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Capital Raising in US Markets easier with the New JOBS Act



Introduction

In general, Indian companies planning to raise capital traditionally view the US public markets with some concern, in part driven by the significant cost of going public and incremental costs associated with compliance after going public. This concern is not without reason as the introduction of Section 404(b) of the Sarbanes Oxley Act of 2002, and additional rules around financial reporting and control attestation, resulted in a significant increase in costs for listed companies – indeed a 2009 Securities and Exchange Commission (SEC) survey reported that the average annual cost of compliance with Section 404(b) was US\$2 million. The number of Indian companies choosing to raise capital in the US public markets declined considerably in the last five years to the extent that there was only one such listing (“MakeMyTrip”).

On 5 April 2012, the Jumpstart Our Business Startups Act (the (“JOBS Act”) was signed into law. The primary objective of the JOBS Act is to stimulate economic growth by improving access to the US capital markets for emerging growth companies. The JOBS Act introduces a new category of public issuer called an emerging growth company (an “EGC”), and relaxes certain requirements around securities offerings and public reporting obligations for such companies. The provisions of the JOBS Act, as it relates to EGCs, are effective immediately and we believe that this law will make it significantly easier for Indian companies qualifying as an EGC to go public in the US and raise capital.

This publication summarises key financial reporting requirements for US securities offerings and amendments to existing requirements introduced through the JOBS Act which we believe will be relevant to Indian companies currently planning to raise capital. This publication does not cover all the changes introduced by the JOBS Act. For more details on the Act or US listing requirements, click on the links below and/or contact the editorial team (refer Page9).

[JOBS Act](#)
[Frequently Asked Questions on JOBS Act- SEC](#)

JOBS Act eases the access to US public markets for emerging growth companies and is a welcome attempt to restore the appeal of raising capital in the US.

Emerging Growth Company (EGC)

An EGC is defined as a company with total annual gross revenue of less than US\$1 billion in its most recently completed fiscal year. The total annual gross revenue means the total revenue as presented on the income statement in accordance with US GAAP or IFRS as issued by IASB. EGC status is assessed at the date of Company's initial public filing.

It should be noted that the Company that completed an IPO on or before 8 December 2011 is not eligible for EGC status. Also, an entity which has the presentation currency other than US dollars should calculate the annual gross revenue in US dollars using the exchange rate as at the last day of the most recently completed fiscal year.

If the financial statements for the most recent year are those of the predecessor of the issuer, the predecessor's revenues should be used.

Example:

Company A, a shell company, formed on 31 March 2013 acquires Company B, a non-US public operating company, determined to be its predecessor. Company A subsequently files an IPO registration statement in June 2013. The revenue of Company B for the year ended 31 March 2013 is used to determine whether Company A meets the definition of an EGC.

For a company to be considered as an EGC, revenue cannot exceed US\$1 billion in its most recently completed fiscal year

An issuer can hold EGC status up to a maximum period of five years after its common equity IPO. The Company loses its EGC status permanently if it meets any of the following criteria during the five year period:

- total annual gross revenue exceeds US\$1 billion;
- market capitalisation exceeds US\$700 million (that is, the EGC is categorised as large accelerated filer under SEC Regulations)
- issues more than US\$1 billion in non-convertible debt securities during the previous three year period

Example:

Company A qualifying as an EGC under the JOBS Act completes its IPO process in May 2012. Company A can hold EGC status up to the fiscal year ending 31 March 2018 unless it loses its EGC status at an earlier date by meeting any of the criteria outlined above.



Summary of financial reporting requirements and accommodations available for EGC

A brief summary of key financial reporting requirements for US securities offerings and accommodations available to EGCs as compared to non EGCs are described below. A more detailed discussion on each of these accommodations is included under separate sections in this publication.

Financial statement requirements/accommodation available	Non EGC /existing requirements	EGC
Financial statement requirements in initial registration statements	Generally required to provide three years of audited financial statements	Permitted to provide two years of audited financial statements
Choice to provide financial statements in compliance with US GAAP or IFRS as issued by IASB without reconciliation to US GAAP	Permitted to provide financial statements in compliance with US GAAP or IFRS as issued by IASB without reconciliation to US GAAP	There is no change from the existing requirements for EGC
Acquired business/equity method investee 's financial statements	Required to include three years of financial statements of acquired business/equity method investee	Permitted to include two years of financial statements of acquired business/equity method investee
Audit report requirements	Audited financial statements should be accompanied with an audit report issued by accountants that are registered with the PCAOB	There is no change from the existing requirements for EGC
Selected financial data and ratio of earnings to fixed charges	Generally required to provide for five years	Permitted to provide only for two years
Benefit of confidential review of draft registration statements by SEC	Available to only certain eligible Non EGCs	Benefit available to all EGCs
Internal control over financial reporting	Required to begin providing management's assessment of internal control over financial reporting (ICFR) and auditor's attestation of ICFR with its second annual report filed with the SEC	Exempted from providing auditor's attestation of ICFR up to a period of five years
Accounting standards	Accounting standards applicable to public companies are to be used	Option to apply accounting standards applicable to non-public companies
Auditing standards	Auditor's of Non EGCs need to comply with PCAOB rules	Auditor's of EGC is exempt from complying with PCAOB Rules adopted and approved by SEC after 5 April 2012. Further, auditor's of an EGC will be exempt from complying with any Rules that may be formulated regarding audit firm rotation and supplement to the auditor's report

Observation:

It should be noted that under Indian securities regulations, only entities listed in Indian stock exchange can plan for listing its securities in US stock exchange

Initial registration statements

Financial statements requirements

Generally, a non-US issuer is required to present three years of audited financial statements. Under the JOBS Act, an EGC is permitted to provide two years of audited financial statements. Concurrently, to comply with the SEC regulations for the presentation of financial statements of acquired business or equity method investee, an EGC is permitted to include two years of financial statements of acquired business/equity method investee even if the SEC regulations otherwise require three years of financial statements of such entities.

Management discussion and analysis

An EGC is permitted to provide management discussion and analysis of financial condition and results of operations covering only two years consistent with as presented in the audited financial statements.

Scaled down disclosures for EGCs for a period of five years

Selected financial data

Generally, a non-U.S. issuer is required to present selected financial data and ratio of earnings to fixed charges for each of the last five years in the registration statements. An EGC is permitted to include selected financial data and ratio of earnings to fixed charges for just two years.

Example:

Company X, a fiscal year end company qualifying as an EGC, plans to file initial registration statement in May 2012. Company X prepares its financial statements in compliance with US GAAP.

Under the existing requirements, Company X is required to provide the following:

- audited financial statements for the years ended 31 March 2010, 2011 and 2012
- management discussion and analysis covering three years of audited financial statements
- selected financial data for the years ended 31 March 2008, 2009, 2010, 2011 and 2012

Under the JOBS Act, Company X, which qualifies as an EGC, is permitted to provide only the following:

- audited financial statements for the years ended 31 March 2011 and 2012;
- management discussion and analysis covering two years of audited financial statements; and
- selected financial data for the years ended 31 March 2011 and 2012

It can be noted from the above that the JOBS Act has significantly reduced financial information required in the registration statements.

Continuing the above example, assuming Company X prepares financial statements in compliance with IFRS as issued by IASB and applies IFRS 1, First-time Adoption of International Financial Reporting Standards, Company X is required to present balance sheet as at 1 April 2010, 31 March 2011 and 2012 regardless of the accommodation provided to an EGC. Balance sheet as at 1 April 2010 is required to comply with IFRS as issued by IASB.

Confidential review of draft registration statements

Currently, a non-US issuer that is registering for the first time with the SEC cannot submit registration statements on a confidential basis, except when the non-US issuer is already listed or is concurrently listing its securities on a non-U.S. securities exchange. Confidential submissions can be a significant advantage because the procedure allows the issuer to resolve complicated issues often encountered in an initial SEC review before making a public filing. The non-US issuer eligible for confidential review process is required to file only its final registration statement publicly prior to going on a road show or selling its securities.

Confidential review process available to all ECGs

Under the JOBS Act, an EGC (even if it is not listed / in the process of concurrently listing in a non-US exchange) can submit its IPO registration statement and subsequent amendments to the SEC Staff for review on a confidential basis before its public filing. However, an EGC is required to make public all confidential submissions and related SEC Staff comments and company responses no later than 21 days before the road show.

In May 2012, SEC made amendments to the non-US issuer confidential filing rules to make it similar to the process for an EGC. In accordance with the new rules if the initial draft of registration statement is filed after May 30, 2012, the Company is required to make public all confidential submissions and related SEC Staff comments and company responses.

It should be noted that both non – US issuer availing the benefit of EGC status and non- US issuer not availing the benefit of EGC status whose initial draft registration statements are filed after May 30, 2012 are required to make public all confidential submissions and related SEC Staff comments and company responses..

Internal control over financial reporting

Under existing SEC rules and regulations, an equity issuer, should begin providing management's assessment of internal control over financial reporting (ICFR) and auditor's attestation of ICFR with its second annual report filed with the SEC. An EGC is exempt from providing auditor's attestation as long as it qualifies as an EGC.

Example

Company X, a 31 March year-end company qualifying as an EGC, completes its initial equity offering on 31 May 2012. Company X files its Form 20-F for the year ending 31 March 2013. This Form 20-F does not require management's assessment or auditor's attestation of ICFR under the existing requirements and JOBS Act.

Company X's public float is US\$500 million on 30 September 2013 and Company X continues to qualify as an EGC on 31 March 2014. Company X files Form 20-F for the year ending 31 March 2014. Under the existing requirements, this Form 20-F should include both management's assessment of ICFR and auditor's attestation of ICFR. Under the JOBS Act, Company X is not required to provide auditor's attestation of ICFR.

Company X's public float is US\$800 million on 30 September 2014. Company X now qualifies as a large accelerated filer on 31 March 2015 and thus, loses its status as an EGC, Company X's Form 20-F for the year ending 31 March 2015 will require both management's assessment of ICFR and auditor's attestation of ICFR.

Accounting standards

Currently, an issuer is required to adopt new or revised accounting standards on the basis of effective dates applicable to public entities. In general, the standards issued by FASB have delayed applicability for non-public entities as compared to public entities.

An EGC is permitted to adopt new or revised accounting standards issued after 5 April 2012 (the date of enactment of the JOBS Act) on the basis of effective dates applicable to non-public entities if such standard is applicable to companies that are not issuers.

Delayed application of new or revised accounting standards

Election to adopt new or revised standards on the basis of effective dates applicable to non-public entities is revocable. However, reverse is not possible i.e., if an EGC opts to apply the new or revised accounting standards on the basis of effective dates applicable to public entities, that election is irrevocable.

Auditing standards

Currently, an independent auditor of the public entity is required to comply with the Rules adopted by the PCAOB from the effective date mentioned therein. The independent auditor of an EGC is exempt from complying with PCAOB Rules adopted and approved by SEC after 5 April 2012 (the date of enactment of the JOBS Act) unless the SEC determines that application of such Rules is necessary or appropriate in the public interest. Further, the independent auditor of an EGC will be exempt from complying with any Rules regarding audit firm rotation and supplement to the auditor's report in which auditor is required to provide additional information about the audit and the issuer's financial statements. It is relevant to note that PCAOB recently issued Concept Release on "Auditor Independence and Audit Firm Rotation" and on "Auditor's Reporting Model". The concept release on Auditor's Reporting Model covers requirement for additional information about the audit and the issuer's financial statements.

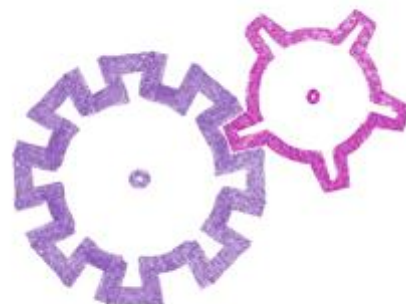
Disclosure of EGC status

An EGC should disclose its status on the cover page of the draft registration statement submitted to the SEC staff on confidential basis as well as in the initial registration statement filed electronically. The SEC staff also expects an EGC to disclose how and when they may lose EGC status, in addition to describing the exemptions available to them as an EGC.

It is critical that the companies should monitor their EGC status as a change will lead to earlier-than-anticipated financial reporting obligations.

Ongoing public reporting

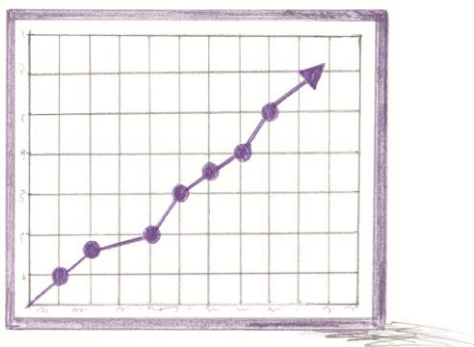
After going public, an EGC will file annual, quarterly and other periodic reports under existing SEC regulations as applicable to non-US issuers except that selected financial data is not required for periods earlier than those presented in the EGC's initial registration statement.



Way forward

The introduction of the JOBS Act brings in the desired flexibility in raising capital in the US markets. The amendments such as reduced periods for presentation of financial statements, delayed implementation of internal control over financial reporting requirements and use of non-public effective dates for accounting standards can significantly reduce the costs and complexities in going public in the US. This is indeed an appropriate time for all Indian companies aspiring to raise capital abroad to consider the US markets. It may be advisable that such companies should discuss the implications of the JOBS Act with their advisers.

Also, considering several changes introduced through the Act we expect that the SEC will be issuing interpretative guidance on many aspects of the JOBS Act. Depending on further guidance and interpretations released by SEC, we will continue to provide with an update through a series of newsletters on this subject



“ With the current status of the capital markets and the domestic IPO market, creating a dearth of listing and capital raising opportunities for Indian companies and Private Equities who invest in these companies, Indian companies are increasingly looking towards the International Markets to raise capital. The largest and deepest market in the world is US and Indian companies have always been keen to explore the US capital markets but have feared the tight and difficult regulation as well as the cost of the regulation. The new JOBS act has considerably eased the situation and we believe that Indian companies should actively consider a US listing.”

Harish HV,
Practice Leader - Corporate
Finance

Key terms used in the publication

EGC: Emerging Growth Company

FASB: Financial Accounting Standards Board

IPO: Initial Public Offerings

IASB: International Accounting Standards Board

ICFR: Internal Control over Financial Reporting

IFRS: International Financial Reporting Standards

JOBS Act: Jumpstart Our Business Startups Act

PCAOB: Public Company Accounting Oversight Board

SEC: Securities and Exchange Commission

US GAAP: Generally Accepted Accounting Principles in the United States of America

US: United States

Editorial team

Yogesh Sharma
Partner, Financial Reporting
Advisory Services
Grant Thornton India LLP
D +91 22 6626 2630
M +91 99679 15527
Yogesh.Sharma@in.gt.com

Pasupathi KG
Client Service Director, Financial Reporting
Advisory Services
Grant Thornton India LLP
D +91 22 6626 2740
M +91 99200 73438
Pasupathi.KG@in.gt.com

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Grant Thornton India LLP (formerly Grant Thornton India) is registered with limited liability with identity number AAA-7677 and has its registered office at L-41 Connaught Circus, New Delhi, 110001

NEW DELHI

National Office
Outer Circle
L 41 Connaught Circus
New Delhi 110 001
T +91 11 4278 7070

BENGALURU

“Wings”, First Floor
16/1 Cambridge Road
Ulsoor
Bengaluru 560 008
T +91 80 4243 0700

CHANDIGARH

SCO 17
2nd Floor
Sector 17 E
Chandigarh 160 017
T +91 172 4338 000

CHENNAI

Arihant Nitco Park, 6th floor
No.90, Dr. Radhakrishnan Salai
Mylapore
Chennai 600 004
T +91 44 4294 0000

GURGAON

21st Floor, DLF Square
Jacaranda Marg
DLF Phase II
Gurgaon 122 002
T +91 124 462 8000

HYDERABAD

7th Floor, Block III
White House
Kundan Bagh, Begumpet
Hyderabad 500 016
T + 91 40 6630 8200

KOLKATA

10C Hungerford Street
5th floor
Kolkata 700 017
T +91 33 4050 8000

MUMBAI

Indiabulls Finance Centre
16th floor, Tower 2
Senapati Bapat Marg
Elphinston Road
Mumbai 400 013
T +91 22 6626 2600

PUNE

401 Century Arcade
Narangi Baug Road
Off Boat Club Road
Pune 411 001
T +91 20 4105 7000

www.grantthornton.in

