

# ISSUES & INSIGHTS

## JOB Act: Relaxing Sarbanes-Oxley for Smaller Businesses

by: Jeremy Sucharski & Jim Gellas

On April 5 this year, President Obama signed the JOBS Act (*Jumpstart Our Business Startups*) into law. The legislation – designed to give a new designation of company, emerging growth companies (EGCs), an easier path to going public and to raise funds privately – has been criticized by the Securities and Exchange Commission and others for weakening regulations. Still, there's no doubt that this controversial legislation will “reduce friction” and costs in the IPO mechanism, potentially enabling many more small but growing companies that meet specific thresholds of revenue to go public. In the following article, Armanino McKenna's Jim Gellas and Jeremy Sucharski explore the JOBS Act and assess its impact on IPO activity.

Fast growing technology startups and mid-caps considering an IPO should have an easier path to becoming public companies thanks to the JOBS Act. EGCs will benefit from changes to the IPO process including:

- New ability to make pre-filing offers to institutional investors;
- Permission to initiate the registration process confidentially with the SEC;
- The need to produce only two, rather than three, years of audited financial statements to go public; and
- Research analysts will be allowed to publish reports on EGCs im-



mediately after they become public companies.

Featured in the new Act is an “on-ramping” process that provides EGCs of under \$1 billion in annual revenue or under \$700 million in market capitalization, a lengthened transition period of one to five years during which the regulatory requirements are scaled back in order to ease the cost of compliance. During the on-ramp process, smaller companies are exempt from the most controversial requirement of the Sarbanes-Oxley act of 2002, Section 404(b); the personal certification and guarantee of financial controls by the chief executive officer and attestation by a licensed auditor. However, companies are still required to comply with the other provisions of the act.. EGCs are

also exempt from:

- Detailed narrative disclosure requirements of compensation discussion and analysis;
- The executive compensation voting requirements of the Dodd-Frank Wall Street Reform Act of 2010, including the requirements for say-on-pay, say-on-frequency and say-on-golden parachute shareholder votes;
- The Dodd-Frank executive compensation disclosure provisions requiring the pay-for-performance graph and CEO pay ratio disclosure; and
- Any rules that the PCAOB may adopt relating to mandatory audit firm rotation and any requirement to include an auditor discussion

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and analysis narrative in the audit report.

In an article that recently appeared on “D – All Things Digital,” a tech blog, Benchmark Capital Partner Bill Gurley was quoted as saying that in the pre-JOBS Act world, a company with \$80 million in revenue and 10 percent operating margins would have paid between \$3 million and \$5 million to go public. “That’s half your profit,” Gurley said.

Under the JOBS Act, EGCs can spread their expenses out over a longer period of time, meaning that you have budget flexibility.

If you’re considering an IPO and your company qualifies as an EGC, start your IPO readiness activities early because the more runway you have the less risk you take on. Here are some of our suggestions for IPO readiness for EGCs:

**Register with the SEC as an EGC** – All companies that qualify as EGCs must do this. However, the process is simple and takes only an hour or two. This is the first move to putting yourself on the IPO runway.

**Set a five-year timeline** – Once you register with the SEC the clock starts ticking and you have up to five years to complete the ramp up to your IPO. It’s important to be prepared to take the full five years in the event you need all of that time. You cannot control what happens in the markets or the business environment so the more time you have the more options you have in terms of

accelerating, aborting or staying on schedule for your IPO if market conditions warrant any of those options. Even if you exceed the \$1 billion revenue / \$700mm market cap limits for EGC sometime in the five year window, the JOBS Act rules enable you to take advantage of the full timeline if you began as a qualified EGC.

**Address highest risk areas first** – Although you are exempt from auditor sign off aspect of SOX compliance during the five year ramp up, this is one of the high risk areas that must be addressed if you aspire to gain full access to the public markets. Becoming SOX compliant takes time and money. Having solid financial controls in place before you go public will allow you to have some experience and knowledge before you are required to be fully compliant.

**Set up or revamp accounting and business processes** – Consult with your accountants or business consultants to audit your accounting processes. Identify where improvement is needed and collaborate with your consultants to get these in place.

**Update your technology** – There is a whole new breed of cloud financial management technology that is revolutionizing corporate accounting. Best-in-class SaaS providers are delivering ERP, CRM, business intelligence, stock option accounting and budgeting and forecasting tools that seamlessly integrate with legacy systems and deliver data to desktops, smartphones

and tablets. These technologies benefit companies because they are customizable and feature rapid ROI and low total cost of ownership. Issues like security, protection of data and investment in hardware and software are taken care of by the providers, who are providing most of the infrastructure, usually for a subscription fee.

**Budget flexibly** – This is a five-year plan, so you can be flexible. For instance, maybe your business is cyclic or seasonal so you know that in years 1 through 3 you’ll have more to spend on IPO readiness than in years 4 and 5. Matching your IPO readiness expenses with your business cycles is a good way to fund your pre-IPO ramp up.

Whether you question the potential risks of allowing these relaxed rules for smaller companies or believe the JOBS Act will jumpstart the U.S. economy, you should know the benefits and the risks of operating in this new environment for your company. However, if an IPO is one of your goals and your company qualifies as an EGC, you owe it to yourself and your enterprise to explore the potential benefits of registering with the SEC and starting down the IPO runway.

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