# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>2</td>
</tr>
<tr>
<td>Is a public offering right for my company?</td>
<td>4</td>
</tr>
<tr>
<td>Advantages of being a public company</td>
<td>4</td>
</tr>
<tr>
<td>Disadvantages of being a public company</td>
<td>5</td>
</tr>
<tr>
<td>Other critical questions and issues to consider</td>
<td>7</td>
</tr>
<tr>
<td>The process of going public</td>
<td>10</td>
</tr>
<tr>
<td>An overview of the IPO process</td>
<td>10</td>
</tr>
<tr>
<td>Legal and housekeeping issues</td>
<td>13</td>
</tr>
<tr>
<td>Financial issues</td>
<td>14</td>
</tr>
<tr>
<td>The board of directors</td>
<td>16</td>
</tr>
<tr>
<td>The players</td>
<td>16</td>
</tr>
<tr>
<td>The due diligence process</td>
<td>18</td>
</tr>
<tr>
<td>A typical timetable</td>
<td>20</td>
</tr>
<tr>
<td>The underwriting</td>
<td>22</td>
</tr>
<tr>
<td>Selection of the underwriter</td>
<td>22</td>
</tr>
<tr>
<td>Types of underwriting agreements</td>
<td>24</td>
</tr>
<tr>
<td>Letter of intent and the underwriting agreement</td>
<td>25</td>
</tr>
<tr>
<td>Underwriters’ compensation</td>
<td>25</td>
</tr>
<tr>
<td>The registration statement</td>
<td>26</td>
</tr>
<tr>
<td>Filing forms</td>
<td>26</td>
</tr>
<tr>
<td>Required disclosures</td>
<td>26</td>
</tr>
<tr>
<td>Life as a public company</td>
<td>28</td>
</tr>
<tr>
<td>Your commitment</td>
<td>28</td>
</tr>
<tr>
<td>Reporting requirements</td>
<td>29</td>
</tr>
<tr>
<td>Investor relations and material disclosures</td>
<td>31</td>
</tr>
<tr>
<td>Summary</td>
<td>33</td>
</tr>
<tr>
<td>Exhibit A</td>
<td>34</td>
</tr>
<tr>
<td>Glossary</td>
<td>36</td>
</tr>
</tbody>
</table>
INTRODUCTION

The purpose of this publication is to assist you in evaluating whether an initial public offering (IPO) of your company’s common stock is a viable method of raising capital. The booklet answers some of the basic questions asked by owners, executives and boards of directors in making this decision. It also provides a guideline for the sequence of events involved in an IPO and some of the general business considerations involved in this decision. This publication is not intended to provide a detailed discussion of the technical requirements of an IPO since these requirements are exceedingly complex and continually changing. We encourage you to discuss the specific requirements of an IPO with your legal counsel, registered public accounting firm and underwriter once you have decided to proceed further in your investigation.

An IPO should not be viewed as an end, in and of itself, but instead should be considered the beginning of a new era for your company. An IPO can be an effective way to obtain the capital necessary to expand and grow your business and to take advantage of additional opportunities.

This publication:

- Provides guidance on determining if, and when, your company is ready to go public
- Reviews considerations for and against being a public company
- Provides an overview of the procedures and processes required
- Helps you prepare for the historic event

RSM US LLP has specialists available to answer questions not covered in this publication. Whether your company is a private equity group or a closely held company seeking to expand through an IPO, we can help. Our experienced professionals can provide guidance before, during and after the process of going public. We encourage you to call your local office [http://rsmus.com/locations.html] to arrange a meeting with an SEC specialist.

The contents of this publication should not be construed as accounting, auditing, consulting or legal advice on any specific facts or circumstances.
The term going public refers to a closely held company’s initial sale of securities to the general public. To go public, a company must file a registration statement with the U.S. Securities and Exchange Commission (SEC) that is in compliance with the Securities Act of 1933 (1933 Act). In addition to filing the registration statement with the SEC, you might be required to file these documents with each state in which you intend to sell your company’s common stock or other securities. The state securities filings generally are referred to as Blue Sky filings. The SEC is primarily concerned with adequacy of disclosure and generally does not evaluate the merits of the offering. However, while most states are concerned with the disclosures, they also evaluate the fairness of the offering price to their residents. Accordingly, many states have certain rules that provide for the escrowing of management’s shares or other restrictions if the offering price is excessively high in comparison to prices of prior sales of the company’s common stock.

Numerous factors must be considered in determining whether your company is a candidate for an IPO. Some key considerations are: company size, profitability, shareholder expectations, current stock market conditions, amount of capital to be raised, alternative forms of financing available to achieve your business goals, depth and experience of your management team, the future outlook for your business and the industry in which it operates, a comprehensive cost–benefit evaluation and your willingness to allow much greater transparency of your company’s operations.

**Advantages of being a public company**

**Capital for growth**
Growth opportunities often require substantial capital, and an IPO is an excellent means of obtaining this capital. An IPO allows a company to raise these additional funds either on an equity basis or on an equity basis combined with additional debt financing obtained from a financial institution or other intermediary. An IPO provides the company with cash to support growth and the related working-capital needs. Access to the public market will continue to be available if your stock performs well.

**Less dilution**
The price received for the securities is usually higher in an IPO than through a private placement or other form of financing.
Liquidity and personal wealth
A major portion of shareholders’ net worth might be tied up in your company’s stock. Once your company has completed a public offering, an active trading market usually will be established for the company’s common stock. A market for these shares might mean that, over time, these shareholders can convert some of their common shares to cash and diversify their personal investment portfolios. This liquidity also allows for increased estate-planning opportunities by making the value of the estate more readily ascertainable and allowing the sale of shares in the market for cash. Another factor to consider is that your shareholders’ personal net worth might significantly increase as a result of an IPO. However, it might be unlikely that significant shareholders and key officers will be able to sell stock in the IPO because of the appearance of insider trading.

Employee recruiting and retention
Stock-based compensation programs, usually stock-option programs, are one way to attract and retain key executives and managers. These programs are especially attractive if the company’s common stock is publicly traded. A stock-based compensation program might provide certain tax advantages to key executives and additional capital for the company. Also, if management successfully increases the company’s earnings and long-term value, a successful stock compensation program might enhance the market price for the company’s shares and create greater wealth for key employees and shareholders.

Acquisition strategies
An IPO is an excellent means of positioning your company for future acquisitions. A public company often can use its common shares, either alone or in conjunction with cash or debt, to acquire other companies, which would otherwise require the outlay of significant cash.

Improved ability to borrow
The sale of common stock increases your company’s net shareholders’ equity and improves its debt-to-equity ratio, which can improve your company’s ability to borrow on more favorable terms in the future.

Possible competitive advantages of going public
The publicity the company receives in going public provides name recognition and increased visibility. Although such publicity is usually positive, it should be noted that negative publicity also is a possibility as a result of an IPO.

Stockholder interest
Customers, suppliers and employees who own stock will have a heightened interest in the company’s success.

Control
An IPO generally results in more passive shareholders than other forms of financing.

Disadvantages of being a public company
The personal “tug-of-war”
In certain closely held businesses, owners are not overly concerned with conflicts resulting from personal-versus-business implications of various transactions. However, in a public environment, it is critical to separate personal and business transactions. In fact, most transactions involving personal conflicts must be eliminated from the business either prior to the IPO or upon its completion.

Privacy
Regulatory rules require a company to disclose a wide array of information, including profitability, financial strength, competitive position, line-of-business and product-line information, related-party transactions, executive compensation and fringe benefits. In most cases, this information previously has not been disclosed to anyone, including most employees. In particular, detailed disclosures comparing your company’s executive compensation and performance with other industry members are required. These disclosures often are viewed by privately held companies as a major disadvantage of going public. Some business owners find it unthinkable that their employees, customers, suppliers and competitors, among others, will know their compensation, the nature and amount of related-party transactions and other previously confidential information.

Loss of control
Depending on the size of the IPO and subsequent offerings, a major shareholder might lose absolute voting control of the company. While a major shareholder might still have the largest single block of common stock and thereby still have effective control, that shareholder might be uncomfortable with not owning more than 50 percent or legal control of the outstanding voting common shares. This concern can be minimized by having a wide distribution of stock to many new shareholders through a retail rather than or in addition to an institutional investment banker, so a concentration of holdings does not occur. Further, poor performance can result in substantial internal and market pressure and, in some cases, loss of management control, since you will have a number of outside (nonemployee) directors as a public company.

Compensation
Public companies usually have a compensation committee that makes recommendations on matters regarding executive compensation. The level of compensation and benefits the company paid as a private company might not be appropriate for a public company.
Reduced management flexibility
As a public company, certain decisions that previously were made unilaterally by management or the owner group will now require approval by the board of directors or shareholders. This can result in reduced management flexibility and require more management discipline.

Costs
There are usually significant transaction costs associated with completing an IPO. The initial cost of an IPO can be as high as 10 to 15 percent or more of the gross proceeds of the offering, depending on its size and complexity. In addition, substantial costs and time can be expended on an offering that is abandoned at the last minute due to unfavorable market or other conditions beyond your control. This can result in significant costs that might have little or no future benefit to your organization.

Upon completion of an IPO, public companies become subject to new regulations and reporting requirements. For example, the Sarbanes–Oxley Act of 2002 imposes many reporting and procedural obligations, and complying with it requires the assistance of professionals.

Your expense for accountants, legal counsel and consultants will increase significantly as they help you comply with applicable laws and regulations. In addition, the application of these new laws and regulations might result in some cultural adjustments and strain for your management resources.

Performance pressure
The stock market is concerned with current quarterly performance, and a company that misses estimated earnings by only a few cents per share can experience a significant adverse effect on its share price. This threat frequently creates substantial pressure on management to meet performance expectations, a short-term emphasis that can be detrimental to long-term performance. A management team not previously concerned about a company’s price per share, or that previously operated with an emphasis on tax minimization, can find this pressure difficult to handle. Development-stage companies usually will be given some grace, but eventually the market will demand performance.

Stock price volatility
After a company goes public, the price of its shares is affected by many factors other than its historical financial performance, including the overall state of the economy, stock market fluctuations in general and adverse events in the company’s industry, so in spite of good financial performance, your company’s stock price may not perform as you believe it should. This can be frustrating, as the value of the stock is impacted by these market swings.

Opportunity cost
The process of completing an IPO can have a short-term negative effect on the business. You must allocate a substantial amount of executive and management time to the IPO process and should anticipate distractions from your company’s day-to-day business activities. The executive and managerial time required for an IPO is usually far greater than initially anticipated.

Responsibility to shareholders
Management will have a permanent responsibility to public shareholders, and must take into account the effect on the shareholders when making decisions.

Sharing growth
If the company expects to experience a rapid increase in profits in the years immediately following the IPO, and other resources (e.g., bank loans) are available to finance that growth, the company may be better off delaying the IPO so as to not share that growth in value of the business with new shareholders.

Restricted shares
Only the shares sold to the public in an IPO are free to trade in the market. Owners’ shares are not freely tradable unless sold or registered through a registration statement or pursuant to Rule 144. Owners’ shares and those of certain officers are restricted from being sold into the public market for a period of time. Additionally, officers cannot sell their shares if inside information is available to them that is not available to the public.

Housekeeping
Many times, the company will have to modify its corporate bylaws and/or charter to complete an IPO. In addition, all corporate records will have to be brought up to date to pass due diligence by the underwriter.

The decision is final
Once you have become a publicly owned company, it is extremely difficult or impossible to reverse the process. Therefore, make sure this is the road you wish to travel before completing this course of action.
Other critical questions and issues to consider

Does company size make a difference?
One of the most commonly asked questions when considering a public offering is how large a company must be to go public. There is no single correct answer because IPOs are undertaken by companies of all sizes—from startup companies in the research-and-development stage to established companies looking to expand their operations.

For established companies, it is most important that there is a sound management team in place and a high likelihood of significant growth in sales and profits in the near term. Predictability of sales and earnings growth is also a major advantage. To evaluate whether the public will be interested in your company’s securities, you should evaluate your company’s sales and earnings performance over the past five years and your prospects for the future. If this evaluation shows above-average growth in sales and profits, the public likely will be interested in your company’s securities.

On the other hand, some start-up companies successfully complete IPOs even though they have losses or limited revenue. In these cases, the company usually has some other characteristic that overcomes this lack of profitability and/or sales. These characteristics might include a unique new product or concept, operations in a business sector favored by the markets, an outstanding management team with a track record of significant successes, or a recent development that has positioned the company for outstanding growth in the future. Examples might include a high-tech company, a software company or a company in the alternative-energy industry.

How much capital can the company raise?
How much money a company can raise in an IPO is dependent upon several factors, such as the company’s value, the current condition of the stock market, the percentage of the company that the existing shareholders are willing to give up (dilution), the business stage of the company, the uses to be made of the funds received, and the underwriter selected. It is sometimes advantageous to raise a lesser amount in the initial IPO, and additional funds in a subsequent offering. This approach can minimize the initial dilution of your interest compared to a larger IPO and delay raising capital until it is needed. However, it is essential that a sufficient number of shares of common stock be sold to enable an active trading market to develop. In addition, going public is an expensive process, and there are no assurances that subsequent offerings will be completed.

Can I sell some of my stock in the IPO?
Whether an owner can sell personally held shares of common stock in an IPO and the amount that can be sold, if any, are questions for you and the underwriter to determine. Usually, however, the inclusion in an IPO of shares owned by individuals who are active in the operation of the business is discouraged if it might be construed as a “bailout” of the current owners/managers. The sale of some or all the shares owned by minority shareholders not active in the business is usually acceptable up to specified limits. This does not mean that you cannot sell any of your common stock if you are active in the management of the business. However, the sale of such shares allowed by the underwriter is usually limited.

Further, the underwriter usually will require a lock-up agreement with major shareholders/managers for a period after the offering—typically six months, but occasionally up to a year. This agreement provides that, even if permitted under the securities laws, these individuals cannot sell shares in the open market until after the expiration of the lock-up period. The intent of the lock-up agreement is to avoid any inference that management or major shareholders are bailing out of the company, which could adversely affect investors’ perceptions about the company’s future and, as a result, jeopardize the underwriter’s ability to sell shares to the public. Frequently, management shareholders precluded from selling shares in the IPO will be able to sell some shares in a future public offering and, in any event, will be able to sell a limited number of shares in the open market after holding the shares for at least two years.

How much of the company will I need to give up?
One of the greatest concerns of an owner or manager of a closely held business is, “What amount of ownership percentage do I have to give up to raise the funds I need?” The answer is normally dependent upon the company’s size, the size of the offering, the near-term outlook for the company and the need for and use that will be made of the funds raised. This topic should be discussed initially with your underwriter to ensure you are in agreement with the anticipated ownership dilution prior to moving ahead with the offering.
How can my employees participate in company ownership?
This issue is most frequently handled by having the company adopt an incentive stock-option plan, either in anticipation of or concurrent with the IPO. Many owners of private corporations have precluded employee ownership in their companies and elect to adopt a stock-option plan concurrent with the IPO. This allows employees to acquire shares at fair market value on the date the options are granted, usually representing the offering price, but to defer the investment decision throughout the term of the option. In addition, options are an excellent vehicle to retain employees by making the options subject to vesting requirements. Of course, in most instances, employees might also purchase shares directly in the open market after the IPO.

Can customers, suppliers and friends purchase shares of my company’s stock?
This question is important if there is significant demand for the company’s common shares and it appears that the offering will be oversubscribed. Generally, you cannot sell shares directly to customers, suppliers or friends of the company. However, underwriters will sometimes assist these groups by allocating some shares to specifically named organizations or individuals. This is a matter to be discussed with the underwriter well in advance of the sales effort.

How can I use the funds raised in an IPO?
Funds raised in an IPO can be used for any valid business purpose, including business or asset acquisitions, repayment of existing indebtedness, research and development activities or working capital and other needs. The greatest success, however, is attained when the proceeds from the sale of shares is used in connection with a well-thought-out business plan, which provides for long-term value growth through expansion of the business, as opposed to debt repayment. Careful consideration should be given to how the proceeds will be used because the planned use of the proceeds must be disclosed in the registration statement, and the proceeds must be expended generally as disclosed. Subsequent to the IPO, the company will be required to report its actual use of the proceeds in its periodic reports filed with the SEC.

How is the stock price determined?
The proposed selling price of the securities to the public, and accordingly, the amount of net proceeds to be received by your company and the selling shareholders, if any, are determined by the underwriter at the conclusion of a preliminary investigation of the company. The underwriter generally considers the company’s future earnings potential, the current stock market conditions and the condition of the industry in which your company operates. The IPO price normally will be set as a range and at a discount from the anticipated after-market selling price. Naturally, you would like to receive the highest price possible for your company’s stock. However, an excessively high IPO price may not be to your company’s advantage. If the initial offering price is perceived as too high by potential investors, the underwriter might have difficulty selling shares in the IPO. Additionally, a weak after-market could result if the price of the company’s shares falls below the offering price. This obviously has an adverse impact on the company, IPO investors and the underwriter’s reputation.

Although the underwriter determines the offering price, you should make a preliminary evaluation of your company to assess the fairness of the proposed price. In the final analysis, you must determine if you are willing to sell shares at the proposed IPO price. You certainly do not want to incur the cost of proceeding with an offering only to determine later that the price is unacceptable. A qualified valuation specialist often can assist you in evaluating the reasonableness of the proposed offering price or in determining a reasonable fair market value for your company.

Once the offering price has been determined, the underwriter likely will propose changes to your authorized shares and will inform you of the number of shares it anticipates purchasing for resale to the underwriting syndicate or the public. Also, the underwriter usually will negotiate an overallotment option of up to 15 percent of the shares offered. If market acceptance is good, the underwriter often will purchase these additional shares from your company at the original offering price for immediate resale to meet this high demand.

A word of caution: The underwriter is not committed to a final price until immediately before the registration statement becomes effective, even if the managing underwriter has indicated a price range that you have found acceptable. At that time, you will have incurred substantial out-of-pocket costs and have expended significant time in the IPO process. However, the actual price might be substantially less than the initial price range due to market changes or other factors that were not anticipated at the time of the initial pricing decision. If you determine the price to be unacceptably low, you are not obligated to proceed with the offering.
What are the tax consequences of going public?
For most private companies, there are no significant tax advantages or disadvantages in being a publicly held company, except that the company can no longer operate as an S corporation or as a limited liability company. However, if your company has experienced significant losses in prior years and is in a net-operating-loss carry-forward position, a public stock offering might severely limit your use of these net-operating-loss carry forwards in the future. Therefore, before undertaking an IPO, management should carefully evaluate the impact the offering may have on the company’s current and future income tax situation. In addition, a careful review of any tax accounting exposure areas should be performed. Appropriate actions should be taken before the IPO process begins.

It is critical that the major shareholders of a private company involved in an IPO develop a comprehensive personal tax strategy before the IPO is commenced. In many instances, the market value of the shares of a private company that goes public will increase substantially. Matters that should be considered in this strategy include:

- The gifting of shares to children and/or other family members prior to the public offering to minimize gift, estate or income taxes
- The timing of the offering and the amount of gain to be realized from the sale of shares if a secondary offering is contemplated by the major shareholders
- The change in cash compensation and employee benefits (e.g., insurance, stock options) to be received from the company as a result of the offering

Where will the stock be traded after the offering?
A company can file for listing on the Nasdaq Stock Market, New York Stock Exchange (NYSE), NYSE MKT LLC, or other exchanges if listing requirements can be met. These requirements change periodically, and you should review the requirements with your attorneys if you want your shares to be listed on one of these exchanges.
THE PROCESS OF GOING PUBLIC

An overview of the IPO process

If you have decided a public offering is the best financing solution for your company, you should realize that the IPO’s success depends on careful planning and the assistance of a team of qualified professionals. The planning process should begin two to three years before the anticipated date of completing the offering. This lead time is important if you wish to keep IPO costs to a minimum, avoid surprises, adequately prepare the company for the due diligence process and the public scrutiny associated with an IPO, and increase the chances of good market timing.

The first thing to do in anticipation of an IPO is to develop a business plan detailing your strategic, marketing and financing plans for the future. This plan should include financial projections showing the amount of financing needed and the uses to be made of the funds raised. To help you identify areas needing special attention before you contact potential underwriters, you also should review a due diligence checklist, an example of which is included in Exhibit A of this guide.

Once you have completed your business plan and due diligence checklist, the company is ready to select a managing underwriter. The underwriter purchases the securities from the company and sells them to the public through a syndicate. Management must demonstrate to the underwriter that the company is qualified to go public. Your business plan, the company’s financing needs, the attractiveness of your company to the market, and a projected shortage of “problems” in the due diligence process will be factors in generating underwriter interest in your company. The estimated sales price per share and the number of shares to be offered are then negotiated with the underwriter.
Once the underwriter is selected, the underwriter begins the due diligence process and the preparation of the registration statement, a disclosure document filed with the SEC that consists of two parts:

- The prospectus, which is distributed to potential purchasers of the securities
- The supplemental information section, which contains other detailed information and various exhibits, including copies of key legal contracts and documents

The due diligence process and the preparation of the registration statement are usually the most time-consuming activities in the IPO process.

As the owner or manager of a private company, you likely will be surprised, and possibly frustrated, by the substantial disclosure requirements of the registration statement. The most important aspects of going public are understanding what information is required of you and then presenting it in a clear and forthright manner. To better understand the process and the role of the key team members, you should know what information will be required. The average two to three months (or more) that it takes to prepare to file the registration statement is generally due to the extensive due diligence process, the registration statement development itself and the frequent and interrelated business decisions that often must be made and implemented as part of the IPO process.

Once the registration statement is in final draft form, it is filed with the SEC in electronic format using the SEC’s Electronic Data Gathering and Retrieval (EDGAR) system. You also may be required to file the registration statement with the various states in which the securities are to be offered. The SEC thoroughly reviews the document and responds (usually within 30 business days) with comments about disclosures and accounting matters that need enhancement, clarification or modification. The comment letter process might require several rounds of SEC comments and company responses, including revisions to the registration statement. The SEC will declare the registration statement effective only after the required changes have been made and when it is satisfied with the responses to the comments. If the initial document filed with the SEC is printed, the underwriter might distribute copies of this preliminary prospectus, also known as a “red herring,” to potential investors during the period that it is under review by the SEC. However, the underwriter frequently will print a preliminary prospectus only after receipt of the initial SEC comments and the filing of an amendment to address such comments.

Prior to its IPO, a company may confidentially submit to the SEC a draft registration statement for nonpublic review by the staff of the SEC prior to public filing. This confidential treatment option permits the company to resolve accounting or disclosure issues with the SEC privately and delays exposure of sensitive competitive information until the certainty of an offering is confirmed. The initial confidential submission and all amendments to the registration statements then must be filed publicly at least 15 days prior to the IPO road show or, in the absence of a road show, at least 15 days prior to the requested effective date of the registration statement.

Although the underwriter cannot take orders or deliver securities until the registration statement becomes effective, most of the underwriter’s selling effort takes place beginning with the original filing and concluding when the registration statement becomes effective. The managing underwriter usually forms a sales and distribution syndicate. This syndicate of underwriters uses its salespeople to distribute the preliminary prospectus to clients and to obtain indications of interest in the stock. Although these indications of interest are not legally binding, they enable underwriters to evaluate the likely success and price of the offering.

Once the SEC is satisfied with the registration statement, but before it is declared effective, you will complete negotiations with the underwriter regarding the selling price per share, and the number of shares to be offered. A final amendment to the registration statement, the “pricing amendment,” is filed when this negotiation is completed. Subsequently, the registration statement is declared effective by the SEC and the securities commissioners of the various states, and the final prospectus is printed and sent to the underwriters’ customers along with the confirmation of sale.

The prospectus might appear to be a contradictory document. On one hand, it is a selling document and is used to persuade the public to purchase shares. At the same time, it must adequately inform investors of the offering’s risk factors and disclose all relevant information to protect against potential liability for material misstatements or omissions of fact. Accordingly, the prospectus can be a somewhat unpersuasive document. Your team of professional advisors can help you walk this fine line between salesmanship and liability protection. Obviously, full disclosure must be your paramount concern.

The final step in the registration process is the closing. The closing is the date on which you give the underwriter the shares of stock and, in return, receive the net offering proceeds. The closing generally is held three business days
after the effective date, giving underwriters time to receive most customers’ payments before the closing date.

Legal and housekeeping issues

Start early! You should begin the registration process well before the anticipated offering date. The following paragraphs summarize some of the steps that should be completed before the registration process begins.

Planning

Some of the steps that should be taken early in the IPO process are probably things your company already is doing. First and foremost, you should develop a thorough and sound business plan, together with financial projections. These documents will be important in convincing the underwriter that your company is an IPO candidate.

You also should consider whether shares of common stock will be gifted to others or whether options are to be granted to management, employees or others. There are many different views on what percentage of the company’s common stock can be set aside in a stock-option plan. Additionally, there are special SEC accounting and disclosure rules related to the exercise price of options issued within one year prior to a public offering if the estimated fair value is substantially below the IPO price. Therefore, it is never too early to consider this matter.

Further, you should evaluate whether each member of your management team is capable of leading the company following the IPO. As stated previously, there are differences in how decisions are made in a private company versus a public company. Certain management styles that succeed in a private setting might not work in the public setting. You need to decide whether each team member can adjust appropriately. If not, this evaluation might result in changes to your team.

Get your legal house in order

There are many differences between operating as a privately held company and as a public corporation. Many private companies operate without the formality of shareholder and/or board of director meetings – something critical for public companies. In addition, certain transactions and agreements (e.g., many related-party transactions) that were considered routine for a private company are inappropriate for public entities. These should be reviewed, revised or eliminated as needed before beginning the IPO process. The proper legal structure is critical. The C corporation is the most often used organizational structure for public companies. Partnerships, limited liability companies and S corporations are generally inappropriate. Termination of the S corporation election usually can be deferred until the completion of the offering if all other issues relative to structure have been resolved. Further, the authorized shares of the company typically are adjusted prior to the filing of the registration statement to ensure that an adequate number of shares are available for sale in the IPO, exercise of warrants and options, future acquisitions or other purposes.

Shareholder agreements

Shareholder control agreements should be dissolved or terminated prior to the offering. All shareholder rights of first refusal and buy-sell agreements also will need to be terminated prior to the offering. Stock-option plans should be established and options granted, if possible, well in advance of the IPO. You should consider adopting anti–takeover provisions to minimize an unwanted takeover of your company following the IPO. Your lawyer can assist in deciding which anti–takeover provisions are best for you and your company.

Pending or in-process litigation

All existing and threatened litigation should be considered carefully by you and your legal advisors. All pending or in-process litigation or disputes should be reviewed and, if possible, resolved to minimize complications and to avoid lengthy disclosures in the registration statement.

Bylaws, articles and minutes

Normally, you will need to authorize additional shares of common stock and, as a result, amend your bylaws and articles of incorporation before undertaking the offering. This should be discussed with legal counsel well in advance of the offering. In addition, your attorney must review and complete, where necessary, all minutes of the directors’ and shareholders’ meetings. Legal counsel probably also will review the ownership documents relating to your major assets.

Major transactions

It is generally not a good idea to get involved in major transactions during the impending IPO process. Transactions such as the purchase of a business or the sale of a piece of your business will add complexity to the registration process and detract from necessary time requirements of key management. However, certain transactions such as bridge loan and some common stock transactions are unavoidable or necessary.
Financial issues

Accounting and reporting systems
Most private companies that maintain their records in accordance with U.S. generally accepted accounting principles usually do not follow some of the unique accounting principles or disclosures that generally are required of public entities. Some of the most common accounting and financial reporting matters a private company will encounter during the IPO process include stock-based compensation issues, the computation of earnings per share, the treatment of preferred and mandatorily redeemable stock, the accounting for transactions with employees and officers, segment reporting, and the use of private company accounting alternatives.

Further, many smaller privately owned companies do not have adequate accounting or internal control systems in place that will be required once they are publicly owned. These issues must be addressed long before the offering is undertaken. Starting with and following the offering process, accurate and timely financial reporting is essential. You must ensure that your company’s accounting and internal control systems are capable of meeting these demands.

Audit requirements
Historical financial statements are a cornerstone of the registration process. Investors view an audit as an independent validation of financial reporting standards. The audit of the financial statements must be performed by an audit firm that is registered with the Public Company Accounting Oversight Board (PCAOB). Further, all periods presented in the financial statements must be audited in accordance with PCAOB standards. If the audit of prior years was performed in accordance with generally accepted auditing standards, the audit firm will need to perform certain procedures to ensure it can issue its opinion in accordance with PCAOB standards.

The SEC has specific requirements for audited financial statements, which must be met before it will review the registration statement. The SEC will not waive the requirements for the number of years of financial statements that must be audited. If your company has been in existence for more than two years, the financial statements presented would generally include balance sheets as of the end of the two most recently completed fiscal years and statements of comprehensive income, shareholders’ equity and cash flows for each of the past three fiscal years, together with related footnotes. Certain IPO registration statement rules for smaller reporting companies and emerging growth companies (as defined) require audited financial statements that include balance sheets as of the end of the two most recent fiscal years and statements of comprehensive income, shareholders’ equity and cash flows for the last two fiscal years. However, the smaller reporting company and emerging growth company rules might not be available to your company. It is a good idea to review these requirements early in the process.

If the filing (or effective) date is more than 134 days after the most recently completed fiscal year-end, interim-period financial statement information is required. The interim-period financial information might be unaudited but must be reviewed by the company’s auditor. Occasionally, underwriters will require interim financial statements to be audited if they believe this will add credibility to the prospectus. In addition, the underwriter usually will require the independent auditor to issue a “comfort letter,” designed to assist the underwriter in the performance of due diligence procedures. As a result, the auditor will be required to perform additional procedures on financial data included in the registration statement.

Acquired companies
A common, significant problem in companies pursuing IPOs involves the audited financial statement requirements for businesses acquired during the reporting period. This issue focuses on whether a business (as opposed to assets) has been acquired and the relative significance of this acquired business to the company.

The determination as to whether a business has been acquired requires an evaluation of the facts and circumstances involved and whether there has been or will be sufficient continuity of operations of the acquired business. Generally, it is assumed that the acquisition of an entity, subsidiary, division, and even generally, a lesser component of an entity, might constitute the acquisition of a business.

If a business has been acquired, the audited financial statements of the acquired business might be required for certain periods prior to the acquisition date. The number of years to be included in the registration statement generally is based on the significance of the assets and net income or losses of the acquired business to the acquiring company. The periods required to be presented include the number of months of the acquired business that are already part of the company’s financial statements presented in the registration statement (i.e., the period since the acquisition was consummated). The requirements to determine the number of years of the acquired business’ financial statements are
complex and beyond the scope of this document. You should discuss this issue with the company’s auditor early in the IPO process. It is difficult to obtain a waiver from the SEC regarding these requirements. In general, if assets or earnings of the acquired business exceed 50 percent of the company’s respective amounts, three fiscal years’ audited financial statements are required. Two fiscal years are required if the results of the test are greater than 40 percent, but less than 50 percent; and one year is required if the results of the test are greater than 20 percent but less than 40 percent. These tests are different if the company files under the smaller reporting company or emerging growth company rules.
The players

There are a number of players, each of whom is involved in, and critical to the success of, any public offering. Selection of the proper professionals who will do a quality job for your organization should be one of your major objectives. Additionally, it is critical to establish the costs of the services to be provided by all members of your IPO team. A brief description of each of the major players is summarized below:

The underwriter

Sometimes referred to as the managing underwriter or the investment banker, the underwriter is responsible for getting your company's stock sold and determining at what price it will be sold. Typically, the underwriter forms a syndicate of other investment bankers who participate in the purchase of securities from your company (or the shareholders, if there are selling shareholders) at the closing date. The underwriter and syndicate members resell the shares to the public in the open market.

In addition to arranging for the sale of a company's shares, the underwriter provides market support for shares after the offering has been completed. The underwriter also can provide assistance in structuring the transaction and the timing of the actual offering, based upon its knowledge of the market and the company's industry. In addition, the underwriter's research capabilities should be evaluated and considered in your selection process. You can sell your shares to the public without an underwriter, but the process is extremely difficult and seldom done. Further, the absence of an underwriter usually has an adverse effect on the after-market support for your company's shares.

See “The Underwriting” for a discussion of the selection of an underwriter.

U.S. Securities and Exchange Commission (SEC)

The company must file a registration statement with the SEC before offering securities for sale in the public markets. The SEC thoroughly reviews the registration statement for compliance with its disclosure requirements, but does not pass on the merits or accuracy of the prospectus or the quality or worthiness of the underlying securities, or in any other way approve the registration statement. However, the registration statement cannot become effective without the consent of the SEC. The SEC has the authority to pursue civil and criminal prosecution against those who breach established procedures and disclosure requirements. Because of these regulations, disclosure documents must contain complete and accurate statements of material fact and not omit any required or other disclosure, which, by its absence, might mislead potential investors.

The registration statement typically is reviewed by the SEC’s Division of Corporation Finance. Teams of SEC attorneys and accountants, and frequently industry specialists, review the registration statement and issue a letter of comment on perceived deficiencies or inaccuracies (commonly referred to as a “comment letter”). An IPO typically will involve at least one comment letter. Upon receipt of the comment letter, the company, its legal counsel and registered public accounting firm together with the underwriters and their legal counsel meet to discuss the required response to the comments. When this group believes a comment letter issue is in need of discussion with the SEC, the SEC examiner is contacted to provide further relevant information. Otherwise, the registration statement is modified to satisfy the SEC’s concerns.

The period needed to respond to the SEC’s comments usually ranges from a few days to two weeks, depending on the nature and number of comments. When the registration statement has been amended to reflect responses to the
The board of directors of public companies typically will have one or more committees, including an audit committee, a compensation committee and a nominating committee. The audit committee must be directly responsible for the appointment, compensation and oversight of the company’s auditor. SEC rules and stock exchange listing requirements require a public company to have an audit committee consisting of independent members and at least one “financial expert” serving on its audit committee. For an IPO, the issuer’s audit committee must have at least one independent member at the time of the IPO, a majority of independent members within 90 days, and a fully independent committee within one year.

SEC’s comments, the company refiles with the SEC as an amendment. The typical review period for the original filing is 30 days, and the review period for amendments is usually a few days to a week. If the registration statement contains unusual disclosures or complex financial transactions, the SEC might have several rounds of comments. Each additional round of comments can add seven to 14 days to the filing process. The registration statement is declared effective only after the SEC is satisfied that all of its concerns have been resolved.

Additionally, the various state securities divisions might review the registration statement. Unlike the SEC, many states also review the offering for fairness. These reviews can cause delays and, in some instances, major changes to the document. In some cases, the state securities divisions have precluded a company from selling its securities in that particular state due to concerns over the merits of the offering. Further, Blue Sky laws are not uniform among states, thereby increasing the chance for delays. To avoid potential Blue Sky issues, it is essential that you, your legal counsel and the underwriters determine where the securities will be sold and identify potential problems that might be encountered. If significant issues are anticipated, it might be necessary to avoid registering the shares in a particular state or states.

Company officers and employees
The company’s CEO, CFO and other key officers will be involved in the registration process, particularly as it relates to drafting the registration statement and reviewing the document for accuracy. Usually, each of these individuals is interviewed by your SEC counsel, the underwriter and the underwriter’s counsel to help them gain a better understanding of the company, including its operations, products, issues and opportunities. The information provided by your company’s officers and employees will be incorporated into the disclosure document. It is critical that these individuals carefully review the appropriate sections of the final document to ensure accuracy and completeness. The CFO and his or her staff will be required to devote the most time to the process due to the need for extensive amounts of financial data, including financial statements, product-line and industry-segment information and management’s discussion and analysis of financial condition and results of operations.

The company’s SEC counsel
Due to the legal implications of going public, it is essential to select a law firm with significant securities law experience. If your present law firm is inexperienced with securities law or is not comfortable in this area, ask for a recommendation of another firm that will represent you well.

The company’s independent auditor
The independent auditor you use must have experience in the registration process and SEC requirements, and have the confidence and respect of your law firm, the underwriter and the underwriter’s law firm. The firm must be registered with the Public Company Accounting Oversight Board. Additionally, the independent auditor should give you the attention required to ensure that the stringent timetable of a public offering is met.
Underwriter’s counsel
The underwriter will be represented by separate legal counsel. While you have no input into which firm the underwriter decides to use, it is beneficial if your SEC counsel and underwriter’s counsel have previously worked together.

You should expect periods of frustration as the underwriter’s counsel and the company’s counsel seem to be duplicating work. The underwriter’s counsel is a necessary member of the IPO team and helps ensure that the underwriter is thorough in its due diligence process and is legally protected from inadvertent liability that could arise out of the registration process.

Financial printer
The financial printer selected should have experience in the printing of registration statements and related prospectuses and in preparing the detailed packages to be filed with the SEC. The financial printer must have the ability to meet tight deadlines, make quick changes and provide a high-quality product. Your legal counsel, the underwriter or your registered public accounting firm can recommend a financial printer that can meet your needs. Usually, the selection of a printer can wait until after you have selected legal counsel and an underwriter because printing is one of the last steps in the IPO process. However, the printer can serve you more effectively if involved in the process early and informed of timing requirements. The selection of a printer should never be determined solely by the lowest bid.

The due diligence process
Due diligence is the process of investigation of the company by the underwriters and their counsel to determine whether the company is fit for an IPO and that all material and pertinent disclosures are included in the prospectus and the registration statement. Additionally, the due diligence process allows the underwriter to develop a marketing strategy to help ensure the successful sale of the securities offered in the IPO. The due diligence review typically includes, but is not limited to, a review of the company’s business plan, market research, management team, articles of incorporation, bylaws, legal issues, patents, financial statements, other financial information and major contracts and agreements. In addition, the due diligence process encompasses the underwriters and counsel meeting with your key management team members and select employees, customers and suppliers.

This investigation effort is critical since, under the securities laws, any person who has signed the registration statement, was a director of the issuer at the time the registration statement became effective, consents to be named in the registration statement as becoming a director, or is an accountant, appraiser or engineer who consents to be named as an expert in the registration statement might be held liable if the registration statement contains any untrue statement of a material fact or if the registration statement fails to disclose materially important information. Be prepared for an in-depth probe of your company, its operations and marketing activities and its management personnel. Exhibit A lists some of the information typically requested as part of the due diligence process.
A typical timetable

The IPO process can extend over a three- to six-month period or longer, depending upon the planning involved, complexity of disclosures and financial transactions, number of rounds of SEC comments, and market acceptance of the offering. A typical IPO timetable follows:
DAY 35: The second draft of the registration statement (with financial statements) is circulated to the IPO team.

DAY 40: The second drafting session is held with the IPO team, and the draft is revised.

DAY 45: The IPO team receives the third draft of the registration statement.

DAY 48: The third drafting session is held with the IPO team. All revisions are made, and the document is submitted to the financial printer.

DAY 52: The first printer's proof is issued.

DAY 110: The road show commences, whereby the underwriters and certain key members of the company management and the company visit other syndicate members to introduce management and the company and discuss future plans and opportunities.

DAY 115: The SEC clears its comments.

DAY 116: The SEC declares the registration statement effective.

DAY 120: The closing of the offering is completed three business days after effectiveness; the company receives the underwriters' net proceeds and provides the underwriters with the necessary stock certificates.
THE UNDERWRITING

Selection of the underwriter

A successful IPO provides a fair price for the company and the selling shareholders, if any; a stable or rising share price subsequent to the IPO; and a strong following of interested security analysts. Almost all IPOs are arranged through an investment banking firm (underwriter, managing underwriter). One of the underwriter’s functions is to underwrite your securities—that is, to buy your company’s securities from you and sell them to other syndicate members and/or the investing public. While nothing prevents you from conducting your own public offering, the use of a qualified underwriter is essential to ensure a successful offering.

Your initial contacts with an investment banking firm likely will be with a representative whose primary responsibility is to bring in new business for the underwriter. It is essential that you meet with and evaluate the investment banking, research and trading department personnel as part of your selection process. Further, your decision to select an underwriter should be based, in part, on the desire by the investment banking firm to develop a long-term relationship with your company. This often is demonstrated by the underwriter’s willingness to help you prepare your company for an IPO, even if the IPO is one or two years in the future.

Ideally, the selection process should begin well in advance of the proposed offering. This will allow you to assess the underwriter and how your company will work with them. Frequently, your independent accountant and SEC counsel can make introductions to several qualified underwriters with whom they have worked successfully in the past. You should talk to several underwriting firms to determine which one is right for you. However, you do not want to talk to so many underwriters that the offering is widely known. Some factors to consider include whether you need a national or regional perspective for the offering and whether the underwriter selected...
should have a strong retail (individual customers) or institutional capability. Bigger is not always better.

The rapport between you and the underwriter, the underwriter's interest in you and your company and the underwriter's ability to perform are essential to a successful relationship. In particular, you should review other IPO transactions the underwriter has completed. In addition, you should exercise caution regarding the proposed offering price per share. An underwriter who proposes to price the offering at an amount that is significantly higher than others may not be able to get the IPO completed at the quoted price or to sustain the stock price in the market following the offering. Your relationship with the underwriter will not, and should not, end when the offering is completed. You and the underwriter should be interested in a long-term relationship.

Underwriters are compensated based on commissions earned upon the successful completion of the offering. However, the selection of an underwriter should not be based solely on the commission to be paid. Instead, it should be based on other characteristics such as reputation, distribution capabilities, experience with companies of your size and industry, and the ability to sell your size of offering. The underwriter's existing backlog of offerings and the amount of attention you will receive also should be considered. Once the underwriting is completed, your underwriter must be capable of making a market for your company's shares and providing research and financial advice. For most companies, the optimal distribution of their shares would be to a large number of investors holding relatively small quantities of stock. This generally results in a larger trading market for your company's securities and somewhat mitigates the large swings resulting from the selling or buying of larger blocks of stock.

In the final analysis, your company might not have the luxury of choosing from a broad range of underwriters. Just as you must decide which underwriter is right for you, the underwriter also must select the companies that most closely match its size and capabilities. Accordingly, many businesses undertaking their IPO might not be able to attract an underwriter who possesses all the qualities they desire. It takes time to get the best match available, and the process should be started early.
Types of underwriting agreements

There are generally two major types of underwritings, with many variations of each. The optimal form of underwriting is the firm underwriting commitment, under which the underwriters agree to buy all the stock being offered at the offering price. They then resell it to other syndicate members or directly to the public. The underwriter bears the financial risk if it is unable to resell all the stock in a firm underwriting commitment.

The second major type of underwriting is the best-efforts arrangement, whereby the underwriters agree to use their “best efforts” to sell your company’s securities, but do not guarantee results. If they do not sell the entire amount to the public, or the minimum amount if there is a minimum/maximum provision, they have no obligation to purchase the shares. As such, they are acting merely as your agent, and you bear the risk if shares cannot be sold or if they are sold, that the minimum proceeds might be inadequate for your needs.

The firm commitment is generally the best arrangement because it provides more assurance that your company’s stock will be sold. The next most desirable arrangement is the best efforts—all or none. Although this puts the risk of sale on you, it assures you that you will not go public unless all stock is sold and sufficient proceeds are received to meet the requirements of your business plan.

However, a word of caution: The underwriter’s “firm commitment” only becomes a commitment when the underwriting agreement is signed by both you and the managing underwriter, which is usually on the day the registration statement becomes effective. Until then, you bear the risk if shares cannot be sold due to changes in market conditions, unfavorable market response to your company or improper pricing of the shares. Accordingly, if you have completed all audit and legal requirements, SEC filing work and printing, but the response to your offering is poor, the underwriter usually will not execute the underwriting agreement, and the IPO might be abandoned—at least temporarily. The result is a costly exercise for your company in professional fees, out-of-pocket costs and time. Accordingly, it is important that you discuss candidly with the managing underwriter the likelihood that it can complete the offering at the indicated price and its experience with terminated offerings.
**Letter of intent and the underwriting agreement**

You will be required to sign various documents with the managing underwriter before the IPO is completed. The two most significant agreements are the **letter of intent** and the **underwriting agreement**. The letter of intent is a nonbinding agreement (except for any expense provisions), which states that you and the underwriter agree to file a registration statement for a specified number of shares within a predetermined price range. Once it is signed, work on the registration process usually begins in earnest. A letter of intent, while not committing the underwriter to sell the shares, usually prohibits you from working with another underwriter for a specific period of time.

The underwriting agreement includes the duties and responsibilities of both your company and the underwriter, including the underwriter’s obligation to purchase the shares for resale to other syndicate members or the public. This document includes various representations and warranties by both your company and the underwriters. It also contains requirements for opinions from your SEC counsel and a “comfort letter” from your registered public accounting firm, which must be received by the underwriter before its purchase of the shares. It is important for your legal counsel and accounting firm to review this document before it is finalized. It is only upon the signing of the underwriting agreement that the underwriter is obligated to purchase the shares from your company for resale. Significant costs will be incurred between the time you sign the letter of intent and the underwriting agreement. Therefore, you should ask the underwriter for a copy of its typical underwriting agreement before signing the letter of intent to assure yourself that you will be able to sign the underwriting agreement when it is required.

**Underwriters' compensation**

Underwriters are compensated by receiving a commission based on a percentage of the gross proceeds from the offering. In most cases, this commission on IPOs ranges from 5 to 7 percent of the gross offering proceeds. A lesser percentage can be negotiated in certain circumstances, for example, in the case of a very large offering or where a seasoned company is undertaking its second or third offering. Underwriters often use other methods to increase their compensation, such as requiring expense reimbursements for certain costs incurred. Some underwriters require companies to reimburse them for accountable expenses up to a specific amount and for unaccountable expenses, often equal to 2 to 3 percent of the gross offering proceeds.

In addition, many underwriters require the registrant to sell them, at a nominal price, a warrant for the purchase of 10 percent of the number of shares sold in the offering at an exercise price equal to the public offering price, plus a percentage (such as 20 percent). This warrant is normally exercisable over a five-year period and, if exercised, results in further dilution of the existing shareholders. As a result, the company receives fewer proceeds as compared to the proceeds received when shares are sold on the open market.

One additional method of underwriters’ compensation is a requirement that you give them the right to act as the underwriter on your next public offering, with the same terms and conditions that you would be able to negotiate with other underwriters. Although the above represent some typical underwriter compensation arrangements, the compensation is usually negotiable with the underwriter to a limited extent and can vary significantly from underwriter to underwriter.
THE REGISTRATION STATEMENT

Filing forms
The most commonly used registration statement form is the S-1. There are also separate registration statement forms for real estate companies, seasoned companies that are already publicly owned and certain other companies, a discussion of which is beyond the scope of this document. Your SEC counsel will assist you in deciding which filing form is required for your offering.

Required disclosures
The following briefly discusses some of the most common types of disclosures included in an S-1 registration statement, but should not be considered all-inclusive.

Prospectus summary and risk factors
This section typically includes a summary of the information included in greater detail elsewhere in the registration statement. It usually provides a brief description of the company and its business, the securities being offered, selected summarized financial information and a listing and discussion of the major risk factors involved with an investment in your company. These risk factors should be company-specific and include industry or other general risk factors.

Use of proceeds
The anticipated use of the IPO net proceeds must be disclosed, including a description of the temporary use, if any. You are required to use the proceeds substantially as described in the prospectus. If not, the SEC might proceed against you for having filed a registration statement that included an untrue statement of a material fact. If the registration statement is your company’s first filing under the 1933 Act, you will be required to report the actual use of proceeds in periodic reports filed with the SEC.

Selected financial data and management’s discussion and analysis
This is, perhaps, the most important section in the prospectus. Selected financial information must be described in the registration statement for the company’s past five fiscal years, or such shorter time if it has been in existence for less than five years. It should be noted, however, that an emerging growth company is not required to present selected financial data for any period before the earliest audited period in its initial effective registration statement.

In addition, similar information must be disclosed for the period from the date of the latest audited financial statements to a month end that is not more than 134 days old at the time the registration statement is filed or becomes effective, as the case may be. This period normally is the period ending at the
Interim information for the corresponding period of the preceding year is also required for the statements of comprehensive income and cash flows.

The company also must discuss, in narrative form, major changes in operations and financial conditions during the last three fiscal years and between any interim periods presented. However, a smaller reporting company or an emerging growth company is only required to provide two years of analysis if it presents only two years of financial statements. The company also must discuss the company’s liquidity and capital resource requirements and off–balance sheet arrangements. This section is referred to as “Management’s Discussion and Analysis of Financial Condition and Results of Operations” (MD&A). Further, these disclosures must include any significant or unusual matters or uncertainties, trends, commitments or known transactions or events of which a prospective investor should be aware before making an investment decision. The impact of inflation on the company’s operations or financial condition also must be discussed, if significant.

**Business**

The registration statement must disclose detailed information, in narrative form, about the company, including its principal products or services, competition, marketing and distribution methods, research and development activities, plant facilities (including owned and leased locations), sources of raw materials and their availability, seasonal aspects of the business, backlog, dependence on key customers, and material legal proceedings. If a company operates in more than one industry, industry segment information must be disclosed, including operating profit by segment.

**Executive compensation**

Currently, companies are required to make detailed disclosures concerning the compensation, including bonuses, stock options, awards and other perks, of certain executive officers. Once your company is publicly owned, certain disclosures likely will be required for long–term incentive compensation plans and pension benefits expected to be paid, together with information comparing your company’s executive compensation and company performance with the performance of other industry members.

**Related–party transactions**

All material related–party transactions, including related–party sales, loans, rental arrangements and similar transactions must be described.

**Stock ownership and board members**

A table of the shares owned by existing shareholders and their families must be disclosed. In addition, disclosure of the company’s board of directors and officers is required, including their occupations for the last five years.

**Financial statements**

The prospectus must include audited financial statements, including balance sheets as of the end of the two most recent fiscal years; statements of comprehensive income, shareholders’ equity and cash flows for each of the three most recent fiscal years; and related footnotes. Smaller reporting companies and emerging growth companies must include audited balance sheets as of the end of the two most recent fiscal years; statements of comprehensive income, shareholders’ equity and cash flows for each of the two most recent fiscal years; and related footnotes. The balance sheet date in an initial registration statement should not be more than 134 days old, except that third–quarter data is timely through the 45th day after the most recent fiscal year–end. After the 45th day, audited financial statements for that fiscal year must be included in the registration statement. The financial information in an initial registration statement for a smaller reporting company may be up to 90 days after year–end if the issuer expects to report income in the current year and has reported income in at least one of the two previous years.

Any interim financial statements are usually as of the end of the company’s most recent fiscal quarter. The interim financial statements are usually unaudited. However, in some cases, underwriters might require audited financial statements for at least the latest stub period. Statements of comprehensive income and cash flows for the corresponding interim period of the preceding fiscal year are, however, normally unaudited.

**Other documents**

In addition to the various disclosures required in a registration statement, you also will be required to file with the SEC all material documents or agreements to which your company is a party. These might include corporate articles of incorporation; bylaws; lease agreements; compensation agreements; purchase, sales or marketing agreements; and other documents considered to be of significance to the investing public. All of these documents and the complete registration statement are available to the public, including your competitors, customers, vendors, employees and friends.
LIFE AS A PUBLIC COMPANY

Your commitment

Once your company becomes public, you have the obligation to keep your shareholders informed of all significant developments affecting the company. Business decisions become more complicated because you need the approval of the board of directors or the shareholders for certain major transactions. You also will need to decide whether a timely news release is appropriate and whether a current report needs to be filed with the SEC. The accounting impact of business decisions also needs to be considered. If an adverse accounting impact results, the stock price could suffer, and your liability exposure could increase.

Your new shareholders primarily are concerned with the value of their stock, and you will be challenged to increase the value of that stock. The desire to maintain earnings might put pressure on the company to delay or cancel necessary research and development activities or other expenditures that have long-term benefits. The result can be the sacrifice of long-term profits for short-term earnings. Management's challenge will be to balance the pressures of these short-term and long-term demands.

Further, the promotion of your company does not cease once the offering has been completed. The better your company is known, the broader the market support for your shares may be. A positive image within the investment community is crucial, and serious consideration should be given to using a public relations firm to assist in developing or maintaining this image.
Reporting requirements

Periodic reports

Once your registration statement becomes effective, the company is required to file certain periodic reports under the Securities Act of 1934 (1934 Act). The most common reports required to be filed with the SEC in compliance with the 1934 Act are as follows:

- **Form 10-K** – Must be filed annually after the company’s fiscal year-end. Form 10-K is designed to update the disclosures in your registration statement and, accordingly, includes the latest audited financial statements and a somewhat condensed version of the information disclosed in Form S-1. The Form 10–K is like a mini prospectus and is not a “form” to be filled out.

- **Form 10-Q** – Must be filed quarterly after the conclusion of each of the first three fiscal quarters. This report principally contains unaudited, condensed quarterly financial statements, MD&A and if needed, disclosure of certain specific reportable events. This report need not be filed for the fourth fiscal quarter.

- **Form 8-K** – Must be filed within four business days of certain events, including entry into or termination of a material definitive agreement; bankruptcy; acquisition or disposition of a significant amount of assets not in the ordinary course of business; public release of earnings information; creation or acceleration of a direct financial obligation or an obligation under an off-balance sheet arrangement; commitment to an exit or disposal plan; material impairments; material modifications to rights of security holders; changes in independent accountants; financial statement restatements; changes in control; departure or appointment of directors or principal officers; amendments to articles of incorporation or bylaws; temporary suspension of trading under employee benefit plans; and amendments to the company’s code of ethics.

- **Other** – There are various other reports that must be filed with the SEC, including reports on stock ownership changes by certain individuals and other forms. As the need arises, your securities counsel can review the requirements with you and discuss the impact of future reporting.
It is important that the company makes every effort to meet all the due dates for these periodic reports. Failure to do so could result in adverse consequences for the company.

The above forms are required primarily as a result of filing a Form S-1 with the SEC. If your filing was made pursuant to the smaller reporting company rules, the report requirements are the same as those above; however, the smaller reporting company can elect to use certain modified disclosure and financial statement requirements. Similarly, a company that qualifies as an emerging growth company can elect to use certain modified disclosure requirements. Your securities counsel or accountant can advise you on these issues.

Management of public companies must evaluate the effectiveness of internal control over financial reporting. Management’s assessment of internal control over financial reporting must be included in the annual report. Accelerated filers and large accelerated filers, as defined, also must provide the registered public accounting firm’s attestation report on management’s assessment of internal control over financial reporting in the annual report. In addition, each quarterly report must disclose the effectiveness of the registrant’s disclosure controls and procedures and disclosure of changes in internal control over financial reporting.

Proxy solicitations
There are select events during the life of a public company that require a vote by the shareholders. Examples of such events are the election of directors and approval of major acquisitions or divestitures.

When matters require a vote by the shareholders, it is usually not practical to assemble all the shareholders. The process of voting on company matters by shareholders is usually accomplished through the proxy system. The company will solicit from the shareholders the authority to vote their shares at a meeting. The SEC’s proxy rules specify the content of the proxy statements that are used in the solicitation process. The proposed proxy statement must be filed with the SEC a certain number of days prior to the date that the proxy materials will be mailed to shareholders. In addition to a proxy statement, the company is required to send a copy of its annual report to each shareholder in connection with an annual or special meeting. The SEC specifies the content of the annual report, but it is generally consistent with the financial statement disclosures required in Form 10-K.

Insider transactions
The 1934 Act requires each officer, director and holder of more than a specified percentage of any class of equity security (insiders) to file a report with the SEC before the IPO becomes effective. This report discloses all beneficial holdings of equity securities of the company. Once the form is filed, any change in the reporting person’s beneficial holdings occurring during any calendar month must be reported on another form within two business days of the transaction.

Insiders also are subject to the “short swing profits” rules of the SEC. These provisions require that any profits realized by insiders on the purchase and/or sale of the company’s equity securities within a six-month period must be turned over to the company. This provision applies regardless of whether the reporting person’s trading was based on material inside information, or whether such person’s trading losses exceeded trading profits. If the company does not sue to recover those profits, any shareholder may do so on behalf of the company. The SEC’s antifraud provisions impose an affirmative obligation on company insiders to disclose material nonpublic information before participating in securities transactions.

Liability and fiduciary duties
The registration process and the subsequent life in the public eye open up a new source of potential legal concerns and litigation. Under the various securities acts, management can be liable for inadequately disclosing a matter that is deemed significant to an investor. The principal executive officer and principal financial officer have a fiduciary responsibility to sign a certification in each Form 10-Q and Form 10-K. The certification addresses the fair presentation of the financial statements and other information in the report, and the company’s evaluation of the effectiveness of its internal control over financial reporting.

In addition, liability can arise if management acts upon insider information to either sell or buy its own company’s stock. Finally, inadequate or improper reporting subsequent to completion of the offering also can lead to liability. As a result of this expanded liability exposure, it is critical that management conducts all of its activities with a view toward its fiduciary responsibilities to its shareholders, rather than its own gain.

The use of an outside board of directors will help carry out this fiduciary responsibility, especially if transactions affecting insiders are required to be approved by a majority of the
outside directors. The liability exposure resulting from the public company environment sometimes can deter qualified outside individuals from serving on a public company’s board of directors. To mitigate this concern, you might want to check with your insurance carrier about obtaining directors’ and officers’ liability insurance.

**Investor relations and material disclosures**

The financial community will take an active interest in your company once you go public. As a result, it is important that you develop a good relationship with the financial community and promptly disclose material information necessary for investors to make informed decisions.

It will be important that your company establish open and effective communication with the financial community, particularly with the research departments of investment bankers and retail brokers and with certain individual analysts following your industry. These individuals help investors evaluate and interpret the potential performance of an investment in your company’s securities by monitoring the financial and other information available to them about the company and the industry. Typical communications used in the evaluation process include the quarterly and annual reports required under the securities laws and press releases about certain significant events affecting the company. Additionally, analysts might request management interviews and visits to your company. As a result, it will be important to have an integrated and effective communication process to provide timely and accurate information to analysts and the investing public.

One of the most difficult and important aspects of being a public company involves the timely and accurate disclosure to the investing public of any material positive or adverse developments affecting the company. These developments typically are reported through press releases. However, certain information might be kept confidential when you have legitimate business reasons for doing so. The typical types of information that should be disclosed include financial results, management changes, acquisitions, important new contracts, and new products or services.

The most difficult aspect of disclosing material events is ensuring that the confidential information is not prematurely disclosed to someone who might rely on it to buy or sell your company’s stock. Regulation FD requires prompt public disclosure of any information that might affect a company’s stock price (such as advance notice of earnings results) when a company has disclosed such information to securities analysts or selected institutional investors before making full disclosure of that information to the general public. If you have disclosed information prematurely, you must release that information to the public as soon as practical. In effect, you must disclose the material information to everyone simultaneously.

To assure compliance with SEC rules regarding material disclosures, many companies authorize only certain officers or employees to communicate with the financial community. Certain larger organizations frequently designate an investor relations officer to provide clear and consistent press releases, financial data and other disclosures and to respond to requests for information from shareholders, analysts and the general public.
An IPO is an excellent tool to help you increase the value of your business, to provide long-term liquidity for shareholders and to assist the company in achieving its business strategies. However, undertaking an IPO is difficult and should not be taken lightly. The decision as to whether an IPO is right for your company depends on many factors, but principally requires you to clearly understand where the company is headed; to obtain a proper balance of short- and long-term needs for both shareholders and the company; and to determine whether the company is strong and organized enough to meet the challenges and requirements of being a public company. A comprehensive business plan, including a financing plan, is one of the best ways to prepare you for this decision.

We hope this document helps you understand whether an IPO will be a beneficial financing tool for you. Please call your local RSM office if we can be of further assistance.

(http://rsmus.com/locations.html)
EXHIBIT A

Example of due diligence request list

1. Business structure
   - Business plan
   - Organization chart by legal entity, division and department
   - Employee counts by functional area
   - Articles of incorporation and bylaws, together with all amendments
   - Company minutes for the last five fiscal years
   - List of all cities and states where the company has operations

2. Financial information for the business
   - Financial statements for the last five fiscal years
   - Auditor’s communication of deficiencies in internal control over financial reporting and management’s responses for the last five years
   - Quarterly breakdown of financial performance for the last two fiscal years
   - Explanation of revenue and cost recognition methods
   - Analysis of components of direct costs
   - Summary of current and historical backlog trends
   - List of top 10 customers for the last three fiscal years, including revenues and profit from each customer; estimated percentage of sales and profits for each for the next two years
   - Discussion of geographic breakdown of revenues, customers and contracts
   - Analysis of accounts receivable and receivables aging
   - Description of budget forecasting methodology and copies of all past board-approved annual budgets and current-year operating plan, with detailed buildup of revenues and expenses
   - Historical budget--versus--actual--results analysis for the last five fiscal years
   - Projected comprehensive statements of income, cash flow statements and balance sheets for the next five years (including quarterly information for next two years), with a list of assumptions
   - Details of any financial transactions with related parties from the last five fiscal years
   - Details of acquisitions in the last five fiscal years
   - Information on all planned acquisitions or dispositions
   - Details on all planned major capital expenditures
   - List of all internal and industry--specific reports utilized by management on a regular basis
   - Summary of the company’s income tax policies, potential exposures and estimated balance sheet reserves
   - Description of any reserves on the balance sheet and timing of reserve utilization going forward
   - Description of any intangible assets on the balance sheet and related amortization schedule
   - Details of patents, trademarks and copyrights
   - Description of contingent liabilities
   - Name of major suppliers and amount of purchases from each in the last five years

3. Marketing
   - Company sales literature and advertisements, including a description of the range of products and services offered by the company
   - Copies of all press releases, news articles or brochures issued to the press or to company shareholders during the past three years
   - Copy of the company’s strategic marketing plan
   - Discussion of competition, together with any detailed factual information
   - Industry studies discussing market size for the company’s products or services
   - Copies of research reports or market studies for the last three years

4. Operations and facilities
   - Details of property ownership and lease arrangements
   - Detailed property and equipment records
   - Details of information system equipment, software and capabilities
   - Review of current needs for relocation and expansion
   - Review of environmental issues
5. References

- Contact names and phone numbers of top 10 customers, key suppliers and professional advisors (including law firms, accountants, insurance agents and other consultants)

6. Shareholder information

- Summary of the company’s capitalization, including number of options, warrants, preferred shares and common shares
- Proposed option plan or compensation for directors
- Shareholder agreements
- Shareholder lists

7. Corporate finance

- Summary of terms of bank line-of-credit agreements, including any amendments, renewal letters, notices, waivers, etc.
- List of other agreements evidencing outstanding loans, guarantees by the company or indebtedness secured by assets of the company
- Summary of currency or other hedging practices

8. Employees, officers and directors

- Resume for each officer and director
- Overview and copies of key employment contracts
- Current and three-year historical remuneration of board members and key employees
- Details of proposed changes in compensation plan
- Benefits programs: option programs, pensions, health and life insurance, profit sharing and any other human-resource–related liabilities
- Discussion of employee relations, including details on any union contracts or strikes
- Employee turnover history
- Details of any contemplated changes in executives or their responsibilities
- Agreements, such as employment contracts, loans to purchase stock, consulting contracts, etc.

- Description of any recent transactions between the company and any “insider” (i.e., any officer, director or owner of a substantial amount of the company’s stock) or any associate of any insider or between or involving any two or more insiders

9. Regulatory/legal

- Review of outstanding or threatened litigation, investigations or regulatory audits
- Description of any contingent liabilities
- Discussion of potential impact of health care reform legislation and the changing health care environment, generally, both in the United States and abroad
- Details of internal quality control/regulatory compliance review efforts
- Details of any material quality control/regulatory compliance problems over the past five years
- Summary of insurance coverage and bonding relationships
GLOSSARY

Accelerated filer
The term *accelerated filer* means an issuer after it first meets the following conditions as of the end of its fiscal year:

- The aggregate worldwide market value of the voting and nonvoting common equity held by nonaffiliates of the issuer is $75 million or more, but less than $700 million (as of the last business day of the issuer’s most recently completed second fiscal quarter);
- The issuer has been subject to the Exchange Act’s reporting requirements for a period of at least 12 calendar months; and
- The issuer has filed at least one annual report.

Acceleration
Upon request, the SEC may waive the automatic effective-date waiting period of 20 days after the pricing amendment is filed. This request is utilized frequently.

All-hands meeting
The full assemblage of your offering team, including company officers, the company’s SEC counsel and accountant, the underwriter and underwriter’s counsel.

All-or-none
A variation of a best-efforts commitment whereby all the stock is sold by the underwriter or the entire offering is canceled. In a “partial all-or-none” or “minimum/maximum all-or-none” commitment, a fixed portion, such as two-thirds of the stock, must be sold for the offering to be effective; the remainder is sold on a best-efforts basis.

Analyst
Someone who studies certain industries or stocks and advises investors.

Best-efforts offering
An underwriter’s hedge: they agree to use “best efforts” to sell the stock but are under no obligation to purchase it.

Bid and ask price
The bid price is the highest price someone is willing to pay. The ask price is the lowest price at which someone is willing to sell.

Blank-check shares
Shares that are undesignated as to rights—typically, preferred shares established before an IPO when such an action can be executed easily without the expense and delays of submitting the action to a broad and diverse group of public shareholders. Although such shares are used infrequently when needed for a timely private placement or other financial need, these shares can be invaluable.

Blue Sky
The name applied to state securities laws. Its origin comes from fraudulent schemes in the early 1900s, including selling building lots in the “blue sky.”

Book runner
The managing or lead underwriter who maintains the books of securities sold for a new issue.

Capitalization
The total amount of securities issued by a company, including, in certain circumstances, short- and long-term debt.

Cheap stock
Shares purchased or options granted at a significantly lower price than the IPO price, within one year prior to an IPO for SEC purposes. However, some states have no time limit.

Closing
The meeting at which final documents are exchanged, stock certificates are delivered and the issuer receives its proceeds.

Comfort letter
A letter that the company’s registered public accounting firm issues to the underwriter to assist with the underwriter’s due diligence process. These letters discuss the results of agreed-upon procedures, as specified by the underwriter, on financial information included in the prospectus.

Comment letter (deficiency letter)
The SEC’s response to the initial or subsequent filings, stating the areas of the registration statement that have been found to be incomplete or which require further explanation.

Dilution
The decrease from the pre-IPO per-share book value of the company to the per-share book value after the IPO net proceeds are received. This also can refer to the decrease in the percentage of ownership held by the original shareholders.

Due diligence
A standard of reasonable investigation by the company’s underwriter, accountant or lawyer.

Effective date
The first day on which securities of a registered offering may be sold. It is automatically 20 days after the pricing amendment but is usually accelerated.

Emerging growth company
A company may be considered an emerging growth company if it had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year. An issuer that is an emerging growth company as of the first day of that
fiscal year may continue to be deemed an emerging growth company until the earliest of:

- The last day of the fiscal year of the issuer during which it had total annual gross revenues of $1.07 billion or more
- The last day of the fiscal year of the issuer following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement
- The date on which such issuer has, during the previous three-year period, issued more than $1 billion in nonconvertible debt
- The date on which such issuer is deemed to be a large accelerated filer (generally an issuer with market capitalization greater than $700 million)

**Exempt offering**
A securities transaction that requires no registration statement under the 1933 Act.

**Exercise price**
The price at which equity securities may be purchased in the future through exercise of a stock option or warrant.

**Firm commitment**
An underwriter’s agreement to buy all the common stock offered at a fixed price and resell it to the public.

**Foreign Corrupt Practices Act**
Requirements, enforced by the 1934 Act, to ensure that companies maintain adequate records and systems of internal control. It also discusses payments to foreign officials.

**Greenshoe**
See “Overallotment option.”

**Gun jumping**
Excessive market stimulus before the registration statement becomes effective. The SEC may object to or postpone an IPO because of gun jumping.

**Housekeeping**
The company’s thorough preparation of legal affairs to avoid last-minute obstacles to going public.

**Investment letter**
A statement obtained from the purchaser of an exempt offering affirming that the securities are being bought for investment and not for redistribution.

**Insider**
Any officer, director or holder of more than 10 percent of a company’s publicly held stock.

**Investment banker**
See “Underwriter.”

**IPO**
Initial public offering.

**Large accelerated filer**
The term *large accelerated filer* means an issuer after it first meets the following conditions as of the end of its fiscal year:

- The aggregate worldwide market value of the voting and nonvoting common equity held by non-affiliates of the issuer is $700 million or more (as of the last business day of the issuer’s most recently completed second fiscal quarter); and
- The issuer has filed at least one annual report.

**Legended stock**
See “Restricted stock.”

**Letter of intent**
Agreement in which the underwriter states an intention to sell your offering. It does not obligate the underwriter to bring your shares to market but usually prevents you from dealing with other underwriters for a stipulated period of time.

**Lock-up**
A contractual handcuff or escrow requirement by underwriters that prevents insiders from selling their shares in the market for a specified period after going public.

**MD&A**
Management’s Discussion and Analysis of Financial Condition and Results of Operations. It is required by SEC Regulation S–K and focuses on the company’s financial condition, results of operations, liquidity, capital needs, resources and off-balance sheet arrangements.

**Managing underwriter**
The managing underwriter forms a syndicate with other underwriters and, as a result, leads the syndicate in its efforts.
Market maker  
A dealer who maintains bid and ask prices of a particular stock in an over-the-counter system.

Market valuation  
The total amount of a company's outstanding shares of common stock multiplied by the current share price.

NASDAQ  
National Association of Securities Dealers, Inc.—reviews the proposed IPO transaction to ensure the underwriter's compensation is reasonable.

NASDAQ  
National Association of Securities Dealers Automated Quotation System—an automated trading and information system that provides price, volume and trade information on securities traded over the counter.

Offering circular  
An abbreviated registration statement and prospectus used in certain offerings that are exempt from SEC registration under the Securities Act of 1933.

Overallotment option  
A provision allowing the underwriter to buy up to an additional 15 percent of shares issued from the company at the offering price, typically within 30 to 45 days of the offering date. (This is also known as the greenshoe option because the Green Shoe Company was the first to use it.)

Overpricing  
When the first trades of the newly issued stock are below the IPO price.

Price amendment  
The registration statement amendment specifying the initial price at which the stock will be sold to the public. This is usually the last amendment, made after the SEC has reviewed all prior amendments.

Price-earnings ratio  
The price of a share of common stock divided by its earnings per share.

Primary offering  
The sale of a company's previously unissued common stock, such that the net proceeds of the offering go to the company.

Private placement  
The issuance of securities that are exempt from registration because they are not being offered to the public (e.g., only to accredited investors, such as banks and wealthy individuals who meet certain criteria).

Pro forma  
A financial statement presentation that reflects the anticipated effects of a particular transaction (e.g., merger, acquisition or divestiture) on a company's historical financial statements.

Prospectus  
The printed document used to sell shares to the public. It is usually Part I of the registration statement, which describes the company and the offering and provides other information on which to base investment decisions.

Proxy  
The means by which a shareholder authorizes another person or group to act or vote on his or her behalf at a shareholders' meeting.

Public Company Accounting Oversight Board (United States)  
A private-sector, not-for-profit corporation created by the Sarbanes-Oxley Act of 2002 to oversee auditors of public companies.

Quiet (cooling-off) period  
The time between reaching an understanding with the underwriter to go public and 90 days (sometimes shorter if listed stock) after the first sale of the common stock. Promotion of the company during this period is subject to restrictions detailed by the SEC.

Red herring  
The preliminary prospectus, which is required to have a legend on the front declaring that the registration statement has not yet become effective, is subject to completion or amendment and does not constitute an offer to sell. It is circulated during the "quiet period."

Registrar  
A person or institution appointed by the company to issue certificates to new shareholders.

Registration statement  
A document consisting of a prospectus, and all other required disclosures not included in the prospectus, which is filed for securities offered under the 1933 Act.
Regulation S–K
The standard instructions for preparation of the nonfinancial statement portions of forms filed with the SEC under the 1933 and 1934 Acts.

Regulation S–X
Establishes the requirements for financial statements, independent audits and financial information included in registration statements and periodic filings.

Restricted stock
Securities, which typically are unregistered with limited transferability, usually purchased in accordance with private placements or other offerings exempt from registration.

Road show
The tour by company officials and the underwriters designed to generate interest in an offering among analysts and investors during the “quiet period.”

Rule 144
A rule that allows the sale of restricted stock in the public market under certain circumstances.

SEC
The U.S. Securities and Exchange Commission.

Secondary offering/partial secondary offering
Previously unregistered stock offered for sale by a public company and/or its existing shareholders.

Securities Act of 1933 (1933 Act)
Regulates the IPO and distribution of securities.

Securities Exchange Act of 1934
Also known as the Exchange Act and the 1934 Act, it regulates the trading of securities in secondary markets after the IPO and distribution of securities under the 1933 Act.

Short sale
Selling a borrowed stock with the intention of repurchasing it after the price goes down.

Short-swing profits
A rule under the 1934 Act that requires officers, directors and holders of more than 10 percent of a company’s common stock to remit any profits to the company on round-trip trades of less than six months.

Smaller reporting company
Under SEC rules, a company qualifies as a smaller reporting company, and therefore for scaled disclosure, if it has (a) less than $250 million in common equity public float as of the last business day of its most recently completed second fiscal quarter, or (b) annual revenues of less than $100 million in the most recently completed fiscal year and either no public float or a public float of less than $700 million.

Stabilization
The act of an underwriter who purchases stock of a new issue at or below its offering price in an attempt to stabilize the price.

Syndicate
Underwriters who form a group to offer securities.

Tombstone
Advertisement of the offering during the “quiet period” that is permitted to state only the issuing company’s name, the title and number of shares being offered and where the prospectus may be obtained. Companies customarily place these ads after the effective date, when more information may be included.

Transfer agent
The company’s appointee to maintain the stockholder ledger cards, which record the transfer of shares from one person to another.

Underpricing
When the first trades of the newly issued stock trades are above the IPO price.

Underwriter
The underwriter with whom you reach an agreement to market your common stock.

Underwriting agreement
A binding contract between the underwriter and the company, normally signed within 24 hours of the expected effective date of the offering.

Waiting period
The time between the initial filing of the registration and the effective date.

Window
The market window refers to the appetite and receptivity of the market to complete an IPO. An open window means many IPOs are being completed, while a closed window means very few IPOs are being completed.
ABOUT RSM

At RSM, we challenge ourselves every day to truly understand our clients’ business, aspirations and challenges—and provide fresh insights and appropriately tailored services. As a leading provider of audit, tax and consulting services, this approach empowers our clients to confidently prepare for changes and address issues of concern.

We offer national and international capabilities, specialized knowledge in a variety of industries, and a full range of professional services that growth-oriented companies need, including audits, accounting for complex transactions, tax compliance services, SOX compliance consulting, IPO readiness assistance, financial advisory services and many other services. Our public clients are listed on all the major stock exchanges and they, along with our private company clients, rely on us to provide hands-on partner-level attention, valuable insights, timely communication and quality services.

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