Grant Thornton

Technical Accounting Alert

Cost of an initial public offering

Introduction

This alert details the accounting treatment for costs of an initial public offering (IPO) that involves both issuing new shares and a stock market listing.

Relevant Standards

References are made to standards issued by the International Accounting Standards Board. The Australian equivalent to each standard included in this alert is shown below:

International Standard reference	Australian equivalent standard
IAS 32 Financial Instruments: Presentation	AASB 132 Financial Instruments: Presentation

Overview

The costs of an IPO that involves both issuing new shares and a stock market listing should be accounted for as follows:

- Incremental costs that are directly attributable to issuing new shares should be deducted from equity (net of any income tax benefit) - IAS 32.37; and
- Costs that relate to the stock market listing, or are otherwise not incremental and directly attributable to issuing new shares, should be recorded as an expense in the statement of comprehensive income.

Costs that relate to both share issuance and listing should be allocated between those functions on a rational and consistent basis (IAS 32.38). In the absence of a more specific basis for apportionment, an allocation of common costs based on the proportion of new shares issued to the total number of (new and existing) shares listed is an acceptable approach.

Discussion

Entities commonly raise additional equity through a public offer of shares and concurrently list new and existing shares on a stock exchange (an exercise referred to as an IPO). The listing creates an active market in the shares and thereby provides liquidity to new and existing shareholders (along with other benefits and obligations).

IAS 32.37 requires that: "*The costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit)*". Raising additional equity through the offering and issuance of new shares is an equity transaction for this purpose, but the listing procedure is not. Only costs attributable to the offer of new shares are deducted from equity.

In practice, the offering and listing are usually a combined exercise. Certain costs, such as stamp duties and underwriters' fees, are clearly attributable to raising additional equity. Other costs, such as listing fees, relate only to the listing and should be expensed. However, the following costs should be considered:

- Legal fees;
- Accountants' fees;
- Other professional advisers' costs; and
- Prospectus design and printing costs.

These are likely to relate to both functions. Such shared costs should be allocated on a systematic basis between the share issue and the listing and then recorded in part as an equity deduction and in part as an expense.

The following table provides a general indication as to some of the costs incurred in an IPO, and the basis on which they might be allocated. The requirements and practices for issuing and listing shares differ significantly between jurisdictions and stock markets, therefore the costs incurred and their allocation will also vary depending on the specific facts and circumstances.

Type of cost	Allocation (share-issue, listing or both?)
Stamp duties	Share issue
Underwriting fees	Share issue
Listing fees	Listing
Accountants' fees relating to prospectus	Both - a prospectus type document may be required for an offer without a listing and vice versa, but in practice IPO documents typically relate both to the offer and the listing
Legal fees	Both - legal advice is typically required both for the offer of shares to the public and for the listing procedures to comply with the requirements established by the relevant securities regulator/exchange
Prospectus design and printing costs	Both - although in cases where most prospectus copies are sent to potential new shareholders the majority of such costs might relate to the share issue
Sponsor's fees	Both - to the extent the sponsor's activities relate to identifying potential new shareholders and persuading them to invest, the cost relate to the share issue. The activities of the sponsor related to compliance with the relevant stock exchange requirements should be expensed.
Public relations consultant's fees	Expense - companies typically engage PR consultants to raise the company's profile which contributes to the ability to issue new shares. However, PR costs generally relate to general company promotion and are not therefore directly attributable to the share issue.
"Roadshow" costs	Expense - although the "roadshow" might help to sell the offer to potential investors and hence contributes to raising equity, it is usually a general promotional activity. Hence the associated costs may not be sufficiently directly related to the share issues to justify deduction from equity. Further, a significant portion of any costs may not be incremental e.g. management time.

Example

Entity A undertakes an IPO in which 500,000 new shares are issued and a total of 750,000 new and existing shares are listed. Costs incurred include:

- Underwriting fees of $200,000;
- Listing fee of $100,000;
- Accountant's and legal fees of $300,000 relating to the offer and listing;
- Roadshow costs and fees paid to PR consultants of $150,000

Ignoring tax effects, how should these costs be accounted for?

- The underwriting fees should be deducted from equity;
- The listing fee and roadshow/PR consultants charges should be expensed;
- Accountant's and legal fees should be allocated between the offer and the listing, one basis being in proportion to the new/existing shares as follows:

Allocated to new share issues (equity): (500,000 / 750,000) x $300,000 = $200,000

Allocated to listing (expense): (250,000 / 750,000) x $300,000 = $100,000

The respective entries for the IPO costs are as follows:

	Debit	Credit
Equity (underwriting = allocation of legal/accountant's fees)	$400,000	
Statement of comprehensive income (listing + allocation of legal/accountant's fees + roadshow/PR consultancy).	$350,000	
Cash/creditors		$750,000

Further Information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au