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Financing in the United States capital market: Accounting and reporting considerations for foreign issuers;

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**Financing
in the United States
Capital Market**

**Accounting
and Reporting
Considerations for
Foreign Issuers**

FOREWORD

The information in this booklet has been prepared to assist prospective foreign issuers in raising capital in the United States. This publication is not an exhaustive discussion of the subject but is intended to outline some of the important aspects to be considered and difficulties that may be encountered. In a brief summary of this kind it is not possible to explore all the complexities of American securities-market regulations, an area in which companies are well advised to consult specialists such as investment brokers, legal advisors and independent public accountants knowledgeable in international financial matters.

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INTRODUCTION

Starting in the early part of the twentieth century and continuing into the thirties, European and Latin American governments and corporations raised considerable amounts of capital in the United States (U.S.). Although Canadian governmental entities and corporations availed themselves of the American capital markets following World War II, it is only in recent times, generally speaking, that non-American entities (particularly European and Japanese companies) have begun to avail themselves of the U.S. capital market. Factors contributing to this change have been both legislative and economic.

In 1974, the interest equalization tax, which had been enacted in 1963 in order to limit outflows of U.S. capital, was repealed. The Tax Reform Act of 1976 was also encouraging in that it is free of capital-export controls.

From the economic side, the American economy now appears politically and economically more stable than those of many other countries. Many non-American companies are finding considerable demand for their products within the United States and are finding it advantageous to have large plants and organizations physically within the United States to serve this market. This has been particularly so in the case of both European and Japanese concerns, for example. Expansion, whether at home or abroad, requires capital.

According to statistics published by the Organization for Economic Cooperation and Development (OECD), the United States, in contrast to other developed capital markets, has in recent years been a leader in directly supplying new long-term capital. In an era of increasing competition for capital funds, certainly this is a market that no major corporation can afford to ignore.

PERSPECTIVE

A foreign company, government or governmental body (foreign issuer) contemplating the raising of capital within the United States should not be surprised to find itself conducting negotiations in English, the official language of the country. However, the foreign issuer may be surprised to find itself dealing in yet another language with which it may not be quite so familiar — namely, that of the accounting principles and practices followed in the United States.

Accounting has often been referred to as the language of business, but, as with the written and spoken word, many countries have devised their own individual accounting languages. It follows that when one party communicates on the basis of its language with another party whose language is different, there can be confusion and misunderstanding. This situation becomes even more complicated, since global accounting and auditing standards have not been formally developed. However, attempts to standardize accounting practices are evolving worldwide because of the ever-increasing efforts of professional organizations such as the International Accounting Standards Committee and the accounting institutes and governmental regulatory bodies within various developed countries.

A prospective foreign issuer considering the merits of raising capital in the U.S. market for the first time is confronted with a number of practical difficulties. Whether capital is raised privately (e.g., through U.S. commercial banks, governmental agencies or insurance companies) or publicly, accounting matters are likely to become of paramount importance. In either case, financial information must be prepared in conformity with U.S. generally accepted accounting principles or reconciled in some way thereto, so that the U.S. investor or investors will be able to analyze the risks and rewards associated with alternative investment opportunities within a financial-reporting framework that is familiar.

The material that follows is intended to provide general background information and answer some of the important, broader questions that may arise. Before an active program of raising capital in the U.S. market is begun, specialists (e.g., legal counsel, underwriters, tax and accounting advisers) knowledgeable in international financial matters should be consulted.

DEVELOPMENT OF U.S. ACCOUNTING PRINCIPLES

In the United States, accounting principles have been largely developed in the private sector. In the decade ended in 1973 the formulation of accounting principles was in the hands of the Accounting Principles Board of the American Institute of Certified Public Accountants (AICPA). Previously, another committee of the AICPA had assumed this responsibility. During the existence of the Accounting Principles Board, thirty-one Opinions were published, covering a wide range of subjects from "Accounting for Income Taxes" to the "Disclosure of Lease Commitments by Lessees." When published, the Opinions of the Board and the bulletins of the predecessor committee became a part of the continually expanding body of concepts, principles and procedures referred to as "generally accepted accounting principles" or GAAP.

Over the years, many individuals and groups expressed concern that the volunteer, part-time Accounting Principles Board was not satisfactorily responsive to the needs of the financial community. In general, it was agreed that a new, functional and yet representative organization was needed, capable of responding quickly to the ever-changing financial environment. As a result, and after an in-depth study, the Financial Accounting Standards Board (FASB) was established in early 1973. The Board is composed of seven full-time members responsible for developing and improving accounting principles.

In the United States there may be a distinction between financial accounting and accounting for other purposes, such as tax reporting. In many countries, reporting for tax purposes and financial purposes is often the same. In some, the release of financial reports to the public or shareholders is not required. However, in the United States the publication of financial statements in conformity with generally accepted accounting principles is common. We view financial statements as the end product of the financial accounting process, a process governed by generally accepted accounting principles, which determines the information to be included in financial statements; how those statements are to be organized, measured and combined; and, finally, how they are to be presented.

Generally accepted accounting principles are not fixed or inflexible but are constantly evolving, responding to the ever-changing economic environment in which American businesses operate. In past years a great deal of emphasis was placed on the income statement, whereas now there has been a shift and renewed thinking with respect to the balance sheet. Presently GAAP require historical cost; however, many accountants, academics and an increasing number of businessmen are convinced that financial statements should be adjusted for the effects of inflation. The growing controversy over the balance sheet has contributed to the 1976 decision of the Securities and Exchange Commission (referred to in this publication as the SEC or the Commission), an independent regulatory agency of the U. S. government, to require certain larger companies under its jurisdiction to disclose certain current replacement-cost information. This information is intended to assist investors in obtaining an understanding of the current costs of operating a business, which usually cannot be obtained from historical-cost financial statements alone.

ROLE OF THE SEC IN THE FINANCIAL ACCOUNTING PROCESS

In the United States, primarily as a result of the Federal Securities Act of 1933 and the Securities Exchange Act of 1934, the Securities and Exchange Commission has been vested with the authority and responsibility to regulate the public sale and trading of securities of most publicly owned companies. Other statutes administered by the SEC are the Public Utility Holding Company Act of 1935, the Investment Company Act of 1940, the Trust Indenture Act of 1939 and the Investment Advisers Act of 1940. The SEC also has certain duties and functions under Chapter X of the National Bankruptcy Act and the Securities Investors Protection Act of 1970, which amended the Securities Exchange Act of 1934. Practice under these statutes can be of a highly specialized nature.

The federal securities laws were adopted in order to regulate distributions of securities. The SEC, in this regard, requires full and fair disclosure of financial and other information — information that a reasonably intelligent person should have in order to make an investment decision about the securities and the entity issuing the securities. The Securities Acts, however, do not provide protection against fully informed, but unwise, investment decisions.

Under the 1933 Act, a company, domestic or foreign, offering its shares for sale to the public must, unless an exemption is available, file a registration statement with the SEC. The registration statement also includes a prospectus, which contains certain financial information and other data, a copy of which must be furnished to the buyer of the registered securities. After processing the registration statement, which usually involves ascertaining whether there has been full and fair disclosure, the SEC may sanction the offering of the securities — stocks, bonds or their equivalents.

The Commission has, as a matter of policy, left the development of accounting principles primarily in the hands of the private sector. This continues to be the basic policy of the SEC, although at times it has exercised its right and required publicly held companies to apply certain accounting principles that it believed to be in the investors' best interest. For the most part, financial statements filed with the SEC must be certified by an independent public accountant. The role of the independent public accountant in registrations is given greater attention in a subsequent section.

As to the form and content of the financial statements to be filed, the SEC has issued comprehensive rules known as Regulation S-X. The financial statements must be prepared in conformity with GAAP and comply with Regulation S-X in all material respects. Additional requirements and information are published by the SEC from time to time in the form of Accounting Series Releases and Staff Accounting Bulletins. Whereas the releases contain official positions of the SEC, the bulletins do not. However, the bulletins give insight into the thinking of the accounting staff of the Commission in administering the disclosure requirements of the Securities Acts, which is informative to public accountants and their clients.

The Commission publishes other information, in addition to Regulation S-X, for the guidance of registrants. Various forms and regulations are available, setting forth the requirements as to what financial statements, consolidated or unconsolidated, are required, as well as for what periods of time. In very general terms, organizations organized for profit are required to file a five-year summary of earnings; a balance sheet as of the current fiscal year end; and statements of income, funds and stockholders' equity for the latest three years. If the filing is not made within a reasonable period of time after the close of a fiscal year, a short-period statement, such as for the most recent quarter, together with comparable data for the prior year, may also be required. These interim periods, or "stub periods" as they are sometimes called, need not be audited.

The principal purposes of the Securities Act of 1934 are to provide for the regulation of national securities exchanges and over-the-counter markets, to prevent certain kinds of transactions on such exchanges or markets, and to permit the SEC to require corporations having listed securities under the 1933 Act to furnish their security holders with periodic information. These periodic reports are intended to maintain financial and other information, such as the initial registration statement, on a current basis. In the case of foreign companies, limited modifications of these requirements may be permitted. However, it should be stressed that all registrants with the SEC must file required report forms at least annually, updating their financial statements and other required information.

The SEC statutes do not generally distinguish between domestic and foreign corporate offerings. Foreign issuers may be required to disclose the same information as are domestic issuers where the type and circumstances of the offerings are the same. However, in some cases the reporting requirements are less comprehensive than for domestic companies. Nonetheless, foreign issuers entering the U.S. capital market need to consider specifically the differences between U.S. requirements and those of their home countries. For example, the registration statement will require disclosure of many facets of the company's business, operations and finances that may never before have been known outside the company. Some particularly sensitive areas of disclosure will be the remuneration of officers and directors; the interests of insiders in certain transactions; the security holdings of officers, directors and controlling stockholders; and details regarding option plans and deferred-compensation plans. Such disclosure practices are not necessarily commonplace in other countries. Many companies (foreign and domestic) are hesitant to enter into the financing markets because they fear that disclosure of such information places them at a severe competitive disadvantage relative to companies in generally the same industries.

Prospective foreign issuers have sometimes been reluctant to enter our public market because of the apparent complexity and pervasiveness of American regulations. However, this is usually due to their unfamiliarity with the regulations, and it is frequently expeditious to select a U.S. national accounting firm with international experience, either to assist in the preparation or to do the auditing and certifying required for a Securities Act registration.

U.S. STOCK EXCHANGE CONSIDERATIONS

A corporation seeking to list its securities on a U.S. national securities exchange must comply with two sets of requirements, those of the SEC and those of the securities exchange. Accordingly, foreign issuers considering a public offering should become familiar with the listing standards and requirements that must be met in order to have their stocks admitted to trading.

Under the Securities Acts Amendment of 1964, many companies whose securities are not listed on a national exchange but are traded over the counter are subject to reporting requirements similar to those applicable to listed companies.

PRIVATE PLACEMENTS

The common exemption from the registration requirements of the Securities Acts that is available to a foreign issuer is the private placement. The private placement can be a viable alternative to a registered public offering for approaching the U.S. capital market.

A private placement of securities — stocks or bonds or their equivalents — involves a limited number of sophisticated purchasers and may avoid some of the complexities of a registration with the SEC. There are a number of advantages. Frequently, a private placement can be offered quickly, since less preparation time and required documentation are involved. In addition, projections for some period of years into the future with detailed explanations can be included in the offering memorandum, whereas this practice is not common in an SEC registration statement and, if included, would be subject to certain restrictions. Unlike a public offering, since there is no legal requirement that three- or five-year audited financials on a fully consolidated basis be included, in a private placement the amount of data to be presented can sometimes be reduced through negotiation. However, it is usually better to approach the matter in the expectation that considerable accounting data will be required.

Private placements are not without limitations, however. Potential purchasing institutions such as insurance companies, state and municipal retirement systems, corporate pension funds, bank trust departments and educational institutions are generally restricted by state and regulatory bodies as to the aggregate amount of dollars available for investment in nondomestic issues. Investors generally consider such securities to be essentially unmarketable, since an active secondary market has not been commonly available for private placements. As a result, a rate concession to the buyer over the rate existing in the public markets may have to be offered by the issuer as further inducement to purchase and hold the securities to maturity. Because of the immense variety of state laws and regulations relating to private offerings of securities, foreign issuers are well advised to seek expert legal and accounting guidance.

It is important to note that an underwriter may require an "SEC-styled" placement document, including financial statements comparable to those that would be required for a public offering.

LACK OF INTERNATIONAL UNIFORMITY AND SOME PROBLEMS ENCOUNTERED

As mentioned in an earlier section of this booklet, accounting principles and reporting practices are continuously evolving. A factor contributing to this evolution is the expansion of operations by multinational companies. Their expansion has increased awareness of the differences that exist in applying accounting principles and in the disclosure practices in financial statements.

To illustrate the lack of uniformity in international accounting and the fact that U.S. accounting principles and practices need be complied with in order to enter the U.S. capital market, we will consider below some of the more common differences in accounting found among countries around the world.

Accounting for Reserves

One grouping of differences might be categorized as reserves recorded for a general purpose, such as contingencies, income-tax regulations, or merely to smooth profits by reducing income in one year and shifting it forward to lean years. For example, reserves for uncollectable accounts are available to companies in some countries on the basis of a formula prescribed by the taxing jurisdiction, regardless of the actual collectability of the related receivables. If reserves having no economic justification are reflected in the financial statements, such accounting would be a departure from U.S. accounting principles.

Tax-Allocation Accounting

The present U.S. concept of tax-allocation accounting resulted from the efforts of the Accounting Principles Board. Fundamentally, in the United States tax-allocation accounting requires that entries be made to provide for income taxes on transactions that enter into the determination of financial-accounting income in one period and taxable income in another. This recognition is often referred to as a "timing difference." An example of a timing difference that would necessitate tax-allocation accounting is a liability for employee severance payments recorded in full for financial-accounting purposes but only partially deductible currently for local income-tax purposes. In such an instance, the future tax benefit to be realized when the severance payments are made is recorded as deferred income taxes in the period in which the liability is recorded.

Permanent differences between financial accounting and taxable income do not result in interperiod tax allocation.

In many countries tax accounting is also financial accounting, which can, of course, make a significant difference in results when compared with practice in the United States.

Accounting for Inflation

Some countries have established accounting and reporting policies that require the reporting of certain inflationary effects in financial statements. Until recently very little had been done in the United States in this regard, and thus far accounting principles in the United States continue to adhere to historical cost as the basis in accounting for fixed assets. However, in 1976, the SEC announced its own brand of inflation accounting, requiring large companies to disclose in a footnote the replacement cost of inventories and the current cost of replacing present productive capacity (the two most inflation-prone balance-sheet items), recalculating depreciation and cost of sales on the new basis. Accordingly, in certain filings with the SEC this matter will need careful attention.

Translation of Foreign-Currency Financial Statements

The FASB in 1975 released Statement No. 8 prescribing generally accepted accounting principles for translation of foreign financial statements and foreign-currency transactions. One of the significant changes in accounting resulting from this pronouncement is that companies will not be permitted to defer unrealized gains from foreign-exchange translations. All gains and losses, realized or unrealized, will be reflected in the income statement. Non-American registrants may be affected by this new GAAP requirement unless their operations do not include any foreign-currency transactions.

The SEC will accept, in filings containing financial statements of foreign issuers, statements denominated in local-currency amounts; however, where it becomes necessary to translate local currency amounts for the convenience of the reader of financial statements, the SEC prefers a translation into dollars on the basis of the current exchange rate at the date of the most recent balance sheet included in the filing.

Consolidation Accounting

The preparation of financial statements that include the accounts of companies of which more than 50 percent is owned has a rather long history in the United States. Consolidated statements are not, at present, regularly prepared by companies in many other countries, although the practice appears to be achieving more general acceptance in many countries.

Equity Accounting

Related to consolidation accounting but more recent in origin is the concept of accounting on an equity basis for corporate joint ventures and for 20- to 50-percent-owned companies. This concept, which became generally accepted in the United States as the result of Accounting Principles Board Opinion No. 18, is based on the presumption that significant influence can be exercised over operating and financial policies if an investor owns 20 percent or more of the voting stock of a company, even though the holdings may be less than the percentage required for full consolidation. Consequently, unless there is convincing evidence to indicate that such accounting is inappropriate, an investor recognizes its share of the earnings or losses of an investee in the periods for which they are reported by the investee in its financial statements, rather than in the period in which an investee declares a dividend.

Generally, the net effect of equity accounting on net income and stockholders' equity in the financial statements of an investor is the same as if the investee companies were consolidated subsidiaries, although the details of assets, liabilities, income and expense are not reported in the investor's financial statements. In very simplistic terms, the details of such amounts are merely presented as a single amount in the balance sheet and income statement.

Accounting for Business Combinations

The acquisition of a business by another company, under U.S. GAAP, is accounted for as a purchase unless there is a sufficient continuity of interests to warrant the "pooling-of-interests" method. Under the purchase method a new basis of accounting for assets and liabilities is determined. The general procedure is to assign a fair value to all identifiable assets acquired and assign a present value to liabilities assumed based on their respective terms. The excess of fair values of assets acquired over liabilities assumed is then deducted from the purchase price of the acquired company to determine the amount of "goodwill," which must be written off against income over an appropriate number of years not to exceed forty. Any earnings accumulated prior to the date of acquisition are included in the determination of net assets acquired, and therefore, under GAAP, any distributions therefrom constitute a return of capital rather than income to the controlling interests.

In some business combinations, foreign issuers have assigned acquired assets at the underlying book values recorded by the acquired company. Any excess of the purchase price over acquired net assets recorded at book value has been known to be deferred, charged against income, or charged against stockholders' equity. Because this treatment is not in conformity with U.S. GAAP, a foreign company and its accountants should carefully consider the costs involved in restating, if necessary, the financial statements.

Liability for Employees' Severance Payments

It is customary in some foreign countries to record only a portion of the liability for employees' pension plans and resignation and dismissal severance-benefit costs. For example, labor laws might require employers to pay these "employment-related costs" to employees upon termination of their employment. In the United States, the practice is to accrue adequately for such liabilities.

Instalment Sales

Instalment-sales accounting is acceptable in some countries. As a general rule, unless there is substantial uncertainty as to the collectability of the sales price, the instalment method of accounting is not permitted in the United States.

Accounting for Leases

The accounting for leases has received a good deal of attention in the United States. In December 1976 the FASB issued its Statement of Financial Accounting Standards No. 13, establishing criteria for classifying leases and prescribing accounting and reporting requirements for each classification. Simply stated, a lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset and the incurrence of an obligation by the lessee, and as a sale or financing by the lessor. Such concepts have not, as yet, found their way into international accounting.

Segment Reporting

In addition to the statement on leases, the FASB issued another statement in December 1976 (No. 14), entitled "Financial Reporting for Segments of a Business Enterprise." This Statement requires that the financial statements of a business enterprise include information about the enterprise's operations in different industries, its foreign operations and export sales, and its major customers. Foreign operations for the foreign issuer that prepares its financial statements in accordance with U.S. GAAP would generally be those operations outside its home country. Furthermore, an enterprise operating predominantly or exclusively in a single industry is required to define that industry.

This new Statement presents a special disclosure problem to many foreign issuers that heretofore dealt principally with financial statements prepared on a consolidated or total-enterprise basis. On the other hand, since 1969 U.S. companies that have been reporting to the SEC have disclosed line-of-business information in registration statements. Thus, any difficulty for them in complying with this new pronouncement is minimized.

Capital-Stock Distributions

Historically, the accounting profession in the United States has viewed free distributions of stock as being similar to stock dividends. Under U.S. accounting practice the transaction is usually recorded at the fair market value of the shares issued, and, based thereon, a transfer from retained earnings to capital stock and capital surplus is recognized. However, in some countries such free distributions are treated much as are stock splits in the United States. There is merely recognition of the increased number of shares outstanding but no change in retained earnings. Other countries may only adjust capital stock and retained earnings for the par value of the shares issued. The SEC may not necessarily require a retroactive restatement of previously issued financial statements if the amounts involved were not too significant in the aggregate, although it may expect the company to account for future dividends on the basis of accepted practice in the United States. A company entering the U.S. market for the first time that traditionally has issued stock under the terms of a free distribution in a manner that differs from U.S. GAAP should discuss the appropriate accounting and reporting for the transaction with its accountants.

Compensation Charged Directly to Retained Earnings

Certain bonuses to employee-directors are not treated as expenses in some countries, but rather are considered as appropriations of earnings and, as such, charged to retained earnings in the financial statements. Where the bonuses are not considered capital distributions, such amounts would be charged against income in the form of compensation expense.

Statement of Changes in Financial Position

In the United States a statement of changes in financial position is considered a basic financial statement. In many other countries this statement is not required. The statement is designed to summarize the significant financial and investing activities of the reporting entity.

Earnings per Share

In contrast with many other countries, earnings per share receive a great deal of emphasis in the United States. Per-share amounts are prominently displayed in the income statement, and the basis for the calculation is disclosed in the notes to the financial statements.

Disclosure

Informative disclosure in financial statements in many countries is minimal. The basis of carrying assets, collateralization of assets, methods used in computing depreciation, contingent liabilities, significant subsequent events, and the existence of affiliated or controlling interests are among the matters that may not be disclosed.

On occasion, special charges or credits to income, which in the United States may be separately disclosed, possibly as extraordinary items, are included in the foreign income statements under captions like "other income" and "other expenses," without elaboration. On other occasions, charges or credits to income that in the United States are considered ordinary may be classified as extraordinary items or prior-period adjustments in foreign statements. Sometimes these classifications when evaluated can be quite significant and far-reaching in their implications.

RECENT INTERNATIONAL ACCOUNTING DEVELOPMENTS

Unfortunately, the cross-fertilization of the international capital markets is occurring at present without the aid of a set of clear, understandable and workable international accounting principles. For years the profession has had communication between individual accountants, firms and accounting organizations on a one-to-one basis. There also have been, and there are, regional organizations or organizations based upon language and cultural similarities, such as the Accountants International Study Group, which includes Canada, the United Kingdom and the United States; the UEC (l'Union Européenne des Experts Comptables Economiques et Financiers) in Europe; the Inter-American Accounting Conference; and the Conference of Asian and Pacific Accountants. These organizations have varied considerably in terms of the scope of their activities, but at best they have been restricted in their membership and have not been truly global organizations. Although complete uniformity appears unlikely, a greater degree of international harmonization appears on the horizon.

The most significant development in efforts to narrow major accounting and reporting differences has been the appearance of the nine-nation International Accounting Standards Committee (IASC), an outgrowth of the Accountants International Study Group. In addition, the International Congress of Accountants, which includes accountants from sixty-five countries, recently formed the ICCAP (International Coordinating Committee for the Accountancy Profession). These newly created organizations have agreed to "work together." Up through 1976, the IASC had issued five pronouncements dealing with the disclosure of accounting policies, valuation and presentation of inventories, consolidated financial statements, depre-

ciation accounting, and disclosure information. In order to make these pronouncements effective, the agreement among the nine member countries calls for (1) support by each professional body for the standards promulgated by the IASC and (2) the use of their *best efforts* to assure that audited financial statements comply with the standards or disclose the extent to which they do not. In addition, the member organizations have agreed that when local laws or regulations contradict a standard they will try to persuade governments, the authorities controlling securities markets, and the industrial and business communities that published accounts should comply with these standards.

Until such time as these and other pronouncements achieve a level of international acceptance, foreign issuers will find it necessary to evaluate the fundamental accounting and reporting differences before venturing into the U.S. capital market.

ROLE OF THE CPA

Similar to public accountants in many countries, the American certified public accountant (CPA) is an individual trained and expert in accounting who has demonstrated his competency by passing an examination and by meeting other requirements. In the United States he is then licensed to practice by a state board. On a day-to-day basis, a CPA, in the field of public accounting, may practice as a general practitioner (principally functioning as an accountant and auditor), or he may specialize as a tax or management consultant. A great deal of time is involved in expressing independent opinions on financial statements in conformity with generally accepted accounting principles. In arriving at these opinions, the CPA conducts examinations in accordance with generally accepted auditing standards as prescribed by the AICPA.

In addition to conducting independent examinations of financial statements, CPAs are often engaged to provide objective advice and consultation on various management problems, which can result, for example, in needed improvements in internal control and constructive suggestions on financial, tax, and other operating matters. CPAs also assist in the development and implementation of programs and special projects requested by management. These projects may be as sophisticated as the development of information and control systems and techniques such as budgeting, cost control, profit planning, internal reporting, automatic data processing, and quantitative analysis. However, CPAs' services do not include giving legal advice or making management decisions.

The complexities of an industrial society encourage a high degree of specialization in all professions. The accounting profession is no exception. Its scope is so wide and varied that many individual CPAs choose to specialize in particular kinds of service.

Since the SEC statutes do not distinguish between domestic and foreign private issuers or accountants, each company entering the U.S. capital markets needs to consider specifically the differences between U.S. standards and those in its home country. As to these matters, it is frequently expeditious for the prospective foreign issuer to select a U.S. national accounting firm with international experience to do the auditing and certifying required for a Securities Act registration. Where a foreign firm is well versed in U.S. requirements, including those of independence, this may not be necessary. Otherwise, much time and grief may be avoided by, as a minimum, retaining a U.S. firm to work jointly with the regular auditor for this purpose.

Independence

The SEC's Regulation S-X specifies in Rule 2.01 that the Commission will not recognize any person as a certified public accountant or a public accountant who is not duly registered and in good standing under the laws of the place of his residence or principal office. The Commission is insistent also that such accountant be independent. The SEC's statutes make no distinction between independence of domestic and foreign auditors. An accountant or members of his firm cannot have any direct or indirect investment in a client that is a registrant and cannot be connected with the registrant client as a promoter, underwriter, voting trustee, director, officer or employee.

The client-auditor relationship is sometimes different outside the United States. As a consequence, foreign accountants may learn that in relation to SEC standards they are not independent with respect to their client. Because of the existence of conditions bearing on the independence of the foreign auditor, his certificate might be rendered unacceptable in an SEC filing. The foreign auditor and prospective registrant may consider it advantageous to discuss this matter with the SEC.

Functions

As mentioned, a prospective foreign registrant may find it desirable to engage an international accounting firm with SEC expertise to consult with and advise the company and its auditors in the preparation of the registration statement. The international accounting firm often functions in an advisory capacity in the following ways:

- Assisting the issuer in preparing and filing financial information
- Providing technical advice as to the format and content of the financial statements, footnotes and supplemental schedules to be included with the filing information
- Assisting the registrant's legal counsel and the underwriters in the preparation of the registration statement and the prospectus
- Providing consultation and advice in negotiations with the underwriter concerning financial matters to be included in a letter of intent and the final underwriting agreement
- Arranging for pre-filing conferences with the SEC, if considered necessary, which is usually the case for initial foreign filings

COMFORT LETTERS

The agreements between issuers of securities and underwriters (or investment bankers) providing for the offering and sale of securities to the public generally are contingent upon the receipt by the underwriter of a letter from the issuer's accountants. This letter is frequently referred to as a "comfort letter." The purpose of this letter is to assist the underwriters in fulfilling their responsibility to make a reasonable investigation of information included in the registration statement that is not covered by the reports of experts — that is, accountants, attorneys, actuaries and the like. Letters to underwriters may cover such subjects as the independence of the accountants, compliance as to form of the audited financial statements and schedules with applicable legislative requirements, unaudited financial statements, and changes in selected financial-statement items during the period subsequent to the date and period of the financial statements. The comfort letter is a communication between the auditors and the underwriters; thus, the company is not directly involved, although the auditors would perform certain procedures as a basis for the preparation of the letter. In this regard, the company would be required to provide certain information in connection with the performance of these procedures.

Clearly, the CPA can be an important member of any team assembled for the preparation of registration materials for the raising of capital in the U.S. market.

CONCLUSION

It has been pointed out that there are many problems in accumulating information for financial statements, schedules and other financial data required to be included in a registration statement prepared in connection with an offering of securities in the United States. In most cases the financial information is drawn from the same basic pool of data used to prepare other financial reports within the company. It is simply that the information may have to be organized in a somewhat different fashion. It is also likely that additional information, particularly with respect to such things as subsidiaries and equity companies, will be required. Consequently, sufficient advance planning is a must if important time schedules are to be met.

In evaluating the accounting principles and reporting requirements with which foreign issuers entering the U.S. capital market must usually comply, it will be necessary to consider both the pronouncements of the United States accounting profession and those of the Securities and Exchange Commission. Expert assistance by underwriters, attorneys and U.S. auditors is necessary and should be obtained from firms with substantial experience.

It is our belief that the United States has a long-term commitment to an open capital market, functioning in the best tradition of a free-enterprise economy by allowing capital to flow where the risk/reward ratio seems most favorable. Recent legislation and a renewed influx of foreign direct investments indicate a common sharing of this belief.

