

Northwestern Journal of International Law & Business

Volume 17

Issue 1 *Winter*

Fall 1996

Reconciling U.S. Disclosure Policy with International Accounting and Disclosure Standards

David S. Ruder

Northwestern University School of Law

Follow this and additional works at: <http://scholarlycommons.law.northwestern.edu/njilb>



Part of the [International Law Commons](#)

Recommended Citation

David S. Ruder, Reconciling U.S. Disclosure Policy with International Accounting and Disclosure Standards, 17 Nw. J. Int'l L. & Bus. 1 (1996-1997)

This Preface is brought to you for free and open access by Northwestern University School of Law Scholarly Commons. It has been accepted for inclusion in Northwestern Journal of International Law & Business by an authorized administrator of Northwestern University School of Law Scholarly Commons.

PREFACE

Reconciling U.S. Disclosure Policy with International Accounting and Disclosure Standards

*David S. Ruder**

In November of 1988, at a Melbourne, Australia meeting of the International Association of Securities Commissioners (IOSCO), the United States Securities and Exchange Commission (SEC) released a policy statement entitled "Regulation of the International Securities Markets."¹ The statement identified three broad areas of regulation that should be addressed in an effective international securities market regulatory system: efficient structures, sound disclosure systems, and fair and honest markets. The Commission stated that: "To achieve those objectives, securities regulators in each nation should work closely with their foreign counterparts and seek coordinated international solutions to world market problems."² Significantly, the SEC did not insist that its methods of regulation were the best or the only means of achieving the stated goals. Instead it said:

* William W. Gurley Memorial Professor of Law, Northwestern University School of Law; Former Chairman, Securities and Exchange Commission (1987-1989); Trustee, Financial Accounting Foundation.

¹ SEC, *Policy Statement on the Regulation of the International Securities Markets*, Securities Act Release No. 6807, 53 Fed. Reg. 46,963 (November 1988).

² *Id.* at 5.

In seeking solutions to common problems, securities regulators should be sensitive to cultural differences and national sovereignty concerns. As regulators seek to minimize differences between systems, the goal of investor protection should be balanced with the need to be responsive to the realities of each marketplace.³

This International Securities Regulation symposium issue of the Northwestern Journal of International Law and Business contains a series of articles written by different authors who collectively provide a brief history of IOSCO,⁴ a description on U.S. regulation of international securities offerings,⁵ an assessment of the SEC's disclosure requirements regarding foreign corporate governance,⁶ an analysis of attempts to harmonize regulation of global futures markets,⁷ and a critique of the extraterritorial elements of the SEC's current securities regulatory regime.⁸ These articles provide excellent insights into U.S. regulation of international futures and securities markets, and also provide background for an extremely important current problem: the difficulty of reconciling U.S. accounting and disclosure standards with international disclosure and accounting standards.

This introduction to the symposium issue will refer briefly to matters covered in the five articles but will concentrate on the problem of reconciling U.S. and international disclosure and accounting standards. It will urge that the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) cooperate with the International Accounting Standards Committee (IASC) for the purpose of enhancing participation in U.S. markets by foreign issuers in an environment providing sound disclosures to investors.

IOSCO

A. A. Sommer, Jr. was a Commissioner of the SEC from 1973 to 1976. Since leaving the Commission, he has been a close observer of the securities regulatory process, particularly in the international area. His description regarding the transition of IOSCO from a Western

³ *Id.* at 5-6.

⁴ A.A. Sommer, Jr., *IOSCO: Its Mission and Achievement*, 17 Nw. J. INT'L L. & Bus. 15 (1996).

⁵ Daniel A. Braverman, *U.S. Legal Considerations Affecting Global Offerings of Shares in Foreign Companies*, 17 Nw. J. INT'L L. & Bus. 30 (1996).

⁶ James A. Fanto, *The Absence of Cross-Cultural Communication: SEC Mandatory Disclosure and Foreign Corporate Governance*, 17 Nw. J. INT'L L. & Bus. 119 (1996).

⁷ Jane C. Kang, *The Regulation of Global Futures Markets: Is Harmonization Possible of Even Desirable?*, 17 Nw. J. INT'L L. & Bus. 242 (1996).

⁸ Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 Nw. J. INT'L L. & Bus. 207 (1996).

Hemisphere forum on securities regulation to an effective world wide organization of securities regulators provides an excellent background regarding a body whose accomplishments are not widely known.

As Mr. Sommer indicates, IOSCO has no direct regulatory power. Instead its effectiveness depends upon achieving agreement among its members regarding desirable securities regulatory initiatives. Since 1986, when SEC Chairman John Shad urged that IOSCO concentrate on technical securities regulatory matters,⁹ the organization has increasingly been effective in providing extremely helpful background information to its members and in launching initiatives designed to improve world-wide securities regulation. For instance, in 1991 it published a survey of international disclosure regulation,¹⁰ and in 1993 it published a report discussing mechanisms for communication between market authorities during periods of market disruption.¹¹

Despite its success in some areas, IOSCO has periodically become a battleground for competing ideas in the securities regulatory field. For instance, as Mr. Sommer reports, U.S. and European regulators have tangled over questions involving capital adequacy for securities firms, with the U.S. asserting the need for an approach involving "haircuts" for liquid securities held in a firm's portfolio and the Europeans favoring a risk based "building block" approach. That controversy escalated into a public war of words during Richard C. Breeden's tenure as Chairman of the SEC, and it has still not been resolved.¹²

PROBLEMS RAISED BY U.S. ACCOUNTING AND DISCLOSURE STANDARDS

An equally important unresolved problem involves the quest for international accounting and disclosure standards. From the United States' viewpoint, the two most important considerations are: (1) whether foreign companies will be able to access the U.S. securities markets for the purpose of raising capital without complying with U. S. disclosure and accounting standards; and (2) whether U.S. investors

⁹ Sommer, *supra* note 4, at 20.

¹⁰ INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, COMPARATIVE ANALYSIS OF DISCLOSURE REGIMES (Sept. 1991).

¹¹ INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, MECHANISMS TO ENHANCE OPEN AND TIMELY COMMUNICATION BETWEEN MARKET AUTHORITIES OF RELATED CASH AND DERIVATIVES MARKETS DURING PERIODS OF MARKET DISRUPTION (Oct. 1993).

¹² Sommer, *supra* note 4, at 29-30.

seeking to acquire foreign securities will be forced to do so in foreign securities markets lacking adequate protective regulation.

Perhaps the most forceful advocate for relaxing U.S. disclosure and accounting standards is the New York Stock Exchange (NYSE). In a working paper,¹³ the Exchange complains that: "Current regulatory policy is unnecessarily driving business overseas at a critical time when the world's major financial capitals are all striving to establish – or maintain – themselves as international financial centers."¹⁴

The problem identified by the NYSE is extremely important. The Exchange expects U.S. investors to double the foreign components of their \$7 trillion investment portfolio in the next few years, moving \$350 billion into foreign securities.¹⁵ It observes that there are 2,300 overseas companies that meet the Exchanges "quantitative" existing standards and that if only a third of those were traded on the NYSE, its market capitalization of about \$5.6 trillion would double.¹⁶

The Exchange observes correctly that if the stocks of foreign companies are not traded in the United States, U.S. investors are likely to trade in overseas markets that are not as well regulated as the U.S. markets. Additionally, the market activity will take place overseas, depriving U.S. markets of the liquidity that would be available if that activity took place in the United States.

One reason that foreign issuers do not enter the U.S. securities markets is the insistence by the SEC that U.S. accounting and disclosure standards apply to foreign issuers seeking to sell securities in the United States.¹⁷ U.S. Generally Accepted Accounting Principles (U.S. GAAP) are promulgated by the Financial Accounting Standards Board, a private non-profit organization that has authority to set U.S. accounting standards because of the endorsement by the SEC, which has decided to look to the private sector to establish and improve accounting standards. The SEC accepts GAAP and requires that it be

¹³ James L. Cochrane et al., *Foreign Equities and U.S. Investors: Breaking Down the Barriers Separating Supply and Demand*, New York Stock Exchange Working Paper No. 95-04 (1995) (on file with the Northwestern Journal of International Law & Business). [hereinafter NYSE Working Paper]

¹⁴ *Id.* at 2.

¹⁵ *Id.* at 1.

¹⁶ *Id.* at 2. The Exchange does not discuss whether its qualitative standards, such as its corporate governance standards, would be met. See generally Fanto, *supra* note 6, at 124. (discussing the lack of disclosure of foreign corporate governance standards and making suggestions for change).

¹⁷ Another reason, not discussed here, is the existence of strong anti-fraud provisions in the U.S. securities laws. These laws can be enforced by the SEC or by private litigants in class actions seeking large damage awards.

followed in SEC filings by U.S. issuers.¹⁸ See generally Miller, Redding, and Bahnsen, *The FASB, The People, The Process and The Politics*, 3rd Ed. (Richard D. Irwin Inc. 1994).¹⁹

For many foreign issuers, the problem is that U.S. GAAP imposes different accounting standards than exist in the country of their domicile. Use of U.S. GAAP involves additional expense for companies desiring to sell their securities in the U.S. but, more importantly, requires different accounting. In some cases, U.S. accounting requirements will produce entirely different income statements and balance sheets.²⁰ A second problem is that U.S. non-financial disclosure standards imposed by the SEC require much more disclosure than do foreign regulatory standards. As a result many foreign issuers do not wish to comply with these different accounting and disclosure requirements and, therefore, are unwilling to enter the U.S. market.

One response to the view that U.S. disclosure standards are keeping foreign companies from entering our markets is the observation that eventually large foreign companies will begin to use U.S. GAAP accounting in order to be able to enter our markets. This response seems useful only if no means of changing U.S. disclosure or accounting standards without injuring U.S. investors is available.

¹⁸ The FASB is composed of seven full time board members appointed by the Financial Accounting Foundation (FAF) to serve for no more than two five year terms. The FAF is the parent organization of the FASB, charged with responsibility of raising funds for the FASB and appointing its members. The FAF Board consists of 16 members who are representative of various accounting related organizations or who are public members. The FASB is advised by the Financial Accounting Standards Advisory Council (FASAC) composed of 30 members charged with the responsibility of advising the FASB on financial issues and priorities.

¹⁹ See generally MILLER, REDDING, AND BAHNSON, *THE FASB, THE PEOPLE, THE PROCESS AND THE POLITICS*, 3d ed. (Richard D. Irwin, Inc. 1994).

²⁰ Edward Niestat, *Internationalization of U.S. Capital Markets — The Effect of a Widespread Multijurisdictional Disclosure System on U.S. Investors, Issuers, and Exchanges* (May 1993) (unpublished paper available in Northwestern University School of Law Library). Edward Niestat discusses the problems of differential standards by referring to German accounting practices permitting hidden reserves. He states: "Of far greater concern to many foreign issuers are U.S. GAAP standards which require the presentation of information that is not required by their home countries' GAAP. For example, Germany permits companies to maintain reserves of undisclosed earnings, a practice that is strictly prohibited by U.S. GAAP. These "hidden reserves" can be used to smooth earnings and thereby to produce a planned rather than actual profit level".³¹ Footnote 31 states: "These reserves are often quite substantial. When Daimler-Benz AG agreed to disclose its reserves as a prelude to eventual listing on the New York Stock Exchange, the reserves amounted to 4 billion marks (\$2.45 billion), or some 210% of its 1991 net income (1.9 billion marks). *Daimler-Benz Discloses Hidden Reserves of \$2.45 Billion, Seeks Big Board Listing*, WALL ST. J., Mar. 25, 1993, at A10. After reporting these reserves, the company reported a 25% decline in earnings. *Daimler Says Mercedes Has Operating Loss*, WALL ST. J., Apr. 7, 1993, at A10.

SEC ACCOMMODATION OF FOREIGN ISSUERS

The SEC has not been unaware of the problems faced by foreign issuers desiring to enter the U.S. securities markets. During the last two decades it has taken steps to accommodate entry of foreign issuers into the U.S. securities markets through different disclosure requirements and exemptions for companies whose securities are traded in the United States.

For reporting purposes under the Securities Exchange Act of 1934, the SEC allows companies that are listed and traded on U.S. stock exchanges or the Nasdaq stock market to file an annual report on Form 20-F. That form permits use of home country GAAP in the preparation of financial statements and requires a reconciliation of material differences for U.S. GAAP, but does not require reconciliation to U.S. GAAP in certain categories.²¹

Companies that are not traded on a U.S. exchange or in Nasdaq²² are allowed to use the SEC Rule 12g3-2(b)²³ exemption from U.S. reporting requirements if the issuer furnishes to the SEC whatever information the issuer has provided to the public or to a stock exchange in the country of the issuer's domicile (the "home country").²⁴ These issues can be traded on the Pink Sheets or in the NASD OTCBB,²⁵ but these quotation media do not provide active trading markets.

If a company wishes to distribute its securities publicly in the U.S. through a registration statement filed under the Securities Act of 1933, the SEC permits use of forms similar to Forms S-1, S-2, and S-3 used for U.S. corporations. Form F-3, which incorporates Form 20-F

²¹ Differences exist between disclosures for reporting purposes and disclosures for public offerings of securities. Form 20-F, 17 C.F.R. §249.220f, has two sets of financial statement requirements, in Item 17 and Item 18. Item 17 contains the minimum disclosure requirements, and contains significant exceptions from SEC requirements for reconciliation to U.S. GAAP, while Item 18 requires reconciliation with U.S. GAAP. Foreign issuers are permitted to use Item 17 in Form 20-F annual reports, but Item 18 must be followed if Form 20-F filings are to be incorporated by reference in Form F-3 filings in connection with distributions of securities. See Frost & Kinney, *Disclosure Choices of Foreign Registrants in the United States*, 34 JOURNAL OF ACCOUNTING RESEARCH 67 (1996).

²² Companies traded on an exchange must register under the Securities Exchange Act of 1934 §12(b), 15. U.S.C. §781(b). Companies traded on the Nasdaq Stock Market ("an automated inter-dealer quotation system") are excluded from use of Rule 12g3-2(b) by Rule 12g3-2(d)(3).

²³ 17 C.F.R. §240.12g3-2(b). [hereinafter regulations are referred to as rules]

²⁴ See Rule 12g3-2; see also Braverman, *supra* note 5, at 101.

²⁵ The OTCBB is the NASD's over the counter bulletin board market, which provides screen based quotations, but no trading system. The Pink Sheets are published by the National Quotation Bureau and also do not provide a trading system.

disclosures by reference, can be used if the issuers 20-F reports are current, if issuers meets a float test of \$75 million, and if the issuer has not defaulted on certain payments. However, if the company plans a public offering of securities it must also provide a reconciliation²⁶ of its financial statements to U.S. GAAP.²⁷ Thus, since a public offering of securities cannot be made by a foreign issuer without reconciliation with U.S. GAAP, access to the U.S. markets for the sale of securities is highly limited.

Regarding disclosures, the U.S. has made some adjustments by foregoing certain compensation disclosures and allowing foreign issuers to report on a semiannual rather than quarterly basis.²⁸ It also has exempted foreign private issuers from the short swing profit and proxy regulation.²⁹ In a recent release dealing with simplification of registration and reporting requirements for foreign registrants, the SEC enumerated areas in which it has provided accommodations to foreign issuers, including the following:

- interim reporting on the basis of home country regulatory and stock exchange practices;
- quarterly reports are not required from foreign issuers;
- exemption from the proxy rules and Section 16 insider stock reports and short-swing profit recovery;
- executive compensation disclosure requirements that allow disclosure of compensation for executives on an aggregate basis, if so reported in the issuer's home country; and
- offering document financial statements that are required to be updated principally on a semi-annual, rather than quarterly, basis.³⁰

By the adoption of Rule 144A under the Securities Act in April of 1990, the SEC provided a means for foreign issuers to access the U.S. institutional investor market.³¹ Rule 144A provides that sales of securities eligible under the rule to qualified institutional buyers³² will be exempt from the registration requirements of the Securities Act of

²⁶ Braverman, *supra* note 5, at 40. Braverman points out that reconciliation can yield important differences, noting that for the year 1991, net income for BET, a U.K. company was £150.0 million under U.K. GAAP and only £77 million under U.S. GAAP. *Id.* at n.16. (?check?)

²⁷ Complying with Item 18 in Form 20-F; *see also id.* at 39.

²⁸ Simplification of Registration and Reporting Requirements for Foreign Companies, Securities Act Release No. 33-7053, 59 Fed. Reg. 21,644 (April 19, 1994)(adopting amendments to Form 20-F and other rules).

²⁹ SEC Rule 3a12-3(b), exempting foreign private issuers as defined by Rule 3b-4 from Sections 14(a), 14(b), 14(c), and 14(d) of the Securities Exchange Act of 1934. Exemption from tender offer regulation under Section 13(d), 14(d), and 14(e) is not provided.

³⁰ Securities Act Release No. 33-7053, *supra* note 28.

³¹ Braverman, *supra* note 5, at 68-73.

³² As defined in Rule 144A(a)(3) as an institutional investor that owns and invests on a discretionary basis \$100 million in securities.

1933. Braverman reports that as of December 31, 1993, 191 foreign companies had raised \$23.415 billion in the Rule 144A market.³³

Although under Rule 144A a private market for foreign securities exists among U.S. institutional investors, the SEC does not allow Rule 144A to be used for securities that are of the same class as securities traded on a national securities exchange or traded on a U.S. automated inter-dealer quotation system.³⁴ The SEC has rejected creation of a separate private market paralleling a public market in part because such a market might have the effect of denying small investors the liquidity resulting from market participation by institutional investors. Additionally, artificial separation of markets for the same securities would have unknown effects on price discovery.

If the SEC continues to object to parallel institutional and public markets, increased use of a Rule 144A market will not be available to bring large public companies into U.S. markets. In recent years, the SEC has been more accommodating to foreign issuers, in part through the Form 20-F and 12g3-2(b) initiatives, and also through its promulgation of Rule 144A.³⁵ More could be done by the SEC to accommodate foreign issuers by further relaxing disclosure standards and permitting deviations from U.S. GAAP.

MULTIJURISDICTIONAL DISCLOSURE

In 1991, the SEC completed the first phase of its "multijurisdictional disclosure" project, which resulted in an agreement between the SEC and Canadian securities regulatory officials to permit the use of home country documents in certain securities offerings.³⁶ The agreement rested on the premise that Canadian and U.S. accounting, disclosure, supervisory, and enforcement standards are so similar that each country's documents can be used in the other country without harm to investors. Although this approach was promising for Canada, in most other foreign jurisdictions the multijurisdictional disclosure model will not work, precisely because of differences between the regulatory systems in the U.S. and those countries, particularly in the accounting and disclosure areas.

³³ Braverman, *supra* note 5, at 66. (citing the SEC Staff Report on Rule 144A).

³⁴ Rule 144A (d)(3)(i).

³⁵ Regulation S might also be included in this discussion, since it relaxes SEC restrictions on sales of foreign securities to U.S. citizens overseas. See Choi & Guzman, *supra* note 8, at 208-13 (critical discussion of Regulation S); see also Braverman, *supra* note 5, at 90-102.

³⁶ Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, Securities Act Release No. 33-6902, 56 Fed. Reg. 30,036 (June 21, 1991).

In the article "The Dangerous Extraterritoriality of American Securities Law" contained in this issue Stephen Choi and Andrew Guzman advance the concept of "portable reciprocity" as a means of solving the problem inherent in different accounting and disclosure systems.³⁷ They note that reciprocity agreements such as the one between U.S. and Canadian authorities "leave it up to the individual country whether to be governed by the host country's or its own country's laws," but advance a solution based on company choice, stating:

Rather than requiring that companies adhere to the regime of their home country, companies would be allowed to select from the regime of any country of their choosing. Such a system would add increased issuer mobility in addition to investor mobility. To the extent an issuer disliked the regulations of a particular regime, they could simply switch to another country's regime.³⁸

As Messrs. Choi and Guzman point out, in response to contentions that each issuer should be governed by the disclosure rules of its own country rather than by the rules of the country in which it desires to sell or trade its securities, former SEC Chairman Richard C. Breeden replied: "[I]f the SEC were to adopt a system of home country exemptions, the U.S. investors would be confronted even today with financial statements prepared under at least forty different sets of accounting principles."³⁹ Surely Chairman Breeden was correct as to home country choice. The SEC has rejected that approach and would surely reject a system based on company choice as suggested by Choi and Guzman. Such a system would make compatibility between disclosure and accounting systems very unlikely, and would probably cause some issuers to choose the systems with the lowest disclosure and accounting requirements.

The willingness of Choi and Guzman to urge the portable reciprocity idea seems to stem from notions that investors can become informed about the effectiveness of a particular disclosure system and will then protect themselves in their investment decision making. They state:

Moreover, American investors are sufficiently well-protected if they understand that they are purchasing securities under a legal regime that differs from that of the United States. With this knowledge, investors can decide whether the risks are worth taking and how much they are willing to pay for a particular security.⁴⁰

³⁷ Choi & Guzman, *supra* note 8, at 227.

³⁸ *Id.* at 228-29.

³⁹ *Id.* at 228. (quoting from Breeden, *Foreign Companies and U.S. Securities Economic Transformation*, 17 *FORDHAM INT'L L.J.* 577, 590 (1994)).

⁴⁰ *Id.* at 219.

This underlying attitude toward information and decision making seems misguided and is not likely to be embraced by regulators who understand that most investors need to be protected against judgments made without adequate information. It is difficult to imagine how an investor would be able to judge the effectiveness of different regulatory regimes, much less quantify that knowledge in a manner allowing the investor to change the purchasing or selling price of a particular security.

INTERNATIONAL ACCOUNTING STANDARDS

The most important and encouraging, yet controversial, development involves international accounting standards being promulgated by the International Accounting Standards Committee (IASC). IASC "is an independent private sector body, with the objective of achieving uniformity in the accounting principles which are used by businesses and other organizations for financial reporting around the world."⁴¹ The IASC's announced goal is to develop accounting standards that can be accepted worldwide. It has made great progress in that direction.⁴²

In the early days of IASC, little tension existed between the IASC standards setters and the U.S. standards setters. Throughout the existence of the IASC, the FASB has sent representatives to IASC meetings as members of the U.S. delegation serving as observers, and the SEC has also sent observers to IASC meetings. However, as IASC has come nearer to completion of its project to develop interna-

⁴¹ IASC, *INTERNATIONAL ACCOUNTING STANDARDS*, at 7 (1996). IASC was formed in 1973, and since 1983 its members have included all of the professional accountancy bodies that are members of the International Federation of Accountants (IFAC). Other organizations are also involved in the work of IASC. Its Board is composed of representatives of accountancy bodies in 13 countries and three accountancy organizations with interests in financial reporting. Each Board member may nominate two representatives and a technical advisor to attend Board meetings. For terms ending December 31, 1997, the Board will consist of 13 countries, including the United States, and representatives of three financial accounting organizations. A Consultative Group composed of representatives of 15 international organizations of preparers and users of financial statements, stock exchanges and securities regulators meets twice yearly to discuss technical issues with the Board. An Advisory Council was established in 1995 for the purpose of reviewing the independence and objectivity of the Board. The IASC Board is supported by a small technical staff located in London, consisting of approximately 3 to 5 professionals acting under the direction of the IASC Secretary-General and the supervision of its Technical Director. Most of the IASC projects are completed through the work of steering committees of part time volunteers who study projects selected by the IASC Board and prepare a draft statement of principles for public comment. Subsequently a statement of principals or an exposure draft will be presented by the steering committee to the Board for review and eventual vote.

⁴² See FASB, *THE IASC-U.S. COMPARISON PROJECT: A REPORT ON THE SIMILARITIES AND DIFFERENCES BETWEEN IASC STANDARDS AND U.S. GAAP* (Claire Bloomer ed., 1996).

tional accounting standards, questions have arisen regarding the inter-relationship between proposed IASC standards and U.S. GAAP.

The most public aspect of differences between the IASC standards and standard setters and the GAAP standards and standard setters occurred in a series of exchanges between IOSCO and the IASC. As Mr. Sommer reports,⁴³ in 1993, IOSCO indicated that it would withhold action on individual IASC standards until IASC had completed action on all of its "core" principles. In 1994, the then Chairman of IASC raised the question whether IOSCO intended to accept the process of setting international standards by IASC or whether it would review in detail each of the IASC standards before approving them. According to Mr. Sommer, the controversy was resolved in 1995 by an agreement that by 1999 IASC would develop a core set of principles that IOSCO could then endorse for cross-border capital raising and listing purposes.⁴⁴

The IASC-IOSCO agreement in turn raised questions whether the SEC, a principal participant in the affairs of IOSCO, would agree to recognize IASC standards. According to Mr. Sommer, after IASC announced that it would expedite its completion of the core principles to March of 1998, the SEC applauded IASC for accelerating the date, but stated that those principles would be acceptable to the SEC "only if they constituted a comprehensive, generally accepted basis of accounting, were of high quality that would result in compatibility and transparency and provided for full disclosure and were rigorously interpreted and applied."⁴⁵

The SEC's expressed reservation makes it seem unlikely that the IASC principles will be embraced in full by the SEC as acceptable substitutes for U.S. GAAP. Although IASC standards are in many respects comparable to U.S. GAAP, they are not presented in the same detail as U.S. GAAP and they are not surrounded with the extensive interpretations of the type issued by the FASB.

Despite the likelihood that the SEC will not accept IASC standards as a substitute for U.S. GAAP, room for optimism remains. The essential thrust of the IASC project is that IASC will promulgate accounting principles that have world wide approval. These standards can then become the starting point for national regulation. Hopefully, the SEC and FASB will continue to cooperate with IASC for the purpose of achieving agreement between the U.S. and IASC concerning

⁴³ Sommer, *supra* note 4.

⁴⁴ *Id.* at 28.

⁴⁵ *Id.*

the substance of the IASC principles. This cooperation should include willingness by the SEC and FASB to reexamine U.S. accounting principles to see whether in some instances the U.S. can change its principles so that they parallel IASC principles. If a common set of broad principles can be agreed to, nothing prevents the SEC from requiring only narrative reconciliation to U.S. GAAP or limiting requirements for numerical reconciliation to U.S. GAAP.⁴⁶ Additionally, the SEC could review its disclosure standards to determine whether there are additional disclosures required in the U.S. that can be omitted by foreign issuers.⁴⁷

One method of encouraging large companies to enter the U.S. securities markets would be to define a special group of "world-class" companies that would be entitled to use home country documents "as long as they included a written explanation of any material differences between home country accounting practices and U.S. GAAP."⁴⁸ This solution presumably would not require numerical reconciliation between U.S. GAAP and home country accounting standards and would be justified on the theory that the companies involved would be so widely followed by securities analysts world wide that comparability of financial statements would necessarily evolve.

The world class company solution might be defended on efficient market theory. The semi-strong form of the efficient market theory presumes that all historic and public information about a widely followed company reaches the market through the activities of analysts and investors, and that the market price of a security reflects all of this information.⁴⁹ Some advocates of the theory believe that companies acting in their own best interest will release all material information about themselves. Others believe they will not do so and believe that the theory depends upon a forced disclosure regime such as that administered by the SEC. To the extent that information is not volunta-

⁴⁶ As it now does in Form 20-F. Form 20-F currently refers to several IASC standards as starting points, including IAS 7 regarding statements of cash flow (Item 17(c)(2)(iii)); IAS 21, dealing with changes in foreign exchange rates (Item 17(c)(2)(iv)(B) and Item 18(c)(2)(iv)(B) and (C)); and IAS 22, dealing with amortization of goodwill (Item 17(c)(viii) and Item 18(c)(viii)).

⁴⁷ Cochrane et al., *supra* note 13, at 15.

⁴⁸ *Id.* The NYSE Working Paper suggests several methods of opening U.S. markets to foreign issuers. In addition to urging special status for world class issuers, it suggests expanding markets for sophisticated investors and urges changing SEC disclosure standards, expanding the SEC's Multijurisdictional disclosure project, and accepting accounting standards promulgated by the International Accounting Standards Committee.

⁴⁹ See Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J.FIN. 383 (1970).

rily provided by companies, differences in required disclosures in various countries will result in differential disclosure, making it difficult for analysts and investors to compare companies.

The possibility that special disclosure and accounting standards might exist for world class companies should not be discarded without extensive consideration. Certainly questions of cost in preparing reconciliations of IASC standards and U.S. GAAP should not be important to world class issuers. Additionally, a study of the areas of disclosure that are disturbing to international issuers might well reveal that U.S. world class issuers would not adamantly seek equal treatment⁵⁰ if disclosures in these areas were required of U.S. issuers and not of foreign issuers. Although some suggest that identifying world class issuers would be difficult, no reason exists why classification based on revenues, assets, or market float as of a particular date such as the end of the calendar year could not be used to establish the members of the class for the coming year.

Underlying the possible disagreements about standards are possible disagreements about procedures. It seems extremely unlikely that the SEC will abandon jurisdiction over its accounting and disclosure standard setting process to IASC or any international body. More likely, and hopefully, the FASB will provide technical cooperation with the IASC standard setting process so that IASC standards and FASB standards will not differ markedly. Both the IASC and the FASB will benefit by compatible rather than differing standards. The SEC should encourage this process. The SEC has been a leader in international securities cooperative efforts, at least, since the time of its 1988 Melbourne release. No reason appears why it should abandon its cooperative attitude now.

In her article "The Regulation of Global Futures Markets: Is Harmonization Possible or Even Desirable?" in this issue,⁵¹ Jane Kang identifies the problem facing market regulators attempting to coordinate their regulation. She identifies that problem as that of choosing between "reputational risk" – a potential consequence of accelerating the commencement of market operations with an underdeveloped or inadequate financial infrastructure – and "market share risk" – concern that other more mature and liquid markets or less

⁵⁰ Presumably U.S. world class issuers could continue to follow U.S. GAAP, perhaps explaining on a narrative or even a reconciliation basis what changes in results would occur if IASC standards were followed.

⁵¹ Kang, *supra* note 7.

prudent regulation will initiate trading and that volume may never migrate home.⁵²

Ms. Kang has identified a real concern for U.S. market regulators. Should regulatory standards be relaxed in order to attract foreign issuers to the U.S. markets? Will failure to relax those standards result in permanent loss of opportunity? Can those standards be relaxed in a manner that will continue to provide ample protection for U.S. investors? In the area of accounting and disclosure regulation, the FASB and the SEC have an opportunity to examine these questions in order to determine what steps can be taken to optimize both market participation and investor protection. Given the past U.S. cooperation in IOSCO and with the IASC, continued attention to these questions seems likely. Hopefully, positive results will emerge.

⁵² *Id.* at 248.