



John Diddams

John Diddams\* explains the IPO due diligence process and the directors' responsibility and liability for that process and the prospectus.

## The IPO due diligence process

The initial public offering, or IPO process is complicated and arduous, fraught with pitfalls for the unwary. It can be a time-consuming distraction for management and can often place a strain on the most cohesive board. Understanding the IPO process and how to manage it effectively can help avoid some of the pitfalls.

For most directors and management there is a steep learning curve during an IPO. Further, if the CEO has to take on the additional burden of managing the IPO process, the ongoing business of the company may well suffer. For this reason, one of the (existing or proposed) non-executive directors should be chairman of the due diligence committee (DDC).

The appointment and management of the external advisers to the IPO follows, which may include solicitors, investigating accountants, a broker and/or underwriter (who will also have their own solicitors), various industry experts, share registry and in some cases patent and trade mark attorneys, PR and investor relations consultants and possibly others. Each of these charge according to their input to the process, so good management is essential to minimise IPO costs.

The ultimate job of the DDC and the advisers is to produce a prospectus, with the following objectives:

- to include all information necessary for a reasoned decision on whether or not to invest in the company,
- to produce a prospectus that complies with the Corporations Law and the ASX Listing Rules,
- to establish due diligence defences for the directors and other participants, and
- to facilitate post-vetting of the prospectus by ASIC or ASX, if required.

The DDC should meet regularly, usually weekly, throughout the IPO process to manage and co-ordinate the due diligence process:

- agreeing on the nature and scope of the process,
- allocating responsibility for inquiries to the relevant advisers and experts,
- considering the reports of the advisers and experts,
- liaising with the prospectus drafting committee,
- implementing procedures to ensure the

prospectus complies with the law, and

- providing a final report to the board before the directors sign the prospectus.

Due diligence defences may protect directors from prosecution under the Corporations Law only if they can prove that, in relation to a defective statement, they:

- had made such inquiries that were reasonable
- had reasonable grounds to believe, and
- believed at all material times, that the statement was not misleading, or that there was no material omission from the prospectus.

A well-managed DDC is obviously an essential element in establishing these due diligence defences and minimising the potential liability of directors.

The DDC chairman should not be one of the advisers, as it is the company and all its directors that are personally liable for the entire prospectus. In some instances, the company solicitor adopts this role but this can often be an expensive exercise and is not ideal.

Prospectus drafting is also a key responsibility of the DDC and can become very tedious when important issues may be overlooked. If the process is well managed, however, "drafting overload" can be avoided.

Finally, the verified prospectus is signed off by the DDC and recommended to the directors, who approve it for lodgement with ASIC. Following the issue, ASIC may do a "post vetting" of the prospectus, which is when good record keeping by the DDC is of great assistance.

The IPO process generally takes around six months and sometimes longer. Only by managing the timeline effectively, will the IPO be completed within a reasonable time frame and obviously, the longer the process takes, the more expensive it will be.

To summarise, there are three fundamental principles for directors to consider:

- have someone who has done it before to manage the IPO due diligence process,
- the board needs someone experienced on their side to deal with and manage the advisers and experts, and
- the directors are ultimately responsible and personally liable for the prospectus and cannot outsource this liability to others.

Consideration of these principles will minimise director liability, saving time and money in the process.



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