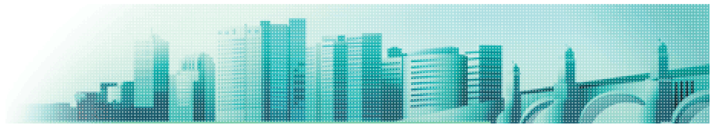

The JOBS Act—The "IPO On-Ramp" Makes IPOs Easier

David A. Westenberg

Enacted with great fanfare in early April, the JOBS Act is intended to improve access to the public capital markets for startup companies. The cornerstone of the act is the creation of an "IPO on ramp" which provides "emerging growth companies" up to five years following their IPO to come into full compliance with various disclosure and accounting requirements. By reducing the cost and complexity of going public, at least to some extent, the act should encourage eligible companies to pursue IPOs.

An emerging growth company (EGC) is any company that had annual revenues of less than $1 billion (indexed for inflation) during its most recently completed fiscal year, other than a company that completed its IPO on or before December 8, 2011. Approximately 90% of all IPO companies over the past five years would have qualified as EGCs. Emerging growth company status ends after five years or earlier if the company's annual revenues reach $1 billion (indexed for inflation); the company has been public for at least twelve months, files one Form 10-K and achieves a public float of at least $700 million; or the company issues more than $1 billion in non convertible debt during a three year period.

The JOBS Act provides a number of important benefits to EGCs:

• Reduced Financial Statement and MD&A Disclosure: In IPO registration statements, emerging growth companies are required to provide only two years of audited financial statements (instead of three) plus unaudited interim financial statements. In addition, an EGC need not present selected financial data in other registration statements or reports filed with the SEC for any period prior to the earliest audited period presented in its IPO registration statement. Similarly, an emerging growth company is only required to include Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) for the fiscal periods presented in the required financial statements.

• Exemption from Internal Controls Audit Attestation: Emerging growth companies are exempt from the requirement of the Sarbanes Oxley Act that an independent registered public accounting firm audit and report on the effectiveness of a company's internal control over financial reporting. As a practical matter, IPO companies will still need to implement robust controls and procedures prior to going public.

• Delayed Application of New Accounting Standards: Emerging growth companies may choose not to be subject to any newly adopted or revised accounting standards unless and until these standards are required to be applied to non-public companies. This election must be made on an "all or nothing" basis and is irrevocable. Opting out may not always be beneficial, however, as it may make the ultimate transition out of emerging growth company status more painful.

• Exemption from New Audit Requirements: EGCs are exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors supplement their audit reports with additional information about the audit or financial statements of the company that the Public Company Accounting Oversight Board might adopt. Any other new auditing standards adopted by the oversight board will not apply to audits of emerging growth companies unless the SEC determines that application of the new rules to audits of these companies is necessary or appropriate in the public interest.

• Reduced Executive Compensation Disclosures: An emerging growth company is allowed to provide the "scaled" executive compensation disclosures previously available only to companies with

a public float of less than $75 million. An EGC need not provide Compensation Discussion and Analysis (CD&A); compensation information is required only for three named executive officers (including the CEO); only three of the seven compensation tables otherwise required must be provided; and the Summary Compensation Table is only required to cover two years (as opposed to three).

• Exemption from Additional Compensation Disclosures: Emerging growth companies are exempt from the Dodd-Frank Act requirements, which are not yet in effect, to include disclosures about the relationship between executive compensation and financial performance and the ratio between CEO compensation and median employee compensation.

• Exemption from Say-on-Pay, Say-on-Frequency and Say-on-Parachute Requirements: Emerging growth companies are exempt from the requirements mandated by the Dodd Frank Act that companies seek stockholder approval of an advisory vote on their executive compensation arrangements, including golden parachute compensation.

• Confidential Submission of Registration Statements: An EGC is able to submit a "draft" Form S-1 to the SEC for confidential review instead of filing it publicly. A Form S-1 that is confidentially submitted must be substantially complete, including all required financial statements and signed audit reports. Confidential submissions do not have to be filed publicly until 21 days before the road show commences, enabling an EGC to maintain its IPO plans in secrecy and delay disclosure of sensitive information to competitors and employees until much later in the IPO process.

Emerging growth company status is also available to companies with annual revenues of less than $1 billion that completed an IPO after December 8, 2011. These companies will need to decide whether to adopt EGC standards in future SEC filings.

An eligible company may choose to forgo any of the exemptions provided to EGCs and instead comply with the requirements that apply to a company that is not an emerging growth company. However, the company must decide whether it will avail itself of the exemption regarding the extension of time to comply with new and revised accounting standards at the time the company is first required to file a registration statement or other report with the SEC after April 5, 2012. An emerging growth company is not permitted to choose to comply with some but not all of the non-EGC accounting standards.

The extent to which emerging growth company standards will be adopted by eligible companies and accepted by the market is uncertain. Institutional investors could, for example, demand that EGCs continue to comply with non-EGC standards for some or all matters. A pre-IPO emerging growth company should discuss with its IPO underwriters the impact of adopting the standards on marketability of the offering. An emerging growth company that went public after December 8, 2011, should consider market and investor expectations before adopting EGC standards.

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