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## Accounting and other requirements for the sale of foreign securities in the U.S. capital market.

American Institute of Certified Public Accountants (AICPA)

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*Accounting and other requirements  
for the sale of foreign*

*securities in*

**THE  
U.S.  
CAPITAL  
MARKET**



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MARKET**

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## NOTE

THIS BOOKLET IS part of a broad and continuing program of international co-operation conducted by the foreign affairs committee of the American Institute of Certified Public Accountants.

The committee is primarily concerned with promoting greater understanding of accounting principles and auditing standards throughout the world in the hope that ultimately accounting can become a truly international language of business. It is convinced that this objective can best be achieved by participation in international accounting conferences; by the exchange of personnel and literature among accounting organizations; and by the elimination of barriers which interfere with the freedom of professional accountants to cross national boundaries in the service of their clients.

In joining with their professional colleagues abroad in pursuit of these objectives, the committee believes that the CPAs of the United States can help to stimulate a wider appreciation of the accounting art as indispensable in the achievement of economic progress.

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## INTRODUCTION

SINCE THE END of World War II the free world has experienced an unprecedented expansion of its business enterprise, financed in large measure by private venture capital. The needs of a steadily growing population, creeping inflation and the inflexible trend toward higher proportions of invested capital per worker point to continuing future demands for investment funds to finance the increased productive facilities which will be required in the years ahead.

A large portion of the capital obtained by American business in recent years has been supplied by individual American investors. A survey made in 1959 by the New York Stock Exchange indicates that one out of every eight adults in the United States is a shareholder in a publicly held company, an increase of nearly 100 per cent since 1952. With the great publicity now being given to the advantages of security investments as a means of participating in the economic growth of the nation, it is reasonable to expect that the proportion of individual investors in the United States will continue to rise.

Most of these individuals are direct holders of securities of operating companies. A significant and growing number, however, invest in securities through mutual funds and investment groups,

which enable investors with a limited amount of capital to achieve considerable diversification. Many Americans are also indirectly contributing to the available capital pool through employee pension, welfare and profit-sharing plans. These plans have greatly expanded in the United States since the end of World War II, and appear to have considerable additional growth prospects. A substantial part of their funds has been, and will continue to be, invested in corporate securities. Together with the savings provided by individual investors, they offer to the investment market a vast potential for future capital resources.

Business firms seeking capital for expansion are continually creating a demand for these available funds. To an increasing extent foreign companies have entered the American financial market in recent years. The purpose of this pamphlet is to outline some general considerations for foreign companies seeking public financing in the United States and to discuss certain requirements for disclosing financial and other data to potential American investors.

## **FEDERAL SECURITIES ACTS**

**T**HE DEGREE to which individual Americans have invested their funds in private business enterprise is a reflection of the restored confidence in the securities market following the 1929 market "crash" and the depression of the early 1930's. One reason for this confidence has been the effectiveness of two Federal statutes passed in the early 1930's to provide some protection for investors and potential investors in their securities transactions.

The first of these laws was the Securities Act of 1933. Its basic objectives are to provide potential investors with significant financial and other information concerning securities publicly offered for sale in interstate and foreign commerce and through the mails, and to prohibit misrepresentation and other fraudulent acts and practices in the sale of securities generally.

This law was followed by the Securities Exchange Act of 1934 which provides for the registration of securities listed on national securities exchanges, the regulation of such securities exchanges and of over-the-counter markets, and the prevention of inequitable and unfair practices. The 1934 Act also created the Securities and Exchange Commission (SEC or the "Commission") as an independent, quasi-judicial agency of the United States Government to administer the acts, including the Securi-



ties Act of 1933. Subsequent legislation has enlarged the scope of the Commission's functions (e.g.—with respect to investment companies and public utility holding companies).

## **REGISTRATION OF SECURITIES OFFERED FOR SALE**

### **Purpose of registration**

**A** COMPANY SEEKING to raise capital in the United States by a public offering of securities must be concerned with the 1933 Act, which provides that a registration statement first be filed by the issuer with the Commission. The purpose of registration is to set forth the facts upon which potential investors may judge for themselves the merits of the securities.

The SEC examines each registration statement to see if it complies with the applicable disclosure requirements. If it appears that a statement is materially incomplete or inaccurate, the registering company is usually informed by letter and given an opportunity to file correcting or clarifying amendments. A company may not sell its securities until the registration statement has become effective—normally twenty days after the date the amended statement has been filed.

The process of registering securities does not insure investors against loss. The SEC does not evaluate the securities for investors nor does it have the power to disapprove of securities for lack of merit. The entire emphasis is

**6** on adequate disclosure of material facts

concerning the company and the securities it proposes to sell. The Commission does have the authority, however, to refuse to permit a registration to become effective (and thereby prevent the sale of the securities) or to suspend its effectiveness at a later date, if it finds that the statement contains misleading, inaccurate or incomplete information.

A registration statement consists of two main sections. The first part is the prospectus, which contains the salient information considered to be of interest and value to the ordinary investor. A copy of the prospectus must be furnished to each prospective investor to permit him to evaluate the securities. (After a registration statement is filed, and before it becomes effective, offers, but not sales, of the securities may be made by means of a "preliminary" prospectus.) The prospectus thus receives wide distribution. The second section (Part II) of a registration statement contains certain supplementary data, including exhibits. This section is not widely distributed but is available for public inspection at the offices of the SEC in Washington, D.C. by anyone seeking certain detailed information.

### **Registration procedures**

To facilitate the registration process, the SEC has prepared special registration forms which vary according to the different types of issuing company and security offered. In general, the registration forms require including in the prospectus information such as (1) description of the registrant's properties and business, (2) significant provisions

of the security to be offered for sale and information concerning the registrant's other outstanding securities, (3) information as to the principal holders of the registrant's securities and as to its management, including remuneration and options to purchase securities and (4) audited financial statements.

The preparation of a registration statement is generally a co-operative effort involving representatives of the registering company's management and outside experts such as investment bankers, lawyers, independent public accountants and sometimes engineers or appraisers. Each has his specific role in the registration procedure. In the case of a foreign issuer, a bank or trust company may also be a participant if the securities to be sold to the public are to be American Depositary Receipts, as discussed more fully below.

One of the first decisions in raising capital is the determination of the type of security to be sold. Here the investment banker plays an important part, since he is informed on current investment conditions and preferences and can help the prospective issuer determine what form of security will best meet his needs and still find a market at reasonable terms. The investment banker may even recommend in a particular situation the private sale of securities, such as a sale to a few institutional investors without registration of the securities with the SEC. If, however, public sale is indicated, the investment banker has a primary role as the principal underwriter and distributor of the securities to be sold.

In certain situations, the underwriters agree merely to sell securities for the issuer on a "best efforts" basis and accept no responsibility for sale of the entire quantity offered. More often, though, the underwriters assume the risk of marketing the securities by agreeing to purchase the entire issue from the company at a fixed price, usually determined immediately prior to the effective date of the registration statement. The company is thus assured of the funds it is seeking without regard to subsequent market fluctuations. The underwriters assume this risk in the belief, based on their knowledge of market conditions, that they will be able to sell the securities in a reasonably short time at the agreed offering price.

When the type of security to be sold has been agreed upon, the company's legal counsel will determine which registration form is to be filed in order to comply with SEC regulations. If company's counsel has not had experience in registration work, it is customary to retain experienced counsel for advice and guidance. The lawyers also prepare the drafts of basic information (other than the financial statements) required for the filing, in co-operation with company representatives, and generally arrange for conferences among the various participants, the printing of the prospectus and registration statement and the filing of the required documents with the SEC. Further, the lawyers normally act as the registrant's agent in dealing with the SEC and carry on necessary correspondence or oral discussion with representatives of the Commission on

matters other than the financial statements as questions arise in connection with the registration statement. The company's independent public accountants, however, rather than the lawyers, will usually participate in discussions with the SEC on the financial statements or other accounting and auditing matters.

### **Financial statements**

As previously indicated, a registration statement filed under the 1933 Act must contain audited financial statements. Although the requirements vary according to the particular circumstances, these financial statements ordinarily include a recent balance sheet and statements of income and surplus for each of the three latest fiscal years and for the period, if any, between the end of the latest fiscal year and the date of the balance sheet filed. In the case of a company registering for the first time, the balance sheet would normally be as of a date not more than ninety days prior to the filing of the registration statement.

In addition, a condensed earnings summary of the company must be presented for each of the last five fiscal years and for the short period, if any, up to the date of the latest balance sheet and for the corresponding short period of the preceding year. This earnings summary is considered to be one of the most important sections in a registration statement. Its purpose is to present the major income and expense items for the respective years in a manner which

**10** fairly reflects the past earnings of the

enterprise in light of circumstances existing at the time of registration. It may therefore be necessary to recast certain figures from those originally reported to give effect in the periods to which they relate those transactions or adjustments which were not recorded until later years. Appropriate disclosure must also be made of significant nonrecurring items of income or expense or of the existence of any other unusual conditions which would affect comparability of earnings for the respective years. Although the summary is not required by the SEC to be audited, in practice the underwriters generally request that the summary be audited through the date of the related audited balance sheet included in the prospectus.

If the company has subsidiaries, the financial statements mentioned above would also be presented on a consolidated basis for the company and its consolidated subsidiaries, and separate financial statements may be required for significant subsidiaries which are not included in the consolidated statements.

Under certain circumstances, where consolidated financial statements are filed, the statements for the company alone may be omitted.

In general, the financial statements filed by a foreign issuer may be expressed in foreign currency, although it is considered desirable to express at least a part of them also in United States dollars for the benefit of American investors. This question should be discussed with the SEC before the registration statement is filed.

The Commission has issued regula- **11**

tions governing the form and content of the financial statements to insure uniform reporting practices and standards of disclosure. A foreign company may therefore find that certain financial information which has not previously been publicly disclosed must be set forth in the registration statement.

The basic financial data referred to above and some of the supporting detail must be included in the prospectus, since they are considered vital for the evaluation of a security by a potential investor. Certain other historical financial information is included in Part II of the registration statement but need not be included in the prospectus. These data must be given for a period of seven years preceding the three years for which income statements are filed and cover such items as—revaluation of properties; restatements of capital shares; changes in surplus; and data with respect to discount and expense and premiums on long-term debt. In addition, supporting schedules giving details of certain balance sheet and income statement items are omitted from the prospectus but must be included in Part II of the registration statement.

Normally any financial information filed with a registration statement, regardless of whether it is included in the prospectus, becomes a public record and is available for inspection by anyone immediately on filing. Certain non-financial data, however, particularly contracts required to be filed as exhibits to the registration statement, may receive confidential treatment if the SEC

12 determines that public disclosure would

impair the value of the contract and that disclosure is not necessary for the protection of investors.

### **Accounting and auditing questions**

The SEC regulations governing the form and content of financial statements also deal with the qualification of independent public accountants (or “auditors”) who report on the statements, and the regulations outline certain minimum requirements as to the information to be contained in the public accountant’s report (or “certificate”). Among other things, the independent public accountant must state whether his examination was made in accordance with “generally accepted auditing standards” and he must give his opinion as to whether the financial statements were prepared in accordance with “generally accepted accounting principles.”

If generally accepted auditing standards were not followed, the auditor must say so and indicate his reason for not following such standards. Where the failure to observe these standards is significant it may be determined that the public accountant is precluded from expressing an opinion on the financial statements. Similarly, he must disclose any significant differences between generally accepted accounting principles and those reflected in the company’s financial statements.

Ordinarily the SEC’s function is to see that adequate disclosure is made of all material facts. Beyond that, the prospective investor is left to determine the



merits of the security based on the information presented. A somewhat different approach is taken with respect to accounting principles followed in financial statements. Here the Commission has ruled that if the statements are based on unsupportable accounting principles, they will be presumed to be misleading or inaccurate despite explanations in the statements or in the auditor's report. In such cases, explanations are not enough. The statements must be corrected.

The auditing standards and accounting principles discussed above are those observed in the United States. Since significant variations exist between American practices and those of many foreign countries, a foreign issuer should consider to what extent changes or additional information will be necessary to conform with the requirements of the SEC. Certain of the more common differences are discussed below.

It is well to bear in mind at this point that the Securities Act makes no distinction between domestic private issuers and foreign private issuers or between domestic independent public accounting firms and foreign independent public accounting firms. The SEC has attempted to adopt rules and develop policies which have as their ultimate objective the inclusion in filings with the Commission of financial statements of foreign private issuers which have been audited by independent public accountants who have followed generally accepted auditing standards and procedures followed by independent professional accountants in the United

States. Furthermore, the financial statements on which foreign auditors express an opinion should reflect, or be reconciled with, generally accepted accounting principles followed in the United States.

### **Qualifications of independent public accountants**

The Commission has adopted strict rules with respect to the qualifications of independent public accountants who may report on financial statements filed by registrants. The auditor first must be in good standing and entitled to practice under the laws of the place of his residence or principal office. Furthermore, he must meet the Commission's standards of independence. An auditor will be considered not independent, for example, if he (or any member of his firm or any member of his immediate family) has or had during the period covered by his report any direct financial interest or any material indirect financial interest in the registering company or any of its parents or subsidiaries or if he is or was during the period connected as a promoter, underwriter, voting trustee, director, officer or employee. In determining whether a public accountant is independent in a particular case, the SEC considers all relevant circumstances bearing on the relationship between him and his client and the client's affiliates.

Very often the concept of independence is different in foreign countries from that in the United States. Therefore, if some question exists as to whether a foreign public accountant will

be considered not independent by the SEC, the company and its auditor should clear the matter with the Commission at the earliest possible date. If this question is deferred until the registration statement is filed, the company may well find that the auditor's report is unacceptable and an audit by another public accountant, who is independent, is required.

### **Auditing standards**

Two important auditing procedures which are generally considered mandatory in the United States with respect to audits of industrial and commercial companies are not generally followed by foreign auditors. These procedures are (1) direct correspondence by the public accountant with debtors to confirm accounts and notes receivable and (2) observation by the public accountant of physical inventory taking by his client. A foreign company planning to register securities in the United States should promptly inform its auditor so that he may make provision for including these two procedures in his current examination. Otherwise, if the amounts involved are material, it is probable that the SEC will not accept the financial statements as "audited."

### **Accounting principles and reporting practices**

The general practice in the United States is to carry inventories in the balance sheet at cost, or at the lower of cost or market. This is not accepted practice in many foreign areas, however. In **16** some countries, for example, it is cus-

tomary to state inventories at market or replacement value; in others it is permissible to provide inventory reserves of somewhat arbitrary amounts as determined by management or as permitted for computing taxable income.

Another common area of difference between American and foreign accounting principles relates to property accounts and the provision for depreciation. The accepted American basis of carrying property in the balance sheet is at historical cost. The provision for depreciation charged in the income account should represent amortization, by a recognized method, of the actual cost of the properties over their economic lives. Although there has been some pressure in the United States to adopt economic depreciation, based on current replacement cost or current price levels rather than on actual cost, the business community and the accounting profession have not accepted this theory and the SEC has not recognized it as proper accounting in financial statements filed with the Commission.

In many foreign countries, however, property accounts are carried at current replacement cost, at appraised values or at historical cost adjusted to reflect currency devaluation, and depreciation of these amounts is often provided by methods not followed in the United States.

Where the bases of inventory or property valuation or the method of providing depreciation ordinarily used in the accounts are not in accord with American practices, the financial statements filed in the registration statement should

either be conformed to United States practices or contain full disclosure of such nonconformity. When the difference between foreign and American treatments has a significant effect on a company's reported net income, it will probably be necessary to state, in a prominent, clear manner, the effect for each period for which income statements and summaries of earnings are presented.

The income statements and summaries of earnings must be reasonably comprehensive in accordance with SEC regulations and therefore must set out separately such items as net sales, costs of goods sold, selling, general and administrative expenses, interest expense, dividends from unconsolidated subsidiaries, income taxes and other significant income or expense items. In many foreign countries this much information is ordinarily not given in published financial statements. The SEC has been firm, however, in requiring full disclosure in the income statement and has generally denied requests to omit information it considers essential.

The Commission also requires that all items of profit and loss given recognition in the accounts be included in the income statement. Thus, for example, profits on sale of properties or investments and bonuses paid to directors and management personnel must be reflected in the income statements filed with the Commission even though they are excluded from "net income" determined in accordance with local practice in financial reports ordinarily prepared by

18 the company.

## **Current reporting to the SEC**

Companies which have registered securities under the 1933 Act, with certain exceptions, must file annual reports with the SEC for each fiscal year after registering. These reporting requirements are contained in the 1934 Act.

The purpose of the annual report is to bring up to date much of the information filed in the registration statement. Ordinarily the financial statement requirements are basically the same as for the original registration except that income and surplus statements and supporting schedules need be filed only for the current year.

Although all companies must file such an annual report, the form required of certain foreign issuers is less elaborate and calls for less information than the equivalent form of report required to be filed by an American company.

Another instance of more lenient requirements for foreign companies is found with respect to the "current reports." The rules of the SEC require American registered companies to file reports for particular months in which specific events occur and to file a semi-annual report showing certain condensed financial information. Foreign private companies, other than those domiciled in a North American country or Cuba, are exempt from filing all such current reports.

## **American shares of foreign issuers**

The discussion so far has considered registration of foreign securities as though the actual foreign securities were

to be sold in the United States. Generally this would not be the case, except for securities of Canadian issuers.

There are a number of physical differences between American securities and those issued in certain foreign countries. In addition, the customs and practices for dealing in and handling such securities differ. Most continental European companies, for example, issue their stock certificates in bearer form with coupons attached. American stock certificates, on the other hand, are in registered form and dividends are mailed by the corporation or its agents directly to the holders of record. Furthermore, American shares are transferable by assignment.

Interest in foreign securities by American investors would probably remain at a relatively low level if these investors were confronted with unfamiliar procedures which they considered burdensome. Thus, if they had to deal with the large continental European style certificates, ship the certificates or coupons to the country of origin or to an agency in the United States to collect dividends, and had to conform to the foreign customs with respect to transfer of securities, voting procedures, etc., they would likely be reluctant to invest in foreign companies. To overcome these objections, arrangements have been developed by various banks and trust companies in the United States to issue so-called American shares or to issue American Depositary Receipts for foreign securities. Although their basic objectives are the same, these arrangements differ somewhat in detail, depend-

ing on the procedures developed by the respective depository institutions. The American Depositary Receipts, for example, are negotiable receipts for foreign securities deposited in a foreign bank as agent for the American bank issuing the receipts. At any time the holder of an American Depositary Receipt may demand and receive delivery of the underlying foreign shares. With this arrangement, however, it is rarely necessary for American investors to have physical possession of the actual foreign share certificates, so that the certificates are rarely transported to the United States.

American Depositary Receipts are in registered form only (even though the underlying foreign shares may be in either bearer or registered form) and are transferable with the same facility as American stock certificates.

Dividends on the foreign shares are collected by the American depository's foreign agent and are in turn paid in U. S. dollars by the depository to the American holders. The depository also will generally arrange for the distribution of financial reports and other pertinent information about the company to holders in the United States.

The American shares or receipts as well as the underlying foreign shares must be registered under the Securities Act of 1933 if they are to be publicly offered in the United States. Similarly, if the depository receipts are to be traded on a national securities exchange, they must be registered under the Securities Exchange Act of 1934, together with the underlying foreign securities (see be- 21



low). In registering under either Act, however, the registration form for the depositary receipts alone is fairly abbreviated, requiring information concerning the depositors, the depositary and the rights and powers of certificate holders. Thus the total registration procedure for the underlying foreign shares and the depositary receipts is only slightly more involved than comparable registration procedure for an American issuer.

## **LISTING ON NATIONAL SECURITIES EXCHANGE**

### **Listing procedures**

**A**FTER SECURITIES registered under the 1933 Act have been sold, the issuer may decide to list them on a national securities exchange (stock exchange) in the United States to enable the holders to find a ready market and to obtain a wider distribution in the hands of the public. In order to list securities, however, two additional procedures must be followed: (1) the company must obtain approval from the particular stock exchange, and (2) the securities must be registered under the Securities Exchange Act of 1934.

To secure trading privileges on a stock exchange a company must measure up to the exchange's standards and must file a listing application with the exchange. Specific requirements differ among the various exchanges. Those of the New York Stock Exchange (the largest in America) are generally the most stringent. Among other factors, the

Exchange will consider the character of the applicant's business, its standing in its field, its size and demonstrated earning power and whether the particular securities have a sufficiently wide distribution to assure a reasonably adequate market. When common stock is proposed for listing, the New York Stock Exchange also requires that the holders possess voting power.

In the listing application submitted to an exchange, a company must present data with respect to its history and business comparable to that previously described for a prospectus under a 1933 Act filing. This would include, among other things, details of its capitalization, funded debt and outstanding options, warrants and conversion rights; descriptions of its business, properties and affiliates; and information concerning management and the business, financial and accounting policies of the company.

The listing application must also contain certain financial statements. The New York Stock Exchange requires consolidated income statements for the last two fiscal years and consolidated balance sheets at each of the two year-ends, audited by independent public accountants. In addition, its instructions ask for any interim consolidated financial statements since the last fiscal year-end which may be available and a condensed summary of consolidated earnings for the past ten fiscal years, but these need not be audited. Separate financial statements for the parent company alone and for significant unconsolidated subsidiaries might also be required if the Exchange considers them necessary.

The form and content of these financial statements are not specified in detail. The applicable instruction requires that they be reasonably informative without being too detailed. Accounting policies of the company are expected to conform to accepted practice. Ordinarily, the New York Stock Exchange's procedure is to ask the company to submit financial statements initially in the form in which they have previously been published in annual reports to stockholders. These statements are examined by the Exchange and any changes deemed desirable are discussed with the company's representatives. Where reports of foreign issuers have not previously conformed to American practice, it is probable that the Exchange would insist on revisions to conform the statements to United States standards.

The financial statement requirements of the American Stock Exchange (second largest in America) are somewhat different from those described above, but the general pattern of information to be presented is basically similar.

If a company applies for listing on an exchange soon after registering securities under the 1933 Act, it may be able to eliminate separate preparation of the data (including financial information) described above for the listing application. The regulations give the company the option of substituting for such data a prospectus of the company filed under the 1933 Act and issued not more than thirty days prior to the filing of the initial draft of the listing application. Where this timing is followed, the material which is required to be fur-

nished is thus substantially reduced.

Another important part of the listing application is the "listing agreement," a standard agreement required of all companies seeking trading privileges. In general it contains certain commitments by the company to the exchange, for example—to disclose certain significant events; to publish annual audited financial statements to stockholders in the form agreed upon between the company and the exchange; to arrange that its shares or depositary receipts will be readily transferable, and to provide transfer facilities through which domestic and international transactions may be effected.

Aside from the listing application, the other major step in the listing process is the filing of an "application for registration" with both the exchange and the SEC. This registration under the 1934 Act for listing on an exchange is required even though the company has previously filed a registration statement under the 1933 Act for public sale of securities. The burden of this registration, however, will be considerably lightened since a substantial part of the information required, including financial statements, will have already been filed with the SEC in the 1933 Act registration and need not be submitted again. Instead, the pertinent data may be incorporated in the current registration by reference to the previous one. A limited amount of more current information may be required, depending on when the 1933 Act registration statement was filed.

After receipt and approval of the list- 25

ing application and the application for registration, the exchange certifies to the SEC that it has approved the securities for listing and registration and has received a registration statement. Assuming the SEC is satisfied with the registration statement, official registration becomes effective, and the securities are admitted to trading, thirty days after receipt by the SEC of the advice from the exchange. This time period may be, and generally is, accelerated by arrangement with the SEC.

### **Concessions to foreign companies**

It has previously been mentioned that most companies registered under the Federal securities acts are required to furnish periodic reports to the SEC and that foreign companies have been exempted from filing certain of the current reports. Other concessions have also been made to foreign companies under the 1934 Act. For example, the Commission has adopted rather elaborate rules concerning the solicitation of proxies by American corporations, but has exempted foreign corporations from these rules. In addition, the 1934 Act requires officers, directors and owners of more than 10 per cent of registered equity securities to report to the Commission the amount of their beneficial holdings of the registrant's securities and to keep the Commission advised monthly of any changes in their holdings. There is also a provision for recovery by the corporation of any profits made by these holders through the purchase and sale of such equity securities completed

within a six-month period. The SEC has, by rule, exempted foreign securities from these provisions of the Act.

### **Listing previously outstanding securities**

Up to this point the assumption has been that a foreign company intended to sell securities in the United States and then list these securities on a national exchange to achieve wide distribution.

Many foreign companies, however, with long-range financing plans in mind, arrange to first list their present securities on an American exchange. This enables Americans to become better acquainted with the foreign company through the publicity normally given listed corporations, stimulates interest in the securities and tends to establish a wide distribution of holdings in the United States. When the company is ready to seek additional capital, the investment market will likely be more receptive than if the foreign company were relatively unknown to the American investing public.

When the listing of presently outstanding securities is undertaken, the information and financial statements required for the listing application submitted to the stock exchange will be the same as discussed above. Registration under the 1934 Act will also be required, but the information to be furnished by a foreign corporation is considerably less detailed than for registration for sale of securities under the 1933 Act. For example, the financial statements to be filed would include a balance sheet as of the close of the most recent fiscal

year, or if it is not practicable to furnish the balance sheet as of such date, then as of the close of the preceding fiscal year. An income statement must be filed for the fiscal year preceding the date of the related balance sheet. In contrast, an American company must file income and surplus statements for the three preceding fiscal years. Furthermore, the financial statements filed by an American company in a 1934 Act registration are required to be as detailed as those included in a 1933 Act filing, whereas there are no detailed requirements covering the form and content of the financial statements to be included in a 1934 Act registration by a foreign corporation. If the statements previously used in annual reports to stockholders conform reasonably well to American practices, they will probably be accepted. Otherwise some changes may be required, and it is therefore advisable to discuss the financial statements with representatives of the stock exchange and with the SEC before filing the registration statement.

### **OVER-THE-COUNTER MARKET**

**M**OST NATIONALLY KNOWN American corporations list their securities on a stock exchange, where trading is carried out in an auction market. A much larger number of security issues, however, are traded "over-the-counter," in transactions through dealers and brokers primarily involving negotiation between buyer and seller. Securities of many foreign companies have also been

28 traded in the over-the-counter market,

largely through the initiation of arbitrage brokers.

As previously mentioned, dealing in the foreign shares themselves presents certain difficulties to American investors and, therefore, American Depositary Receipts have been developed to facilitate trading in some of the more popular foreign issues. Where the receipts are used in connection with registration of the underlying shares under the 1933 or 1934 securities acts, the foreign issuer will also register the receipts and will pay the fees of the depository.

If, however, no public offering is being made of the underlying shares in the United States by or on behalf of the issuer (or by an underwriter for a person controlling the issuer), the foreign company has no concern with the American Depositary Receipts. Instead, the legal entity created by the agreement for the issuance of the American Depositary Receipts registers the receipts, and not the underlying shares, with the SEC (under the Securities Act of 1933) and charges investors fees for performing the services outlined in the prospectus, which is the receipt itself. The registration form for the receipts is very abbreviated and requires only information as to the depository, the terms of the deposit, fees and charges and undertakings with respect to making reports of the underlying issuer available to certificate holders. No data are included regarding the issuer of the underlying securities.

Although the foreign company is not a party to this type of registration, it could stand to benefit indirectly from



such an arrangement. The use of American Depositary Receipts may be an important factor in stimulating broader distribution of the company's securities in the over-the-counter market. This in turn creates wider market recognition which is favorable for a public sale of securities if the company anticipates raising new capital in the United States at some future date.

### **STATE SECURITIES LAWS**

**T**HE 1933 AND 1934 securities acts previously discussed are Federal statutes regulating sale of and transactions in securities in interstate and foreign commerce and through the mails. It should be noted that most of the individual states in America have their own laws governing the sale of securities within their states, commonly known as "blue-sky" laws. These laws vary considerably among the several states. An established foreign company complying with SEC and stock exchange regulations will generally satisfy the disclosure requirements of the individual states. The company's lawyers, however, must check the specific laws of each state in which securities may be sold to be certain that all technicalities of the respective state laws, and the requirements for filing, are being met.

### **SUMMARY**

**S**UBSTANTIAL AMOUNTS of private capital will be required in the next few years to provide for the growth and expansion of business throughout the free

world. It seems probable that a significant portion of this capital will be supplied by millions of individual Americans with large total savings available for investment.

Controls have been established in the United States through laws and regulations promulgated by the SEC and stock exchanges designed to protect American investors from fraudulent practices in the sale of securities and to assure them of adequate disclosure of material facts needed to evaluate securities.

Procedures have been provided for foreign companies to register under United States securities laws and list their securities on American stock exchanges. Foreign companies may thus compete on equal terms with their American counterparts for the American investor's dollars. As explained herein, special concessions have been granted in certain respects to foreign issuers.

From the time the Securities Act of 1933 became effective until June 30, 1958, over 12,800 registration statements were effectively filed with the SEC, registering for public sale in the United States over \$147 billion worth of securities. The number of registration statements filed and the value of securities registered have shown a steady increase in recent years. It is reasonable to expect that they will continue to rise in the future, with securities of foreign companies providing an increasing portion of the total offered to American investors.