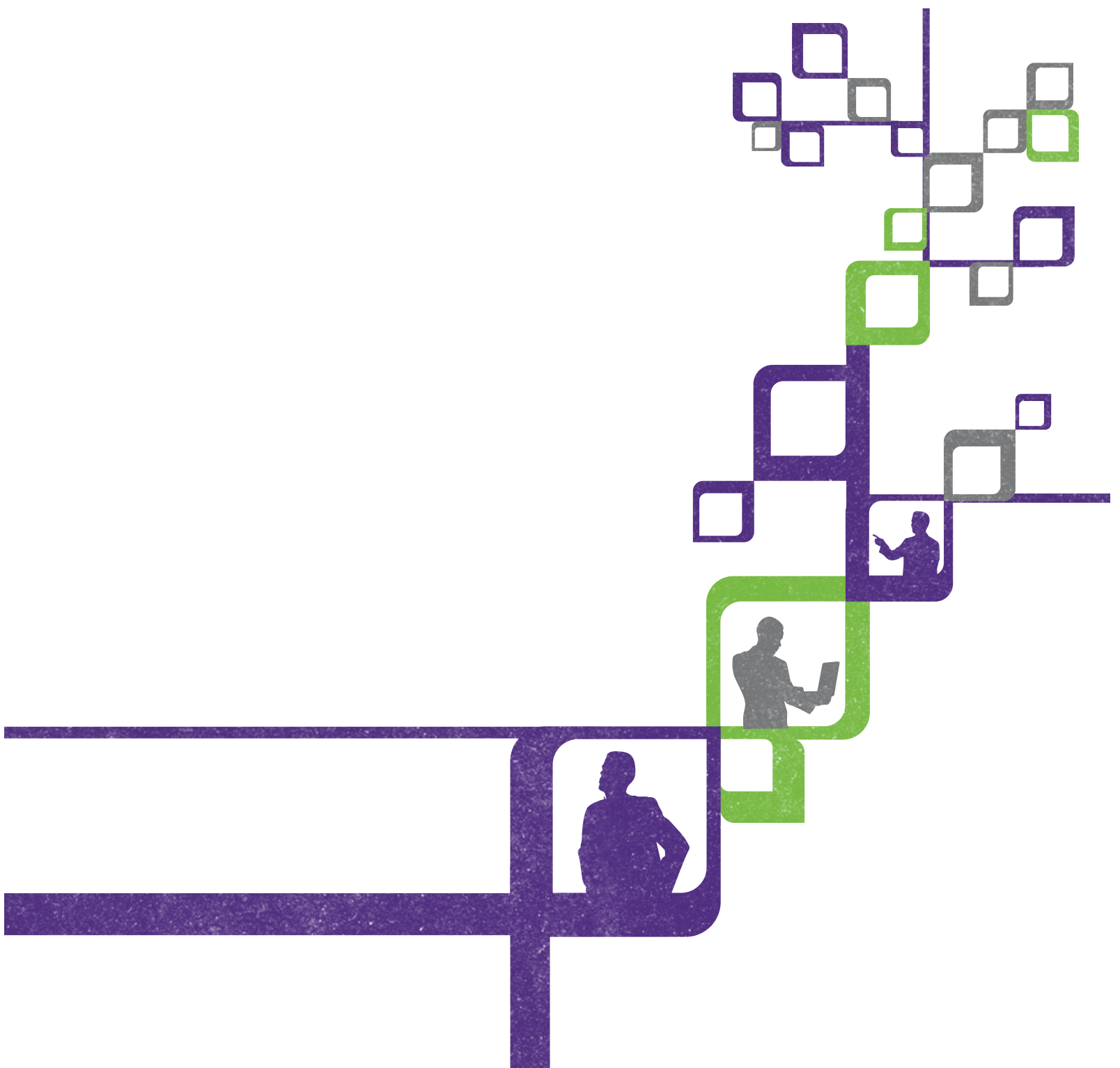




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# Capital Raising in US Markets Three years after the JOBS Act



# Introduction

In general, Indian companies planning to raise equity capital traditionally viewed the US capital 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.

In 2012, the Jumpstart Our Business Startups Act (the “JOBS Act”) was signed into law. The primary objective of the JOBS Act was to stimulate economic growth by improving access to the US capital markets for private companies. The JOBS Act introduced a new category of issuers called an Emerging Growth Company (an “EGC”), and relaxed certain requirements around common equity securities offerings and ongoing reporting obligations for such companies. As a result, JOBS Act has changed traditional view on the US capital markets in relation to costs of going public and compliance after going public. We believe that this law will continue to make it significantly easier for Indian companies qualifying as an EGC to go public in the US and raise capital.

There has been a significant increase in number of non-US issuers who have filed their initial registration statement with EGC status over the last two years as compared to the first year of enactment of JOBS Act. It is relevant to note that the JOBS Act has been successful in attracting Indian companies having principal business operations in India to raise equity capital in the US. Such companies include Videocon d2H, Eros International and Amira Nature Foods.

This publication summarises key financial reporting requirements for the 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 equity capital.

# Emerging Growth Company (EGC)

An EGC is a company with total annual gross revenue of less than US\$1 billion in its most recently completed fiscal year. The term “most recently completed fiscal year” refers to the most recent annual period completed, regardless of whether the financial statements for the period are included in the registration statement.

The total annual gross revenue means the total revenue as presented in the income statement under US GAAP or IFRS, as issued by IASB (if used as the basis of reporting by the issuer).

In case of banks and similar financial institutions, total annual gross revenue shall include all gross revenues from traditional banking activities. Banking activity revenues include interest on loans and investments, dividends on investments, fees from loan origination, fees from trust and investment services, commissions, brokerage fees, mortgage servicing revenues, and any other fees or income from banking or related services. Revenues do not include gains and losses on dispositions of investment portfolio securities, although it may include gains on trading account activity if that is a regular part of the institution’s activities.

If the financial statements for the most recently completed fiscal year are those of the predecessor of the issuer, the predecessor’s revenues should be used for the purpose of determining whether the issuer qualifies as an EGC.

If the company’s presentation currency is other than US dollars, annual gross revenue should be calculated in US dollars using the exchange rate as at the last day of the most recently completed fiscal year.

EGC status is assessed at the date of company’s public filing of initial registration statement. If the company files draft registration statement to initiate confidential review process by the SEC staff, EGC status is assessed at that date and at each amendment followed by the assessment as at the date of public filing of initial registration statement.

In case the company had first sale of common equity securities in a registered offering on or before December 8 2011, it is not eligible for EGC status. First sale of common equity securities include registered offerings of common equity securities pursuant to an exchange offer, selling shareholder’s secondary offering on resale registration statements, in addition to initial primary offering of common equity securities for cash. Further, if the predecessor was not eligible to be an EGC because its first sale of common equity securities was on or before December 8 2011, then its successor is not eligible to be an EGC.

The SEC staff may question the EGC status, if it appears that the issuer is engaging in transactions only with a purpose of converting a non-EGC to an EGC and thereby avail the benefits available to an EGC.

## Example:

Company X with a March 31 year end would like to file an initial registration statement for an initial public offering of common equity securities in April 2015, which would include financial statements for fiscal 2014 and 2013 and the nine months ended December 31 2014 and 2013. The annual gross revenue for the year ended March 31 2015 should be used for the purposes of determining whether Company X qualifies as an EGC even though the financial statements for the year ended March 31 2015 are not included in the initial registration statement.

## Example:

In April 2015, Company A, a shell company, acquires Company B, a non-U.S. public operating company, determined to be its predecessor. Both Company A and Company B have a March 31 year end. Company A subsequently files an IPO registration statement in June 2015. The revenue of Company B for the year ended March 31 2015 should be used to determine whether Company A qualifies as an EGC.

# Losing EGC Status

An issuer can hold EGC status up to a maximum period of five years from the date of the first sale of common equity securities. The issuer loses its EGC status permanently at the earliest of the following during the five year period:

1. The last day of the fiscal year when the total annual gross revenue is US\$ 1 billion or more
2. The date when:
  - a. the issuer has issued non-convertible debt of more than US\$ 1 billion in the immediately preceding rolling three year period (not immediately preceding three fiscal years). Non-convertible debt means any non-convertible security that constitutes indebtedness, whether issued in a registered offering or not. Bank debt generally does not constitute a debt security.
  - b. the issuer becomes a large accelerated filer (generally when public float is US\$ 700 million or more)

An issuer may lose the EGC status during the period of confidential review of its draft registration statement. In such a situation, the publicly filed initial registration statement would need to comply with the rules and regulations applicable to non-EGC.

As mentioned earlier, EGC status is assessed at the date of company's initial public filing of a registration statement and reassessed again only after the completion of first sale of common equity shares. As a result, the company's EGC status would continue to be in effect through the date of effectiveness of the registration statement even if the company loses its EGC status between initial public filing date and the date of effectiveness of the registration statement.

## Example:

Company B files its initial registration statement on April 10 2015 in connection with the IPO. As on that date, the company qualified as an EGC. The registration statement is declared effective on February 10 2016. The company issued non-convertible debt in excess of US\$ 1 billion between April 10 2015 and February 10 2016 and as a result, will no longer qualify to be an EGC. However, the company will continue to be eligible for the benefits that an EGC can avail at the time of initial filing of registration statement. Further, post completion of the IPO, the company is required to comply with financial and other reporting requirements as applicable to non-EGC issuer unless exempted otherwise.

## Example:

Company A, an EGC under the JOBS Act with a March 31 year end, completes its IPO process in September 2015. Company A will qualify to be an EGC up to the fiscal year ending March 31 2021 unless it loses its EGC status at an earlier date by meeting any of the disqualification provisions outlined above. The last day of the fiscal year in which the fifth anniversary occurs will be the first day the issuer is considered a non-EGC.

## Example:

Company A is an EGC and submits its registration statement for confidential review on September 30 2014. The company publicly files its initial registration statement on May 1 2015. If the company loses its EGC status between September 30 2014 and May 1 2015, by meeting any of the disqualification provision outlined above, the initial registration statement publicly filed on May 1 2015 should comply with the requirements as though the company is a non-EGC.

# Summary of financial reporting requirements and accommodations available for EGC

A brief summary of key financial reporting requirements for US equity securities offerings and accommodations available to non-US issuers if they elect EGC status under JOBS Act as compared to non-US issuers who are not

qualified as an EGC 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 include <b>three</b> years of audited financial statements	Permitted to include <b>two</b> 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 include financial statements in compliance with US GAAP or IFRS as issued by IASB without reconciliation to US GAAP	Similar to Non-EGC requirements
Acquired business/equity method investee's financial statements	Required to include <b>three</b> years of financial statements of acquired business/equity method investee	Permitted to include <b>two</b> years of financial statements of acquired business/equity method investee
Audit report requirements	Company's audited financial statements should be accompanied with an audit report issued by independent accountants that are registered with the PCAOB	Similar to Non-EGC requirements
Selected financial data and ratio of earnings to fixed charges	Generally required to provide for <b>five</b> years	Permitted to provide only for <b>two years</b>
Benefit of confidential review of draft registration statements by SEC	Available to only <b>certain</b> eligible Non-EGCs	Benefit available to <b>all</b> EGCs
Internal control over financial Reporting (ICFR)	Required to begin providing management's assessment of ICFR and auditor's attestation of ICFR with its <b>second annual report</b>	Exempted from providing auditors attestation of ICFR up to a maximum period of <b>five</b> years.
Accounting standards	Accounting <b>standards applicable to public companies</b> are to be used	Options to apply Accounting Standards applicable to <b>non-public companies</b>
PCAOB Rules	Auditors <b>need to comply</b> with PCAOB rules	Auditors are <b>exempt</b> from complying with PCAOB rules adopted and approved by SEC after April 5 2012, unless SEC determines otherwise. Further, auditors will be <b>exempt</b> from complying with any rules that may be formulated regarding audit firm rotation and supplement to the auditor's report

# Initial registration statements

## Financial statements requirements

Generally, a non-US issuer is required to include three years of audited financial statements in its initial registration statement filed with the SEC. Under the JOBS Act, in case of initial public offering of common equity securities, an EGC is permitted to include two years of audited financial statements in the initial registration statement.

Generally, a non-US issuer is required to present up to three years of audited financial statements of significant acquired business/ equity method investee. Under the JOBS Act, an EGC is permitted to include audited financial statements of significant acquired business/equity method investee for a number of years consistent with as presented in the audited financial statements of the issuer.

An EGC (similar to Non – EGC) is permitted to provide management discussion and analysis of financial condition and results of operations covering only two years consistent with the periods presented in the audited financial statements.

## Selected financial data and ratio of earnings to fixed charges

Generally, a non-US issuer is required to present selected financial data and ratio of earnings to fixed charges for each of the last five years in the initial registration statements. An EGC is permitted to include selected financial data and ratio of earnings to fixed charges for a number of years consistent with as presented in the audited financial statements in the initial registration statement.

### Example:

Company X, a March 31 year end company qualifying as an EGC, plans to file initial registration statement in July 2015. Company X prepares its financial statements in accordance with US GAAP.

Under the existing requirements for Non-EGC, Company X is required to include three years of audited financial statements and such periods can be the following:

- audited financial statements for the years ended March 31 2013, 2014 and 2015
- management discussion and analysis covering three years of audited financial statements
- selected financial data for the years ended March 31 2011, 2012, 2013, 2014 and 2015

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 March 31 2014 and 2015;
- management discussion and analysis covering two years of audited financial statements; and
- selected financial data for the years ended March 31 2014 and 2015

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

Continuing the above example, assuming Company X elects to prepare 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 April 1 2013, March 31 2014 and 2015 regardless of the accommodation provided to an EGC. Balance sheet as at April 1 2013 is required to comply with IFRS as issued by IASB.

### Confidential review of draft registration statements

Confidential submissions of draft registration statement 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.

A non-US issuer that does not qualify to be an EGC may submit the draft registration statement with the SEC staff for a confidential review only in limited circumstances, such as where non-US issuer is already listed or is concurrently listing its securities on a non-US securities exchange or it can demonstrate that a public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction.

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 draft 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.

### ICFR

Under existing SEC rules and regulations, an equity issuer, should begin providing management's assessment of ICFR with its second annual report filed with the SEC. Further, auditor's attestation of ICFR is also required unless the issuer qualifies as "Non accelerated filer". An EGC is exempt from providing auditor's attestation as long as it qualifies as an EGC. An EGC is, however, not exempt from the requirement to perform management's assessment of ICFR.

#### Example:

Company X, a 31 March year end company qualifying as an EGC, completes its initial equity offering on January 31 2015. Company X files its first Form 20-F for the year ending March 31 2015. This Form 20-F does not require management's assessment or auditor's attestation of ICFR under the existing requirements and JOBS Act.

Assuming, Company X continues to qualify as an EGC as at March 31 2016. Under the existing requirements, Form 20-F in relation to the year ending on March 31 2016 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.

Alternatively, assuming Company X loses its EGC status on March 31 2016, Company X's Form 20-F for the year ending March 31 2016 will require both management's assessment of ICFR and auditor's attestation of ICFR.

## Delayed application of new or revised accounting standards

Prior to the introduction of the JOBS Act, an issuer was 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.

With the introduction of the JOBS Act, an EGC is permitted to adopt new or revised accounting standards issued after April 5 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. If non-public entities are specifically excluded from the scope of certain accounting standards, JOBS Act does not exempt EGCs from compliance with such accounting standards. Instead, EGCs, like non-EGCs, should evaluate the scope of each accounting standard.

EGCs are not permitted to apply some new or revised accounting standards at the same date a non-EGC is required to comply but defer the adoption of other standards.

Election to adopt new or revised standards on the basis of effective dates applicable to non-public entities should be made at the time of initial filing of registration statement and such election is revocable. 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.

Majority of EGCs have elected not to delay the adoption of new or revised accounting standards

## PCAOB Rules

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 April 5 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 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, the initial registration statement filed electronically and every subsequent registration statements filed with SEC. The SEC staff also expects an EGC to disclose how and when they may lose EGC status, in addition to describing the exemptions as an EGC. Further, if the issuer has elected to follow the effective date of new or revised accounting standards as applicable to public company, the issuer should disclose that this election is irrevocable.

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 completion of its IPO, an EGC is required to file annual, quarterly (if applicable) and other current reports under existing SEC regulations as applicable to non-US issuers except that selected financial data and ratio of earnings to fixed charges are not required for periods earlier than those presented in the EGC's initial registration statement.

## Accommodations available to EGCs even after losing EGC status

Issuer losing EGC status is required to comply with SEC Regulations applicable to Non-US issuers except that (i) it is not required to include audited financial statements for any period prior to the earliest audited period presented in connection with its initial public offering of common equity securities, in case of follow on offerings of common equity securities; (ii) it is permitted to include audited financial statements of significant acquired business/equity method investee for a number of years consistent with as presented in the audited financial statements of the issuer; and (iii) it is not required to provide selected financial data and ratio of earnings to fixed charges for periods prior to the earliest audited period presented in its initial registration statement.



# Way forward

The JOBS Act is expected to continue to facilitate access to capital markets in the US. The amendments such as reduced number of periods for which financial statements are required, delayed implementation of ICFR requirements as it relates to auditor attestation and use of non-public effective dates for accounting standards have resulted in a reduction in the costs and complexities in going public in the US. This indeed proves to be an appropriate time for all Indian companies aspiring to raise capital abroad to consider the US markets.



# 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 (United States)

**SEC:** Securities and Exchange Commission

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

**US:** United States of America

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