of hobbles the firm's operations.

A typical assessment not only offers peace of mind, it can:

- Provide an enterprise-wide view of risk – not just focused on financial risk as mandated by SOX, but also reputational, legal, resource, operational risk and more
- Improve information for decision-making
- Reduce costly surprises
- Contribute to long-term value creation and protection

By focusing on both enhancing and protecting stakeholder value, the comprehensive assessment and control exercise allows a fast-growing company to capitalize on what is going right while diminishing the risks associated with what might be going wrong.

05.

SOX PREPARATION CONDUCTED LATE OR INADEQUATELY

Strategic CFOs will focus their efforts on making internal controls a part of day-to-day business operations.

When an organization moves to public company status, the requisite fiscal audits increase in scope and price. However, companies that rush to ring the bell and start their Sarbanes-Oxley (SOX) preparations late put themselves at risk for even greater audit fees and the potential to have to disclose material weaknesses. SOX preparation is often perceived to be a bureaucratic process with no upside. But taking an incremental approach, and thinking about business upsides, can reduce risk and give management and the board visibility and comfort around important risk areas.

There are two phases for SOX readiness. The first is design and readiness and the second is testing for both design and effectiveness.

If you begin the process early, you have the ability to leverage in-house staff to do some of the "heavy" lifting around process documentation. There is a lot of work to get done to document each process narrative. Companies will need between 10 and 15 process narratives depending on the nature of their business and those narratives average between 20 and 30 pages.

Using an outside vendor in an outsourced model will cost between $150K and $200K for the design work alone. If your processes or systems are more complex, then you are far more likely to exceed these estimates. However, if you co-source the work and do more of the design work in-house, then you will be able to reduce the role of your external provider to that of a subject matter expert. In doing so, you are able to cut your outsourcing cost to just $30K to $50K. Practically speaking, taking the work in house will only be successful if you begin early.

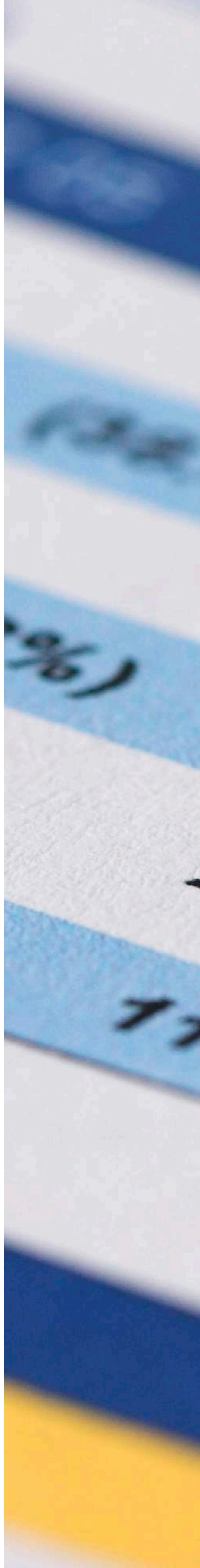
The other benefit of beginning early is that you are less likely to have unforeseen issues or controls exceptions. You give yourself a longer runway to get your controls in place and have them operate over a longer period of time. This allows for the processes to mature and for controls to be tested. When exceptions are found early, the process and root cause can be reexamined and updates can be put in place with sufficient time to allow them to operate and be retested.

There are multiple stakeholders that have to get aligned for a successful SOX project.

The effective review of a company's internal controls provides assurance regarding the completeness and accuracy of the financial data necessary to drive the business and bolster investor confidence. Strategic CFOs will focus their efforts on making internal controls a part of day-to-day business operations.

There are multiple stakeholders that have to get aligned for a successful SOX project. These include management, the board, external auditors, SOX provider, legal counsel and any other consultants that may impact financial processes (e.g., technical accountants, equity advisors, and so on). Expectations have to be set and progress measured against these expectations.

Caveat: Many companies who have registered as an EGC (Emerging Growth Company pursuant to the JOBS act) tend to put off beginning SOX compliance preparation as they are not required to obtain an opinion regarding their controls from external auditors (a 404(b) opinion). While exempt from the requirement to obtain such an opinion, these companies are not exempt and in fact require that management attest in writing to the quality of these controls (a 404(a) assertion). This assertion should be based on documentation and testing—the work that you began early in anticipation of this and a multitude of IPO readiness requirements.



06.

MISSED PROJECTIONS / OTHER SURPRISES

A rule that always applies in the public markets, and should always apply in the private markets, is to under promise and over deliver.

A rule that always applies in the public markets, and should always apply in the private markets, is to under promise and over deliver. Failure to adequately prepare can result in misses from two sources. The first is finance and management not being on the same page regarding an investor relations communication philosophy. Entrepreneurs are born with aggressive DNA and this is one area where this trait can be problematic.

The other source of errors and surprises is simply inadequate or rushed preparation. A full four quarters (even better, eight quarters) of reporting and projecting as a public company will help to identify weaknesses. And utilizing a full suite of ERP, CRM, FP&A and BI tools to give the CEO and Board of Directors a well-defined landscape for the company's current and future status can facilitate the development of reasonable management expectations and reduce the likelihood of error.

149
1,758
31
1,595
2,313
92
2,028

07.

LACK OF CLARITY ON PROFITABILITY DRIVERS

Without a clear understanding of how your company is bringing in revenue and what factors might impact those profits, you cannot articulate your value proposition to investors. This puts an organization at risk for stock price declines and thus, limited capacity to reinvest in the organization.

By building strong FP&A resources and implementing corporate performance management software, your leadership team can learn and monitor the critical performance indicators for your organization. Additionally, completing a comprehensive enterprise risk management assessment gives you the confidence to prepare for any upcoming risks to your bottom line.

There's no better way to learn how to operate as a public company than to practice being one.

08.

POORLY PREPARED / LAST-MINUTE EARNING CALLS

Organizations who deliver earnings calls with financial reports completed at the 11th hour and little time for the CEO, CFO, and board (often represented by the Audit Committee) to review, question and practice can be penalized by plummeting stock prices, loss of confidence, and investor lawsuits. And once again, the CFO is likely to end up in the hot seat.

During the IPO preparation process, CFOs can begin practicing for public company reporting requirements. By implementing new deadlines and driving toward measurable process improvement, the CFO can task the finance department with cutting its reporting time. CFOs can take a lesson from a Silicon Valley start-up called Box, Inc. Before filing its IPO, Box held company-wide lunch meetings to answer questions about the business and give management a feel for how similar calls with investors would be handled. Likewise, many companies use their boards or investors as proxies for public investors.

By the time your company is public, it will be too late to think about how to meet the added financial reporting responsibilities. CFOs can facilitate immediate demands by implementing key technology solutions—ERP, CRM, financial reporting, budgeting and forecasting and BI—while helping their finance team and executives streamline reporting procedures well before being placed in the spotlight of the public arena.

These practices create transparency and help provide a glimpse into what life as a public company will feel like. There's no better way to learn how to operate as a public company than to practice being one.

09.

UNPREPARED OR INEXPERIENCED BOARD

On the job training is challenging for a public company's finance and accounting staff and the same holds true for its board. The habits of operating as a public entity are in many ways different than those in the private realm: working with public investors, the functioning of board committees, and the intricacies of SOX and ERM are only some examples of the differences. Bringing on experienced board members (especially those with Audit and Compensation Committee experience), who can help manage the process and serve as resources for the management team, can reduce risk and accelerate the process.

Conversely, a board that isn't internally aligned or which struggles to make rapid and clear decisions amplifies risk and adds to management's challenges. Early identification and recruitment of appropriate board members can be one of the most effective preparatory steps a company can take.

INVESTOR RELATIONS (IR) CONDUCTED LATE OR INADEQUATELY

An effective investor relations program is much more than preparing presentations and scripts. Deeper value should come from building investor relationship early, providing a disinterested channel for two-way communications, building discipline around the calendar and preparation, and reducing the burden on operating management. This is particularly true for teams with relatively little public company experience and where the impulse to manage the stock price from day to day may be difficult to avoid. Focusing on financial and operating performance and not catering to the Street can be easier said than done, but is likely to lead to better long-term outcomes.

An additional benefit from beginning an early IR program is to create a smooth and de-risked path to an IPO. Underlying all the hoopla and energy that goes into choosing bankers, writing the S-1, and preparing the roadshow is the simple transaction of one party selling something (in this case, stock) to another party. And like any transaction, this can be facilitated by personal relationships, a history of performing, and occasional but regular updates. A strong IR program can start this process early, identify potential investors, and help to create consistent and compelling outreach.

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#	Issue	Risks	Solution	Potential Investment & ROI
1	**Unable to file S-1 in desired timeframe**	• Missed market	• Quality ERP implementation • Strong technical accounting team	• Quality ERP = $100,000 - $3 Million, depending on the size & complexity of your organization • Resource investment = $100,000-150,000/ annual salary • ROI = 16 percent profit margin gain (Aberdeen Group, "The Value of Upgrading ERP, Maintaining Modern Technology")
2	**Financial Statement Restatement**	• Stock volatility • CFO unemployment • Lawsuits	• Quality ERP implementation • Strong technical accounting team	
3	**Enterprise Risk Management (ERM) conducted late or inadequately**	• Lack of data necessary to run business • Overly manual processes that cannot scale	• Upgrade ERP early • Have a defined systems strategy that goes beyond ERP • Define data/reporting regulatory requirements and separation of duties	
4	**Missed Projections / Other surprises**	• Stock volatility • CFO unemployment • Lawsuits	• Quality ERP implementation • Strong FP&A • Reasonable management expectations	• Quality ERP = $100,000 - $3 Million, depending on the size & complexity of your organization • FP&A automation = $50,000 - $500,000, depending on size and complexity of organization • ROI = 16 percent profit margin gain • ROI = 95% decrease in time spent on budgeting processes (Adaptive Insights Study)
5	**Unable to file 10-K or 10-Q on time**	• SEC Penalties • Stock price decline • CFO unemployment • Lawsuits	• Quality ERP implementation • Strong FP&A • Reasonable management expectations	
6	**SOX preparation conducted late or inadequately**	• Audit issues • Increased audit fees • Material weakness	• Begin early • Take phased approach • Complete in advance of IPO	• SOX preparation = $100,000 - $1 million, depending on the size and complexity of organization • ROI = ability to use internal staff for some tasks. An online company valued at more than $2.5 billion took a $300,000 documentation project in-house prior to its IPO and spent just $40,000 in audit preparation fees

	Issue	Risks	Solution	Potential Investment & ROI
7	**Lack of clarity on profitability drivers**	• Stock price decline • Limited capacity to reinvest	• Quality ERM implementation • Strong FP&A	• Quality ERM = Varies by size and complexity of organization • FP&A automation = $50,000 - $500,000, depending on size and complexity of organization • ROI = Thinking about risk proactively to evaluate smart risks that will help companies grow • ROI = 95% decrease in time spent on budgeting processes
8	**Poorly prepared/ last minute earnings calls**	• Stock price decline • CFO unemployment • Lawsuits	• Continuous improvement in close • Pre-IPO dress rehearsals	• No cost investment except time well spent • Best in class organizations have a 3.9 day close cycle; laggards spend 8.1 days or more on their close (Aberdeen Group)
9	**Unprepared or inexperienced board**	• Dysfunctional board • Difficult process	• Early identification and recruitment of appropriate board	• No cost investment except time well spent • ROI = Time savings achieved by well-run board meetings and streamlined decision
10	**Investor Relations (IR) conducted late or inadequately**	• Poorly executed IPO • Stock price decline	• Early start on Wall St relationships • Understanding key metrics	• No cost investment except time well spent • ROI = Difficult to measure but will be strongly felt, especially in a down quarter.

CONCLUSION:

By taking advantage of the synergies created when implementing the solutions outlined above, whether or not an IPO is imminent, companies eliminate the leakage that occurs from poor business processes or from focusing on non-strategic risk mitigation. For instance, the internal controls/fraud risk is cut in half in the following scenario:

> *A fast-growing company currently requires four finance staff members and ten days to close the books on QuickBooks. When the organization implements a modern ERP, it can reduce the close to three days, increase segregation of duties, and provide management with more relevant, actionable information earlier in the month.*

If your organization has already evolved beyond QuickBooks or homegrown financial systems, your initial investment costs for quality ERP may not be as high as estimated in the "potential investment" section of the chart on the previous page. The more strategic you are as the CFO in your systems selections and enterprise risk management processes, the easier and more cost-effective your road to IPO will be.

When CFOs take the broad perspective of treating IPO preparation not as an event, but as part of their focus on strategic leadership, the CFO can provide continuous improvement over the long run. By acting like a public company, the organization benefits from a CFO who can provide visibility to internal processes, ensure proper SOX compliance and enterprise risk management systems are in place, and allow the company to identify risks and opportunities for efficiency. In addition, management will have the accounting and information systems and processes in place to provide the information needed to effectively run the company.

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