

A STEP TOWARD GLOBALIZATION: THE MOVE FOR INTERNATIONAL ACCOUNTING STANDARDS

I. INTRODUCTION

This note addresses the difficulties faced by foreign companies who make public offerings of stock in the United States.¹ Specifically, this note addresses the problem caused by the Securities and Exchange Commission's (SEC) requirement that all issuers of foreign stock file financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP).

The United States possesses the world's largest and most prestigious capital markets.² Foreign companies want access to U.S. capital markets but are unwilling to incur the substantial costs of reconciling their financial statements from their "home" accounting standards to U.S. GAAP.³ Consequently, U.S. investors are denied convenient access to foreign investment opportunities through U.S. capital markets. In order to gain access to these foreign investment opportunities, U.S. investors are forced into foreign capital markets.⁴ As American capital flows into foreign markets, the dominant status of U.S. capital markets is weakened.⁵ Although U.S. capital markets are not currently in jeopardy of losing their dominant status,⁶ the SEC should take preemptive steps to ensure that U.S. capital markets remain the world's leaders.

The best way for the SEC to protect the dominant status of U.S. capital markets is to allow foreign companies to use international accounting standards (IAS) as a substitute for U.S. GAAP. The SEC should accept IAS as a substitute for U.S. GAAP for several reasons. First, acceptance of IAS would allow foreign companies greater access to U.S. capital markets and help ensure that the capital markets of the United States do not lose their dominant status. Second, the amount of value investors place on the value of U.S. GAAP disclosures is in doubt. Third, and most important, the SEC's acceptance of IAS would be a large step towards worldwide

1. For a discussion of the other, more limited ways in which a foreign company can enter the U.S. markets, including private placements, see William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 *FORDHAM INT'L L.J.* S10 (1994).

2. See Nicholas G. Demmo, *U.S. Securities Regulation: The Need for Modification to Keep Pace with Globalization*, 17 *U. PA. J. INT'L ECON. L.* 691 (1996).

3. Eric M. Sherbet, *Bridging the GAAP: Accounting Standards for Foreign SEC Registrants*, 29 *INT'L LAW.* 875, 876 (1995).

4. See *id.* at 887.

5. See *id.*

6. See Demmo, *supra* note 2, at 692.

harmonization of accounting standards. Worldwide harmonization of accounting standards would greatly benefit both issuers of public stock and investors.

Section II of this note provides background information on the legal issues the SEC faces with respect to cross-border offerings of stock. Section III provides a comparison of some of the major differences between U.S. GAAP and IAS. Section IV reviews the alternatives available to the SEC with respect to foreign issuers and proposes that the SEC accept IAS as a substitute for U.S. GAAP.

II. OPENING U.S. CAPITAL MARKETS TO FOREIGN COMPANIES

In response to financial crises and stock market crashes of 1929-1932, Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934.⁷ The 1934 Act created the SEC.⁸ One of the functions of the SEC was to ensure that potential investors have information, in the form of financial statements, upon which to base intelligent investment decisions.⁹ Congress gave the SEC the authority to establish the accounting standards used in financial statements by companies under its jurisdiction.¹⁰ Accounting standards are the rules that companies use in preparing their financial statements. In 1939, the SEC delegated its authority to establish accounting procedures to the American Institute of Certified Public Accountants (AICPA), a nongovernmental entity.¹¹ The AICPA established the Financial Accounting Standards Board (FASB), which now has the responsibility for establishing the appropriate accounting procedures for use in financial statements by companies making public offerings of stock.¹²

Foreign companies desperately want access to large U.S. capital markets.¹³ However, the SEC currently requires foreign companies making

7. See KENNETH S. MOST, *THE FUTURE OF THE ACCOUNTING PROFESSION: A GLOBAL PERSPECTIVE* 52 (1993).

8. See *id.*

9. See *id.* at 52-53.

10. See JAMIE PRATT, *FINANCIAL ACCOUNTING* 23 (2d ed. 1994). Defining the word accounting is a difficult undertaking. One definition is "the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information." MOST, *supra* note 7, at 5 (quoting AMERICAN ACCOUNTING ASSOCIATION, *A STATEMENT OF BASIC ACCOUNTING THEORY* (1966)).

11. See PRATT, *supra* note 10, at 23.

12. See *id.* The FASB has had several predecessors. The Committee on Accounting Procedures governed from 1939-1959, and the Accounting Principles Board from 1959-1971. See *id.* The FASB was established in 1973. See *id.* For more on the FASB's standard setting process, see *infra* part III.

13. The combined volume of the New York Stock Exchange, American Stock Exchange, and the NASDAQ reaches close to \$4 trillion dollars annually. See Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L

public offerings of stock in the United States to file financial statements¹⁴ prepared in accordance with U.S. GAAP or to reconcile their financial statements to U.S. GAAP.¹⁵ In order to comply with SEC regulations, a foreign company must provide audited balance sheets for the two most recent fiscal years.¹⁶ In addition, the company must provide audited statements of income and cash flows for each of the past three fiscal years.¹⁷ Most foreign companies prepare their financial statements in accordance with either international accounting standards or the accounting standards of the company's home country.¹⁸ In other words, foreign companies use different rules when preparing their financial statements than do their U.S. counterparts. Thus, in order to make a public offering of stock in the United States, a foreign company must first prepare its financial statements using its "home" accounting standards. The company must then prepare the financial statements again in accordance with U.S. GAAP. U.S. GAAP tends to be more complicated and requires more disclosures than most other

L. & BUS. 207 (1996).

14. Jamie Pratt explains the four basic financial statements as:

(1) the balance sheet, (2) the income statement, (3) the statement of retained earnings, and (4) the statement of cash flows. The balance sheet lists the assets, liabilities, and stockholder's equity of a company at a given point in time. The income statement contains the revenues earned and expenses incurred by a company over a period of time. . . . The statement of retained earnings reconciles the retained earnings amount from one period to the next. The statement of cash flows reconciles the cash amount from one period to the next.

PRATT, *supra* note 10, at 28.

15. 17 C.F.R. § 210.4-01(a)(2) (1997). For the exact forms a foreign registrant must file, as well as other general filing requirements, see M. Elizabeth Rader, *Accounting Issues in Cross-Border Securities Offerings*, 17 FORDHAM INT'L L.J. S129 (1994).

16. 17 C.F.R. § 210.3-19(a)(1).

17. 17 C.F.R. § 210.3-19(a)(2).

18. Aside from IAS, the accounting standards for the countries of the world can be divided into four particular factions based on the similarities of their accounting practices. First, the British-American model, which includes the United Kingdom, the United States, and the Netherlands, focuses its accounting procedures on the needs of investors and creditors. See MUELLER ET AL., ACCOUNTING: AN INTERNATIONAL PERSPECTIVE 8, 11 (1994). Second, there is the Continental model which is used by most of Europe and Japan. See *id.* at 11. Accounting procedures in the Continental model are legalistic in nature and are designed to satisfy government imposed regulations. See *id.* The third model is the South American model. This faction, which includes nearly all of South America, is characterized by its persistent use of accounting adjustments for inflation. See *id.* The final model is the mixed-economy model. The mixed-economy model is used by many countries of the former USSR and Yugoslavia. See *id.* Countries under the mixed-economy model operate "dual accounting systems" which were formed in the wake of the political upheavals in the early 1990s. *Id.* In the mixed economy system, accounting information is used in aiding the transition from a command to a market economy. See *id.* at 11-12. For a listing of countries comprising each model, see *id.* at 9.

comprehensive sets of accounting standards.¹⁹ This second preparation of financial statements results in additional costs and can be very time consuming.²⁰ In most cases, foreign companies have been unwilling to bear these additional costs.²¹ Consequently, foreign companies have avoided U.S. markets.

The differences between U.S. GAAP and other foreign sets of accounting standards can result in considerable differences in a company's net income. For example, in 1993, the German company Daimler-Benz needed to make a public offering of stock in the United States in order to raise capital. Daimler was forced to reconcile its financial statements with U.S. GAAP. Under German accounting procedures, Daimler-Benz showed a profit of over 300 million U.S. dollars.²² However, once the more stringent U.S. accounting procedures were applied, Daimler-Benz's income statement revealed a one billion U.S. dollar annual loss.²³ The company's true financial position had not changed. The difference was mere "accounting fiction." The change related specifically to the different accounting procedures applied to the exact same financial data.²⁴ This bottom line difference can make foreign companies hesitant to reconcile their financial statements with U.S. GAAP.²⁵

As the world's economic markets move toward globalization, it will become increasingly important that foreign companies have access to U.S. capital markets. At present, the United States' capital markets are the largest and most efficient in the world.²⁶ However, representatives of the major U.S. stock exchanges, such as the New York Stock Exchange (NYSE), have expressed concern that if the barriers to foreign companies are not relaxed, investors will turn to other capital markets to obtain potentially fruitful

19. See Rader, *supra* note 15, at S135.

20. See Demmo, *supra* note 2, at 703. The exact amount of these costs is difficult to estimate, and varies from company to company. See Todd Cohen, *The Regulation of Foreign Securities: A Proposal to Amend the Reconciliation Requirement and Increase the Strength of Domestic Markets*, 1994 ANN. SURV. AM. L. 491, 519 (1995). For domestic companies, an initial public offering can cost hundreds of thousands of dollars in legal and accounting fees. See *id.* Due to the complex nature of the GAAP reconciliation, the costs to foreign companies are even greater. See *id.* Maybe the best evidence that issuing costs are too high is that foreign companies cite them as the primary obstacle to entering U.S. capital markets. See *id.*

21. See Sherbet, *supra* note 3, 886.

22. See *id.* at 885.

23. See *id.*

24. A study performed by two college professors of a computer-generated hypothetical company showed a net profit of \$34,600 in the United States, \$260,600 in Britain and \$240,600 in Australia. See Lee Berton, *All Accountants Soon May Speak the Same Language*, WALL ST. J., Aug. 29, 1995, at A15.

25. See Cohen, *supra* note 20, at 494.

26. See Sherbet, *supra* note 3, at 875.

foreign investment opportunities.²⁷ As American capital flows into other markets, the dominant position of the U.S. capital markets is weakened.²⁸ At present, there are approximately 200 foreign companies trading on the NYSE.²⁹ That number is minute when one considers that there are in excess of 2000 foreign companies that could potentially qualify for listing on the Exchange.³⁰ Moreover, most of the foreign companies currently listed on the NYSE come from either Western Europe or Canada.³¹ U.S. investors want access to companies from growing markets, such as Eastern Europe and Asia.³²

The SEC has expressed concern about relaxing disclosure requirements for foreign companies. The SEC is concerned that if fewer disclosures are required, investors will have less information upon which to make intelligent investment decisions.³³ A conflict exists between the SEC's priority of protecting investors and the needs of the U.S. capital markets to have foreign companies listed on their exchanges.

To address the U.S. GAAP reconciliation problem, Congress passed the Capital Markets Efficiency Act of 1996.³⁴ Under the Act, Congress recognized the increasing globalization of security markets³⁵ and the accounting difficulties foreign issuers face.³⁶ Congress recognized that the establishment of a high quality set of international accounting standards would greatly enhance the ability of foreign companies to make stock offerings in the United States.³⁷ Congress then ordered the SEC to increase its efforts toward developing a high-quality set of international accounting

27. See David S. Ruder, *Reconciling U.S. Disclosure Policy with International Accounting and Disclosure Standards*, 17 NW. J. INT'L. L. & BUS. 1, 4 (1996).

28. See *id.*

29. Berton, *supra* note 24, at A15.

30. *Id.* See also James L. Cochrane, *Are U.S. Regulatory Requirements for Foreign Firms Appropriate?*, 17 FORDHAM INT'L L.J. 558 (1994). One study found that only 5% of the companies on the New York or American stock exchanges were foreign. See MOST, *supra* note 7, at 86. By comparison, 58% of the listings on the Zurich stock exchange were foreign, 50% on Amsterdam, 28% on Paris, 27% on Frankfurt, and 22% on London. See *id.*

31. See Cohen, *supra* note 20, at 492.

32. See *id.*

33. See Michael A. Schneider, *Foreign Listings and the Preeminence of U.S. Securities Exchanges: Should the SEC Recognize Foreign Accounting Standards?*, 3 MINN. J. GLOBAL TRADE 301, 307 (1994). All financial statements not prepared in accordance with generally accepted accounting principles are presumed to be misleading or inaccurate. 17 C.F.R. §210.4-01(a)(1) (1997).

34. Capital Markets Efficiency Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, 3449 [hereinafter Capital Markets Efficiency Act].

35. See *id.* § 509(2).

36. See *id.*

37. See *id.* § 509(3).

standards as soon as would be "practicable."³⁸ Finally, the SEC was to report back to Congress one year after enactment of the Act with an update on the progress made on a set of international accounting standards that would be acceptable for foreign companies making public offerings of stock through U.S. capital markets.³⁹

To remedy this problem, the International Accounting Standards Committee (IASC)⁴⁰ is developing a new, revised set of international accounting standards due for completion in March 1998.⁴¹ The IASC plans to submit the new standards to the SEC in hopes that the Commission will recognize the standards as a substitute for U.S. GAAP. The existing set of international accounting standards is already accepted by many foreign stock exchanges for use in cross-border listings.⁴² The IASC estimates that hundreds of multinational⁴³ and international companies prepare their financial statements in accordance with existing international accounting standards.⁴⁴ The IASC is preparing the new set of international accounting standards with the intent that these new standards will be universally accepted for cross-border listings.⁴⁵ It is the conclusion of this note that the SEC should accept the IASC's new set of core accounting standards as a substitute for U.S. GAAP in order to facilitate cross-border offerings of stock and preserve the status of the United States as the world's dominant capital market.

38. *Id.* § 509(4).

39. *See id.* § 509(5).

40. The IASC was founded in 1973 by accounting representatives from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom, and the United States. IASC, *About IASC* (visited Nov. 1, 1997) <http://www.iasc.org.uk/frame/cen1_1.htm>. The IASC presently includes representatives from 85 countries. *Id.* The IASC has two broad objectives. The first is to develop accounting standards to be observed in the preparation of financial statements and to encourage their worldwide acceptance. *See* BARRY J. EPSTEIN & ABBAS ALI MIRZA, *INTERPRETATION AND APPLICATION OF INTERNATIONAL ACCOUNTING STANDARDS 1997*, at 9 (1997). The second is to work generally for the improvement and global harmonization of accounting standards. *See id.*

41. The standards were originally to be completed in mid-1999. *See* EPSTEIN & MIRZA, *supra* note 40, at 13. However, due to pressure from the international community, the completion date "was . . . accelerated to early 1998." *Id.*

42. *See* IASC, *About IASC* (visited Nov. 1, 1997) <http://www.iasc.org.uk/frame/cen1_5.htm>.

43. However, Microsoft is the only major American company to refer to International Accounting Standards in its financial statements. *See* IASC, *About IASC* (visited Nov. 1, 1997) <http://www.iasc.org.uk/frame/cen1_7.htm>.

44. *See id.*

45. *See* Sir Bryan Carsberg, *Foreword* to BARRY J. EPSTEIN & ABBAS ALI MIRZA, *INTERPRETATION AND APPLICATION OF INTERNATIONAL ACCOUNTING STANDARDS 1997* (1997).

III. COMPARISON OF U.S. GAAP AND CURRENT INTERNATIONAL ACCOUNTING STANDARDS

This section begins with a comparison of the standard-setting processes of the FASB and the IASC. The remainder of this section emphasizes some of the major differences between U.S. GAAP, established by the FASB, and the current set of international accounting standards, established by the IASC. This listing is by no means all-inclusive. However, this list should help highlight some of the discrepancies the IASC hopes to resolve when it issues its new set of core standards.

A. Comparison of Standard-setting Procedures of the IASC and the FASB

In the United States, accounting standards are developed by the FASB.⁴⁶ The Board determines standards by way of a political process.⁴⁷ All groups with an interest in accounting standards, including Congress and government agencies, lobby before the Board.⁴⁸ The Board also holds public hearings on issues regarding the setting of accounting standards.⁴⁹ The process of issuing a new accounting standard begins with the identification of a problem area, and the appointment of a task force.⁵⁰ After input from the public, the FASB issues an exposure draft of the proposed standard.⁵¹ The Board then allows sixty days for further discussion of the issue, at which time the Board votes on whether to adopt the new standard.⁵²

The standard setting process for the IASC is similar to that of the FASB.⁵³ After an international financial reporting issue is placed on the board agenda, a steering committee of four representatives is appointed.⁵⁴ The steering committee receives input and comments from the IASC board.⁵⁵ Based on these comments, the steering committee writes an exposure draft, which, on approval of the board, is circulated among the public for six

46. The FASB consists of seven full-time members who are independent from private industry. See PRATT, *supra* note 10, at 23. The FASB has issued in excess of 100 statements of financial accounting standards. See *id.* See also PAUL B. MILLER & RODNEY J. REDDING, *THE FASB: THE PEOPLE, THE PROCESS, AND THE POLITICS* (1986).

47. See PRATT, *supra* note 10, at 23.

48. See *id.* at 24.

49. See *id.*

50. See MOST, *supra* note 7, at 56.

51. See *id.*

52. See *id.* For a new standard to be adopted, a majority vote of five to two is required. See *id.*

53. See JAMES R. BOATSMAN ET AL., *ADVANCED ACCOUNTING* 644 (7th ed. 1994).

54. See *id.*

55. See *id.* at 645.

months.⁵⁶ After reviewing public comments and suggestions, the steering committee revises the draft and submits it to the IASC board for final approval.⁵⁷ If the draft is deemed acceptable, a new international accounting standard pronouncement is issued.⁵⁸ The process of issuing a new pronouncement is slow and tedious. It often takes three to four years for a new pronouncement to be issued.⁵⁹

B. *Accounting for Research and Development*

The United States is virtually alone in its accounting treatment of research and development (R&D) costs.⁶⁰ Research and development costs are those incurred in hopes of creating future revenues through the development of new products.⁶¹ In the United States, under U.S. GAAP, all R&D costs are simply expensed as they are incurred.⁶² Thus, all R&D costs result in a direct, immediate reduction in net income.

Under international accounting standards, however, research costs are distinguished from development costs. According to international accounting standards, research is defined as "original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding."⁶³ Development, on the other hand, is defined as "the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to commencement of commercial production or use."⁶⁴

Although the line between research and development seems blurred, the distinction is important because the accounting treatment is different for the two segments.⁶⁵ Research costs are treated much the same as R&D costs in the United States, expensed as incurred.⁶⁶ However, development costs

56. *See id.*

57. *See id.*

58. *See id.* A new standard requires a vote of three-fourths of the IASC board for approval. *See id.*

59. *See* John L. Kirkpatrick, *The Role of the International Accounting Standards Committee*, in HARMONIZATION OF ACCOUNTING STANDARDS: ACHIEVEMENTS AND PROSPECTS 87, 89 (1986).

60. *See* DHIA D. ALHASHIM & JEFFREY S. ARPAN, INTERNATIONAL DIMENSIONS OF ACCOUNTING 85 (3d ed. 1992).

61. *See* PRATT, *supra* note 10, at 411. R&D costs can be a substantial outlay for companies. For example, in 1990 IBM and DuPont invested \$6.5 billion and \$1.4 billion respectively in R&D. *See id.*

62. *See* ALHASHIM & ARPAN, *supra* note 60, at 85.

63. EPSTEIN & MIRZA, *supra* note 40, at 247.

64. *Id.*

65. *See id.*

66. *See id.* at 248.

may be capitalized and expensed over time.⁶⁷ Consequently, foreign companies using international accounting standards recognize less expense than U.S. companies. This results in higher net income for foreign companies who use IAS.

C. Accounting for Goodwill

Goodwill may be recognized when one corporation purchases the assets of another. The amount of goodwill recognized by purchasing a company will equal the excess of the purchase price over the fair market value of the assets acquired.⁶⁸ In the United States, goodwill is recognized as an intangible asset and amortized over the useful life of the acquired asset in a period not exceeding forty years.⁶⁹ International accounting standards also allow for goodwill to be amortized over the useful life of the asset. However, amortization under international accounting standards is limited to a period not exceeding five years, unless a longer life can be demonstrated.⁷⁰ Under no circumstance may the amortization period exceed twenty years.⁷¹

This appears to be an instance where U.S. GAAP results in a more favorable bottom line than international accounting standards. Given equal amounts of goodwill, U.S. companies will recognize an amount of expense over forty years equal to the amount that foreign companies will recognize over a period not exceeding twenty years. Consequently, U.S. companies

67. The distinction between "expensed as incurred" and "capitalization and amortization" is best demonstrated through an oversimplified example. Suppose XYZ, an American company, incurred \$2000 in research and development costs over the course of one year. The accounting treatment is simple, XYZ expenses \$2000 through the income statement. Suppose ABC, a foreign company using international accounting standards, also incurs \$2000 in total research and development costs. Further suppose that ABC's costs can be divided into \$500 for research and \$1500 for development. With U.S. GAAP, the \$500 is immediately expensed through the income statement. The \$1500, however, is "capitalized and amortized" over the asset's useful life, say 15 years. Instead of recognizing \$1500 of expense this year, ABC will recognize \$100 of expense in each of the next 15 years. The net result is that this year XYZ, the American company, recognizes \$2000 in R&D expense, while ABC, the foreign company, recognizes only \$600 (\$500 research expense plus \$100 amortization of development costs).

68. See MUELLER ET AL., *supra* note 18, at 23.

69. Business combinations can result in extremely large amounts of goodwill. For example, in 1990, when Philip Morris acquired the assets of Kraft, Inc., it recognized \$11 billion U.S. dollars in goodwill. See PRATT, *supra* note 10, at 342. Consequently, Philip Morris must recognize approximately \$275 million in goodwill amortization expense each year. See *id.*

70. See EPSTEIN & MIRZA, *supra* note 40, at 330. For a comparison of accounting treatment of goodwill in various countries, see MUELLER ET AL., *supra* note 18, at 24.

71. See EPSTEIN & MIRZA, *supra* note 40, at 330.

recognize a lesser amount of goodwill expense on a year-by-year basis, which results in higher net income.⁷²

D. Accounting for Business Combinations

There are also significant differences between U.S. GAAP and IAS when accounting for business combinations. When a business combination, such as a merger, takes place, it can be accounted for as either a "pooling of interests" or a "purchase."⁷³ Under a pooling of interests, the assets of the acquired company are not revalued at the date of acquisition.⁷⁴ The assets are simply transferred from the subsidiary's books onto the books of the parent. In a business combination treated as a pooling, no goodwill is recognized.⁷⁵ However, under a business combination accounted for as a purchase, the assets of the acquired company are revalued at their fair market values.⁷⁶ Any difference between the fair values of the assets and the purchase price is then attributed to goodwill.⁷⁷ Consequently, as the goodwill is amortized in subsequent years, the purchase method will result in lower net income for the acquiring entity.⁷⁸

In general, managers would prefer to treat business combinations as a

72. Although goodwill accounting under U.S. GAAP results in higher net income for accounting purposes, it has been observed that goodwill accounting harms U.S. companies with respect to tax law. See PRATT, *supra* note 10, at 342. Since goodwill is an intangible asset, amortization is not recognized for tax purposes. See *id.* Therefore, although Philip Morris recognizes \$275 million a year in goodwill expense, it receives no corresponding tax deduction. See *id.* This runs contrary to countries, such as Japan, where a tax deduction is allowed for amortization of goodwill. See *id.* This tax disadvantage may place U.S. companies at a disadvantage when competing with foreign companies. See *id.*

73. BOATSMAN ET AL., *supra* note 53, at 8. International accounting standards use different terminology to describe a business combination. Under IAS the business combination is called either a "uniting of interests" (instead of a pooling of interests) or an "acquisition" (instead of a purchase). EPSTEIN & MIRZA, *supra* note 40, at 309-10.

74. See BOATSMAN ET AL., *supra* note 53, at 9.

75. See *id.* at 9-10.

76. See *id.* at 10.

77. See *id.* at 9.

78. See *id.* at 10-11. Again, perhaps an oversimplified example would help illustrate the difference between a business combination accounted for as a pooling versus a purchase. Suppose XYZ acquires the net assets of ABC for \$1 million. Further suppose that the net assets of ABC had a book value of \$500,000 and a fair market value of \$750,000. If the business combination is accounted for as a pooling, the net assets of ABC appear on the books of XYZ at \$500,000. No goodwill will be recognized. If the business combination is accounted for as a purchase, the net assets of ABC will appear on XYZ's books at their fair market value of \$750,000. The difference between the price XYZ paid for the assets and the fair market value of the assets (\$250,000) is recognized as goodwill on the books of XYZ. XYZ would then have to amortize the goodwill (recognizing an expense) over a period not exceeding 40 years. See *id.* at 9-10.

pooling so that no goodwill (and the corresponding expense) will have to be recognized.⁷⁹ The distinction between IAS and U.S. GAAP comes in the criteria for determining whether a business combination is eligible to be treated as a pooling. Under U.S. GAAP, a set of twelve conditions must be met in order for the business combination to be treated as a pooling.⁸⁰ By contrast, IAS has only three criteria.⁸¹

The U.S. GAAP criteria for a pooling have been described as complex and difficult to apply.⁸² The twelve criteria are divided into segments based on the characteristics of the entity, the nature of the exchange transaction, and post-combination transactions.⁸³ This is compared to the three direct, relatively simple criteria of IAS.⁸⁴ The result is that foreign companies using IAS are more often able to take advantage of pooling accounting treatment and the corresponding net income advantages.⁸⁵

IV. PROPOSAL AND RECOMMENDATION

In order to increase foreign access to U.S. capital markets, the SEC should accept the IASC's new set of core accounting standards as a substitute for U.S. GAAP. One NYSE official has commented that foreign companies will be "knocking down our door" if the IASC's proposal is accepted as a substitute for U.S. GAAP.⁸⁶ This solution results in benefits that are two-

79. *See id.* at 10-11.

80. *See id.* at 11-14.

81. The three tests under IAS are:

- (1) The shareholders of the combining enterprises must achieve a continuing mutual sharing of the risks and benefits attaching to the combined enterprise;
- (2) The basis of the transaction must be principally an exchange of voting common shares of the enterprises involved; and
- (3) The whole of the net assets and operations of the combining enterprises are combined into one entity.

EPSTEIN & MIRZA, *supra* note 40, at 309-10. Each test must be met for the business combination to be considered a purchase. *See id.*

82. *See id.* at 309.

83. *See id.* at 309. *See also* BOATSMAN ET AL., *supra* note 53, at 11-13.

84. *See* EPSTEIN & MIRZA, *supra* note 40, at 309-10.

85. There are also significant accounting differences between U.S. GAAP and IAS with respect to leases, pensions and foreign currency translation. These subject areas involve complex accounting procedures which are beyond the scope of this note. For information regarding international accounting procedures in these areas, see David Mercado, *Evolving Accounting Standards in the International Markets*, in INTERNATIONAL SECURITIES MARKETS 1996, at 343 (PLI Corp. L. & Practice Handbook Series No. B4-7166, 1996). *See generally* EPSTEIN & MIRZA, *supra* note 40.

86. Cochrane, *supra* note 30, at S65. Mr. Cochrane has been an avid supporter of the IASC and its principles. On separate occasions, Mr. Cochrane has stated his belief that the NYSE would "blow London off the map" if the SEC were to relax its disclosure requirements for foreign companies. Berton, *supra* note 24, at A15.

fold: (1) It gives the foreign companies access to the capital they desperately want, and (2) it helps insure that the United States will remain the world's dominant capital market place.

A. *Recent Developments*

Recent developments suggest that both the SEC and the FASB are willing to take a more conciliatory stance towards IAS. As noted earlier, in October of 1996, Congress passed the Capital Markets Efficiency Act. In this Act, Congress ordered the SEC to begin developing alternatives to U.S. GAAP for foreign companies.⁸⁷ The Capital Markets Efficiency Act is a sign that Congress understands the importance of giving foreign companies easier access to our capital markets. Under the Act, the SEC is to formulate a set of suitable international accounting standards as soon as would be "practicable."⁸⁸ The IASC's proposal would seem an obvious and convenient way of satisfying the congressional demand. The SEC has already pledged its support for the IASC in a press release issued in the spring of 1996, stating:

The Commission is pleased that the IASC has undertaken a plan to accelerate its development efforts with a view toward completion of the requisite core set of standards by March 1998. The Commission supports the IASC's objective to develop, as expeditiously as possible, accounting standards that could be used for preparing financial statements in cross-border offerings.⁸⁹

The SEC has also taken the time to set out the criteria the new standards must meet in order to be considered a substitute for U.S. GAAP. The standards must:

- [1] include a core set of accounting pronouncements that constitutes a comprehensive, generally accepted basis of accounting;
- [2] . . . be of high quality[,] . . . result in comparability and

87. Capital Markets Efficiency Act of 1996, Pub. L. No. 104-290, § 509 (4), 110 Stat. 3416, 3449.

88. *Id.*

89. Paul Pacter, *Evolving Accounting Standards in the International Markets: The Perspective of the International Accounting Standards Committee*, in INTERNATIONAL SECURITIES MARKETS 1996, at 430 (PLI Corp. L. & Practice Handbook Series No. B4-7166, 1996).

transparency, and provide for full disclosure;

[3] . . . be rigorously interpreted and applied.⁹⁰

Although it is uncertain whether the IASC's standards will meet these criteria, the SEC's efforts at least indicate that it is willing to listen to new proposals and ideas.⁹¹

The FASB has also been receptive to international accounting standards. Recently, Ed Jenkins replaced Dennis Beresford as FASB chairman.⁹² This change in leadership has been positively viewed by proponents of IAS.⁹³ Mr. Beresford was seen by some as a barrier to IAS, intent on preserving U.S. GAAP as the world's dominant set of accounting standards.⁹⁴ By contrast, Jenkins is seen as more flexible and open to IAS.⁹⁵ With Jenkins' leadership, the growing trend toward IAS can only be expected to continue.

Even before Mr. Beresford's exit, the FASB took steps to accommodate foreign issuers. In 1992, the FASB announced that it would take a more active and supportive role in the international accounting standard-setting process.⁹⁶ The FASB proclaimed that it would intensify consideration of IAS in domestic projects and collaborate with the IASC on projects of mutual interest.⁹⁷ The FASB also announced that it would consider adopting portions of IAS, or other foreign standards, that are judged superior to U.S. GAAP.⁹⁸

More recently, in February 1997 the FASB changed the U.S. GAAP

90. See Michael H. Sutton, *Developing International Accounting Standards, in INTERNATIONAL SECURITIES MARKETS 1996*, at 328 (PLI Corp. L. & Practice Handbook Series No. B4-7166, 1996). However, SEC chairman Arthur Levitt has warned that the SEC-acceptance of the IASC's new standards "should not be seen as a 'foregone conclusion'." *SEC Chief Cautions IASC on New Core Rules*, ACCT., June 1, 1997, available in 1997 WL 12699341. Levitt has warned that efforts to develop a comprehensive set of global accounting standards will fail if it becomes "merely a search for the lowest common denominator, or an excuse to weaken effective national standards." *Id.*

91. The SEC has already made several limited concessions to foreign companies. For a discussion of these concessions, including rule 144A, and form 20F, see Ruder, *supra* note 27, at 1, 6-9.

92. See James R. Peterson, *Walking the Tightrope*, ACCT., July 1, 1997, available in 1997 WL 12699375.

93. See *id.*

94. See *id.*

95. See *id.*

96. See MOST, *supra* note 7, at 85.

97. See *id.*

98. See *id.* However, it is also important to note that the FASB affirmed its commitment to persuading the IASC and foreign countries to adopt U.S. GAAP in areas where U.S. standards are deemed superior. See *id.* Considering that the FASB set U.S. standards in the first place, one must wonder in how many instances the FASB will be willing to admit that U.S. GAAP is inferior to IASC or foreign accounting standards.

method of accounting for a significant financial statement item, earnings-per-share (EPS).⁹⁹ Previously, the U.S. GAAP method of calculating EPS differed significantly from that of other countries and IAS.¹⁰⁰ The new accounting method for EPS brings the United States more in line with the rest of the world.¹⁰¹ The substantive content of the accounting change is unimportant. What is important is that this change in accounting standards demonstrates a new attitude on the part of the FASB to work with the international community to resolve accounting differences. Whether the FASB will be willing to alter any other of its standards to match the rest of the world remains to be seen. However, this is at least an indication that the FASB understands the international implications of its standards. This is one instance where the FASB has made good on its pledge to resolve weaknesses within the U.S. GAAP framework. In issuing the new EPS pronouncement, one FASB board member commented that in this case, "[t]he IASC standard was superior [to U.S. GAAP], so we followed their lead."¹⁰²

All of these recent developments seem to indicate that the movement towards U.S. acceptance of international accounting standards is strengthening. Through the Capital Market Efficiency Act, Congress has recognized the importance of making accounting allowances for foreign companies. The SEC has pledged its support for IAS and even set out the criteria the new standards must meet in order to be considered a substitute for U.S. GAAP. The FASB has begun to recognize that there are flaws in U.S. GAAP and has increased its efforts to reconcile accounting discrepancies. The SEC should now take the next logical step and accept the IASC's new set of international accounting standards as a substitute for U.S. GAAP.

B. *Illusion of Comparability*

One argument that has been advanced in favor of relaxing SEC disclosure requirements is that forced reconciliation of foreign financial statements to U.S. GAAP may convey to investors "an illusion of comparability that does not exist."¹⁰³ Although U.S. GAAP is the most stringent of the world's accounting standards, there are still many gray areas where estimates must be made. For example, to avoid large fluctuations in

99. See Glenn Cheney, *FASB and IASC Harmonize with New Standards on EPS*, ACCT. TODAY, Apr. 7, 1997, available in 1997 WL 9510261.

100. See *id.*

101. See *id.*

102. See *id.* For more information on the new EPS calculation, see Michael G. Stevens, *Earnings Per Share Made Easier, Relatively Speaking*, PRAC. ACCT., May 19, 1997, available in 1997 WL 8955018.

103. Cochrane, *supra* note 30, at S66. See also Demmo, *supra* note 2, at 714-15.

income levels, managers sometimes use permissible "creative" accounting techniques to lower net income in exceptionally good years and to raise net income in poor years. The net income of the company over time then appears to be a nice, even upward slope, instead of a jagged up-and-down line.¹⁰⁴ The point is that there is considerable room to maneuver, even within the confines of U.S. GAAP.¹⁰⁵ The financial statements of two U.S. companies may not be comparable without some close scrutiny and analysis of accounting estimates.¹⁰⁶

The problem of estimation is exaggerated even further when dealing with foreign companies. It has been noted that a mechanical reconciliation to U.S. GAAP may lead investors to believe that financial statements of a U.S. and a foreign company are comparable simply because both companies use U.S. GAAP.¹⁰⁷ In fact, to understand the true financial picture of a company, an investor must consider the legal and regulatory environment of the company's home country in addition to the accounting procedures used in preparing the financial statements.¹⁰⁸ In this way, forced reconciliation to U.S. GAAP may actually mislead investors in foreign stock. If U.S. GAAP reconciliation is misleading investors, the SEC's stringent reporting requirements serve no purpose.

C. *The Value of U.S. GAAP to Investors is Questionable*

The amount of value investors place on U.S. GAAP is questionable. If investors truly valued the additional information contained within U.S. GAAP, they should be willing to pay a premium for stocks issued in conformity with U.S. GAAP. Suppose the existence of a share of stock from two identical companies. Further assume that one company uses IAS and the other uses U.S. GAAP. If investors place more value on U.S. GAAP than IAS, we would expect that the share of stock from the company using U.S. GAAP would sell at a higher price than the company using IAS. However, there is no evidence that the additional disclosures required under U.S. GAAP have any effect on the value (*i.e.*, the price) of the stock.¹⁰⁹ If the stock price does not increase with the additional disclosures required under U.S. GAAP, perhaps this suggests that investors do not value the additional

104. See Randall Smith et al., *How General Electric Damps Fluctuations in Its Annual Earning*, WALL ST. J., Nov. 3, 1994, at A1.

105. See Cochrane, *supra* note 30, at S65-66.

106. See *id.*

107. See *id.* at S66. Demmo, *supra* note 2, at 714-715.

108. See Cochrane, *supra* note 30, at S66.

109. See *id.* at S62. See also Edward F. Greene et al., *Hegemony or Deference: U.S. Disclosure Requirements in the International Capital Markets*, 50 BUS. LAW. 413, 432 (1995).

disclosures.¹¹⁰ In fact, U.S. investment analysts who follow foreign companies rely mostly on the financial statements prepared under the company's home country accounting.¹¹¹ If the investors and analysts do not value the additional disclosures, then it seems useless to require companies to reconcile with U.S. GAAP. Because investors do not value U.S. GAAP disclosures, the SEC should allow foreign companies to prepare financial statements using IAS.

U.S. investors have also demonstrated apathy towards U.S. GAAP by purchasing foreign stocks through other exchanges. In fact, Americans are turning in record numbers to foreign markets for investment opportunities.¹¹² During the mid-1980s, American investors purchased approximately two billion dollars of foreign securities a year.¹¹³ By contrast, American investors now purchase in excess of two billion dollars of foreign stocks a week.¹¹⁴ This suggests that Americans are willing to forgo the extra "protections" of U.S. GAAP to gain access to stocks of foreign companies.¹¹⁵ Thus, the SEC's attempts to protect U.S. investors through the disclosures of U.S. GAAP can best be described as a "victory of theory over practice."¹¹⁶ In this regard, the SEC's stringent reporting requirements actually harm U.S. investors. In order to gain access to foreign stocks, U.S. investors are forced into foreign markets and denied the lower transaction costs and greater liquidity of the U.S. markets.¹¹⁷ Philip R. Lochner Jr., former commissioner of the SEC, has admitted that "many SEC rules are arbitrary and were written in an era when U.S. securities markets could exist in splendid isolation. . . . The fact is that U.S. citizens buy foreign stocks anyway, they just do so . . . at greater cost than if those foreign securities could be bought here."¹¹⁸ If Americans are purchasing foreign stocks through overseas markets anyway, why not simply make accommodations to allow them to purchase these same stocks through U.S. markets? If the SEC fails to recognize IAS as a substitute for U.S. GAAP, American capital will continue to flow into foreign capital markets. Meanwhile, U.S. stock exchanges will be prevented from competing in a service where their competitive advantage is undisputed.¹¹⁹

110. See Greene et al., *supra* note 109, at 432.

111. See Cochrane, *supra* note 30, at S62.

112. See Schneider, *supra* note 33, at 327-29.

113. See Cohen, *supra* note 20, at 491.

114. See *id.*

115. William C. Freund, *That Trade Obstacle*, WALL ST. J., Aug. 27, 1993, at A6, available in 1993 WL-WSJ681776.

116. *Id.*

117. See *id.* See also Demmo, *supra* note 2, at 713.

118. Freund, *supra* note 115, at A6 (quoting former SEC Commissioner Philip R. Lochner, Jr.).

119. See *id.*

D. *Other Alternatives*

The SEC may choose from several other alternatives to solve the cross-border offering dilemma. Aside from the adoption of the IASC's proposals, stock exchange officials have suggested another, more limited alternative which would allow foreign companies increased access to U.S. capital markets. The first of these options is to exempt special "world class" companies.¹²⁰ These companies would need to meet certain guidelines in order to be exempt from the requirement that they reconcile their financial statements to U.S. GAAP. These companies would still be required to provide an explanation of the differences between U.S. GAAP and the accounting standards used in their financial statements.¹²¹ For example, the NYSE has proposed that companies with revenues in excess of five billion dollars be exempt from the U.S. GAAP reconciliation requirement.¹²² A second alternative would be to exempt all companies with weekly trading volumes of at least one million dollars or 200,000 shares.¹²³

In order to protect investors, companies that qualify for world-class status would either be listed on a separate table apart from other companies or marked with an asterisk.¹²⁴ This separate listing would alert investors that world-class companies use different accounting standards.¹²⁵ The world-class proposal would at least give some of the larger, more prestigious foreign companies easier access to U.S. capital markets.

However, the world-class proposal is too limited in scope to effectively allow foreign companies to access U.S. capital markets. Currently, only about 200 foreign companies would qualify for world-class status.¹²⁶ Even if the world-class proposal is accepted, there are still in excess of 1800 foreign companies who will continue to be denied access to U.S. capital markets. The world-class company proposal does little to allow smaller foreign companies increased access to U.S. capital markets. It would seem that smaller companies would have at least as great a need for U.S. capital in order to increase their prospects for growth.

Another alternative available to the SEC is to simply maintain the status quo and continue to force foreign issuers to reconcile their financial statements to U.S. GAAP. This viewpoint is founded, at least partially, on the notion that the allure of the U.S. capital markets is so great that foreign

120. Cochrane, *supra* note 30, at S63.

121. *See id.*

122. *See id.*

123. *See id.*

124. *See* Freund, *supra* note 115, at A6.

125. *See id.*

126. *See* Sherbet, *supra* note 3, at 888.

companies will eventually give in and comply with U.S. securities regulations.¹²⁷ This perspective seems unnecessarily rigid, as well as shortsighted.¹²⁸ It may appear that the SEC is simply playing the role of a schoolyard bully.¹²⁹ Essentially, the SEC is saying to the rest of the world, if you want to play in our capital markets, you will play by our rules.¹³⁰ In the future, the SEC may need the cooperation of foreign countries.¹³¹ If the SEC maintains its current hard-line stance toward foreign issuers, it may come back to haunt the SEC later.¹³² Although the U.S. capital markets are not currently in jeopardy of losing their dominant status, the SEC should not wait for that day to come before it acts.¹³³ Instead, the SEC should take steps to solidify the United States' position as the world's leader.¹³⁴

At least one commentator has proposed that the SEC consider arranging "mutual recognition" agreements with certain foreign countries.¹³⁵ Under such an agreement, the United States would agree to recognize the accounting standards of a foreign country for use in cross-border security offerings.¹³⁶ In return, that foreign country would agree to recognize U.S. GAAP as appropriate for use on its stock exchanges.¹³⁷

In order to qualify for mutual recognition, a foreign country would have to meet four criteria.¹³⁸ First, the country's home markets must be highly regulated in order to protect U.S. investors from potential securities fraud.¹³⁹ Second, the accounting standards of the foreign country must be similar to those of U.S. GAAP.¹⁴⁰ Third, the foreign country must have an established capital market, complete with sophisticated analysts to provide information to investors.¹⁴¹ Finally, the candidate country would have to be historically, politically, geographically, culturally, or economically linked to the United States in some substantial way.¹⁴²

The concept of "mutual recognition" is flawed in several ways.

127. See generally Richard C. Breeden, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation*, 17 *FORDHAM INT'L L.J.* 577 (1994).

128. See Cohen, *supra* note 20, at 538.

129. See *id.*

130. See *id.*

131. See *id.*

132. See *id.*

133. See *id.* at 538-39.

134. See *id.* at 538.

135. *Id.* at 533-34.

136. See *id.* at 526.

137. See *id.* The United States entered into one such agreement with Canada in 1991. See *id.* at 527.

138. See *id.* at 534-36.

139. See *id.* at 534.

140. See *id.*

141. See *id.*

142. See *id.*

Because U.S. GAAP is already recognized as appropriate on most major stock exchanges, this alternative would seem to hold little benefit for U.S. companies. One must also question how many foreign countries will meet the four above-stated criteria. These criteria seem to allow for mutual recognition only in situations where the country's accounting and regulatory environments are comparable to those of the United States. In this regard, mutual recognition does not appear to be much of an improvement over forced reconciliation to U.S. GAAP. Finally, mutual recognition forces investors to become familiar with the accounting rules of each country approved for mutual recognition. By contrast, if the SEC simply recognized IAS as an appropriate substitute for U.S. GAAP, investors would only have to become familiar with one new set of accounting standards.

E. *Worldwide Harmonization of Accounting Standards*

In a perfect world all foreign and domestic companies would prepare their financial statements using the same accounting principles. If all of the companies in the world used the same accounting standards, investors would only have to become familiar with one set of accounting rules. The acceptance of IAS as a substitute for U.S. GAAP would be a large step toward worldwide "harmonization" of accounting standards.¹⁴³ Until recently, worldwide harmonization of accounting principles was thought to be an "ideal" not realistically attainable.¹⁴⁴ Today, however, the movement towards harmonization of accounting standards is growing.¹⁴⁵ In the past, there were many political and social limitations that prohibited the companies of the world from using the same accounting standards.¹⁴⁶ Although these differences will never be fully eliminated, the main deterrent to one comprehensive set of accounting standards remains the SEC's insistence that foreign issuers prepare their financial statements in accordance with U.S. GAAP.¹⁴⁷ As noted earlier, the current version of IAS is already acceptable on a number of foreign stock exchanges, including London and Hong

143. EPSTEIN & MIRZA, *supra* note 40, at 13. There are three basic concepts of harmonization. In absolute harmonization, "one set of accounting standards applies, irrespective of the circumstances leading to the production of the accounting information." BOATSMAN ET AL., *supra* note 53, at 646. In circumstantial harmonization, "the same set of accounting standards applies when the underlying conditions . . . [of respective countries] are similar." *Id.* In purposive harmonization, the same set of accounting standards is applied in situations where the purposes of the accounting information are similar. *See id.* The IASC and the FASB have primarily been working towards circumstantial harmonization. *See id.*

144. Greene et al., *supra* note 109, at 436.

145. *See* MUELLER ET AL., *supra* note 18, at 38.

146. *See* EPSTEIN & MIRZA, *supra* note 40, at 15.

147. *See* Cohen, *supra* note 20, at 522.

Kong.¹⁴⁸ The question remains, if IAS is acceptable to the rest of the world, why is it not acceptable in the United States?

Opponents of IAS argue that allowing foreign companies to use IAS in cross-border listings in the United States will place U.S. companies at a competitive disadvantage.¹⁴⁹ These opponents rightly point out that domestic companies would spend additional time and resources in complying with the more detailed and complicated disclosures of U.S. GAAP.¹⁵⁰ However, this argument against IAS may actually be an argument in favor of harmonization. If the SEC allows foreign companies to use IAS as a substitute for U.S. GAAP, U.S. companies may indeed have a legitimate complaint that they would bear unnecessary, extra costs complying with U.S. GAAP. The solution to this problem is to simply allow domestic companies to also use IAS in preparation of their financial statements. After all, if the SEC deems that IAS is not misleading to investors and is appropriate for foreign companies, why would it not be appropriate for domestic companies? If U.S. and foreign companies are both using IAS, the world would be one step closer to a single set of comprehensive accounting standards.

There are several reasons why the world's accounting bodies should pursue harmonization of accounting standards as a goal. As all companies would use the same set of standards, harmonization would increase comparability of financial statements for domestic and foreign companies.¹⁵¹ This would help investors make intelligent investment decisions.

If only one set of accounting standards is used, investors will become "intimately familiar" with these standards, which will help them more easily understand financial statements.¹⁵² Harmonization would also result in cost savings for U.S. companies. Although U.S. companies use U.S. GAAP in preparing their financial statements, these U.S. companies often own foreign subsidiaries. The financial statements of these foreign subsidiaries must be

148. *See id.* at 510-11.

149. *See Breeden, supra* note 127, at S87-88. Mr. Breeden's attitude typifies hard-line "pro U.S." feelings. While admitting that U.S. GAAP has serious flaws and that the world would benefit from greater harmonization, Breeden, a former SEC commissioner, still refuses to support relaxing standards for foreign issuers. *See id.* at S87-88, S95-96. Although admitting to the benefits of harmonization, Breeden colorfully states his belief that the day the world's accountants will agree on one set of principles will be just after "all the world's lawyers get together and agree on a single tax law, a single antitrust law, and a uniform legal code for other issues." *Id.* at S96. Shortly after leaving office at the SEC, Mr. Breeden commented that "[h]ell will freeze over before the U.S. changes its [accounting disclosure] standards." Cohen, *supra* note 20, at 523. This type of attitude on the part of U.S. officials is offensive to foreign regulators and has impeded harmonization efforts. *See id.* at 522. Fortunately, current SEC chairman Arthur Levitt is seen as more flexible and open to international accounting standards. *See id.* at 523.

150. *See Breeden, supra* note 127, at S88.

151. *See ALHASHIM & ARPAN, supra* note 60, at 48-49.

152. *See Mercado, supra* note 85, at 348.

reconciled to U.S. GAAP for presentation in the domestic companies' consolidated financial statements.¹⁵³ These costs could be avoided if all companies simply used IAS.¹⁵⁴

Harmonization would also facilitate economic activity. Harmonization makes firms easier to value and thus facilitates business combinations.¹⁵⁵ It has also been noted that harmonization eliminates unjustified financial statement differences, which in turn leads to more efficient markets.¹⁵⁶ Since a comprehensive set of accounting standards would already exist, harmonization also reduces the costs to developing countries of generating their own new set of accounting standards.¹⁵⁷

The prospect of harmonization raises an interesting question. If U.S. companies begin using IAS, and the IASC becomes the world's accounting authority, does that then render the FASB obsolete?¹⁵⁸ In this regard, the FASB has at least some interest in ensuring that IAS does not become a complete substitute for U.S. GAAP.

One factor weighing against harmonization is that international accounting bodies have no authority to enforce their standards. For example, in the United States, the FASB draws its power from the fact that the SEC will only accept the FASB-created U.S. GAAP standards. Standard-setting bodies, such as the FASB and the IASC, have no independent power to enforce standards.¹⁵⁹ In this regard, a major regulatory organization, such as the SEC, may hold a "veto power" over any international accounting body. If the SEC were to disagree with the IASC standards, it could simply decide that IAS are no longer a suitable means for preparing accounting standards. Thus, efforts to harmonize accounting principles must be made by way of political agreement between nations.¹⁶⁰

In the past, harmonization was thought to be an unattainable goal. However, with the passage of the Capital Markets Efficiency Act and the new conciliatory stance of the SEC, the world is moving towards the goal of accounting standard harmonization. The acceptance of the IASC's new set of core standards as a substitute for U.S. GAAP would be a large step toward achieving that goal.

153. See, e.g., ALHASHIM & ARPAN, *supra* note 60, at 49; EPSTEIN & MIRZA, *supra* note 40, at 15.

154. Other arguments in favor of harmonization include improving the allocation of resources in global financial markets, reducing the cost of capital for all enterprises, and facilitating social control over the global corporation. See MOST, *supra* note 7, at 79. See also BOATSMAN ET AL., *supra* note 53, at 646.

155. See BOATSMAN ET AL., *supra* note 53, at 647.

156. See *id.*

157. See *id.* at 647. See also EPSTEIN & MIRZA, *supra* note 40, at 18.

158. See Cheney, *supra* note 99, at 3.

159. See *id.*

160. See MUELLER ET AL., *supra* note 18, at 47.

V. CONCLUSION

The United States possesses the world's most dominant capital markets. If the SEC maintains its U.S. GAAP reconciliation requirement, foreign companies will continue to avoid U.S. markets. Consequently, Americans will be forced to seek out overseas markets to obtain foreign investment opportunities. As American capital flows into foreign markets, U.S. capital markets are weakened. The SEC should not wait until U.S. markets are in jeopardy to act, but instead, should take steps now to protect U.S. capital markets.

The IASC is developing a new set of international accounting standards that will be appropriate for all cross-border listings. When the IASC completes the new set of standards in March of 1998, the SEC should accept IAS as a substitute for U.S. GAAP. SEC acceptance of IAS is the best way to ensure that U.S. capital markets remain the world's leaders. IAS is already recognized on several foreign stock exchanges. It is time for the SEC and the United States to follow suit. IAS will give foreign companies greater access to U.S. capital markets. In turn, U.S. investors will have opportunities to invest in foreign companies without leaving U.S. markets. Perhaps, most importantly, acceptance of IAS by the SEC would be a major step toward the long-term goal of global harmonization of accounting standards.

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