

## THE COMING CONFRONTATION ON INTERNATIONAL ACCOUNTING STANDARDS<sup>1</sup>

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### **ABSTRACT**

*In 1999, the US Securities and Exchange Commission will begin a momentous process of judging the acceptability of the core standards promulgated by the International Accounting Standards Committee. It is the aim of this paper to review the major developments relating to the IASC's Comparability/Improvements Project (which evolved into its core standards project) and to anticipate the process that the SEC is likely to adopt when deciding on whether, and to what extent, the IASC's standards may be used by foreign companies listed in the US.*

### **INTRODUCTION**

As the International Accounting Standards Committee (IASC) completes work on the core set of standards it is to submit to the International Organization of Securities Commissions (IOSCO) for endorsement, questions about the likely reaction of the US Securities and Exchange Commission (SEC) have been raised. A principal aim of the IASC's core standards project has been to convince the SEC to allow foreign companies complying with these standards to trade their securities in the US. In particular, officials of the New York Stock Exchange (NYSE) have repeatedly asserted that the SEC's requirement for foreign listed companies to reconcile their earnings and shareholders' equity to US generally accepted accounting principles (GAAP) from whatever

non-US GAAP they are using has deterred many hundreds of foreign companies from listing in New York.<sup>2</sup>

## THE EARLY YEARS OF THE IASC AND IOSCO

The IASC was established in 1973 at a time when private-sector standard setting had been a function performed entirely within professional accountancy bodies: committees or boards of the American Institute of Certified Public Accountants (AICPA), the Institute of Chartered Accountants in England and Wales, the Canadian Institute of Chartered Accountants (CICA), and both the Institute of Chartered Accountants in Australia and the Australian Society of Accountants. The IASC began as a collaboration among 16 accountancy bodies representing 10 countries (the UK, Ireland, the Netherlands, West Germany, France, Canada, the US, Mexico, Japan and Australia), and today it represents 140 bodies from 101 countries. Ironically, the first major 'independent' standard setter, the Financial Accounting Standards Board (FASB), replaced the AICPA's Accounting Principles Board on 1 July 1973, the very date on which the IASC came into existence.

IOSCO was founded in 1974 as the Interamerican Conference of Securities Agencies and Similar Organizations, and adopted its current name and wider focus in 1983. It is today a loose federation of regulators of securities and futures markets, with stock exchanges and other organisations as affiliate members, from 83 countries. The SEC, which had much to do with energising IOSCO in the mid-1980s, was concerned that the increasing globalisation of the securities market had not been matched by comparably global regulatory oversight. Among the areas requiring attention were the international ramifications of take-over activity, increasingly complex financial products and transactions, insider trading and market manipulation, and the harmonisation of accounting and auditing standards. The last of these areas brought IOSCO into contact with the IASC.

One of IOSCO's early decisions was to encourage the IASC to 'pursue its project to eliminate accounting alternatives and to ensure that its standards are sufficiently detailed and complete, contain adequate disclosure requirements, and are prepared with a visible commitment to the needs of users of financial statements' (IOSCO, 1988, p. 8). This ap-

proach and the wording of the charge were doubtless orchestrated by the SEC.

During its first 13 years, the initial phase of its life, the IASC issued 26 generic standards, allowing multiple options and prescribing only minimal disclosures. The standards primarily served as guidance to professional accountancy bodies in developing countries, which had a small stock exchange or none at all. Options accepted in the US and the UK were always included in the IASC standards. Yet few countries with significant securities markets paid much attention to the IASC's output; international harmonisation was not yet a major issue in those capital markets.

In 1987, however, the IASC entered a new phase. Several representatives on the board, including Ralph E. Walters (a former member of the FASB), were becoming impatient with the 'free choices' in most of the standards. They believed that if the IASC genuinely wanted to promote comparability and secure the support of major regulatory bodies it should appoint a committee to review the standards and eliminate a significant number of the options. A Committee on Comparability was set up with Walters as chairman, and IOSCO, at the IASC's invitation, designated the SEC, the Ontario Securities Commission (OSC), and the Commission des Opérations de Bourse to send an observer (in fact, their chief accountants) to the committee's meetings.<sup>3</sup> The IASC invited IOSCO to join its consultative group, which it did in June 1987.<sup>4</sup>

The result of the committee's deliberations, which came to be called the IASC's 'Comparability/Improvements' Project, was the issue in January 1989 of E32 *Comparability of Financial Statements* which proposed the elimination of 23 optional treatments in 13 of the IASC's standards. After receiving comments, the IASC issued a *Statement of Intent* in July 1990 which proposed to eliminate 21 choices in 10 standards. With this important initiative, the IASC became a player in the high-stakes game of recommending a set of accounting standards for use in the world's most sophisticated capital markets. In particular, it sought to persuade the SEC to allow foreign registrants to adopt IASC standards without the need to reconcile to US GAAP, and the SEC Chief Accountant held out a hope that this might one day happen.<sup>5</sup> Also, in the minds of not a few Europeans, the IASC represented a fortress against US accounting

imperialism — a fear that US GAAP would come to dominate world accounting.

## ABOUT THE SEC

The scope and rigour of the SEC's regulation of the securities market are often misjudged overseas. The agency, which has an admirable reputation among Washington insiders for its professionalism and probity, employs some 2,600 lawyers, accountants, economists and financial analysts. Among its many responsibilities is to assure that full and fair disclosure is provided to the securities market. Toward that end, its Division of Corporation Finance, with about 300 staff, scrupulously reviews a sampling of 'registration statements for new securities, proxy material and annual reports the SEC requires from publicly held companies, documents concerning tender offers, and mergers and acquisitions in general' (SEC, 1997a, p. 27). Companies are notified of any departures from GAAP in their filings, and these differences must be resolved to the satisfaction of the SEC's staff.

The Office of the Chief Accountant, with about 20 staff, is concerned with 'rulemaking and interpretation that supplements private-sector accounting standards, implements financial disclosure requirements, and establishes independence criteria for accountants' (SEC, 1997a, p. 37), among other duties. 'The Chief Accountant is the principal adviser to the Commission on accounting and auditing matters arising from the administration of the various securities laws' (SEC, 1997a, p. 37). In the course of its work, the Office of the Chief Accountant drafts Financial Reporting Releases for approval by the Commission. It also makes its views known in Staff Accounting Bulletins and by speeches, articles and 'staff announcements', as well as in ad hoc decisions in meetings with registrants whose filings have been questioned.<sup>6</sup>

The SEC is truly a control agency, and it has a low tolerance for ambiguity. Rather than developing its own code of accounting practice, it has historically looked to the private sector for leadership in establishing and improving accounting standards. In 1973, when the FASB became the US standard setter, the SEC declared that the 'principles, standards and practices promulgated by the FASB in its Statements and Interpretations will be considered by the Commission as having substantial



authoritative support [for GAAP], and those contrary to such FASB promulgations will be considered to have no such support' (SEC, 1973, p. 2, footnotes omitted). Since then the SEC has exercised 'oversight authority' over the FASB's deliberative process as well as over the contents of its draft pronouncements. It ordinarily presses the FASB to include in its Statements detailed prescriptions on how to treat numerous variations coming within the purview of a standard, often drawn from actual cases that the Commission's staff has addressed when reviewing registrants' financial statements. Other authoritative literature on GAAP emanating from the FASB's operation are the opinions of its Research and Technical Activities staff, published in Technical Bulletins, and the consensus positions of the Emerging Issues Task Force, published as Abstracts.<sup>7</sup>

The SEC regards transparency, comparability, and full and fair disclosure as indispensable to financial reporting. It believes that similar transactions and events should be accounted for in a similar way. Above all, it is concerned with financial reporting that facilitates capital formation and promotes investor protection.

The SEC requires a parity between financial reporting by domestic and foreign registrants; all foreign private issuers must use, or reconcile to, US GAAP. Up to now, the SEC has not, for example, abided the policy of the London Stock Exchange by which the financial statements of domestic listed companies reflect British accounting standards, while those of foreign listed companies may use British, American or IASC standards as well as the standards of all other European Union countries, under the principle of mutual recognition. Indeed, if the SEC were to allow foreign registrants to adopt measurement and disclosure standards that are less prescriptive and more permissive than those applicable to US companies, it would immediately come under pressure, perhaps in the form of lawsuits, to allow US companies the same right. It has even been suggested that some US companies might go 'offshore', i.e., relocate their head office in Canada or elsewhere outside the United States in order to take advantage of less demanding reporting standards in the US capital market.<sup>8</sup>

The SEC is sensitive to the fact that it cannot exercise 'oversight authority' over an international body such as the IASC as it can over the FASB. Hence, any endeavour to make an IASC standard applicable to

foreign registrants requires the SEC to issue a 'rule proposal', in which the Commission solicits comments on the acceptance of the standard, with amendments as indicated, followed by the issue of a final rule.

## DEVELOPMENTS SINCE 1992 RELATING TO THE IASC

### *Approaches to IOSCO<sup>9</sup>*

At the end of 1992, the IASC approved IAS 7 *Cash Flow Statements* which, although not part of the Comparability/Improvements Project, was endorsed in 1993 by IOSCO and accepted by the SEC for foreign registrants. By their decisions, both IOSCO and the SEC demonstrated public support for the IASC's work programme. In substance, however, IAS 7 was very similar to the FASB's Statement of Financial Accounting Standards 95 *Statement of Cash Flows*, issued in 1987. Thus, the SEC's acceptance of IAS 7 for foreign registrants did not mark a substantive departure from US GAAP.

Also in 1993, Working Party No. 1, on Multinational Disclosure and Accounting, of IOSCO's Technical Committee, identified an expanded list of 'core standards' that should be addressed if the IASC's standards were to be regarded as reasonably complete. Hence, it became clear that the IASC's review of its previously issued standards would need to go considerably beyond the Comparability/Improvements Project.

In November 1993, the IASC completed its revision of the 10 standards in the Comparability/Improvements Project as envisaged in 1990:

- IAS 2 *Inventories*
- IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*
- IAS 9 *Research and Development Costs*
- IAS 11 *Construction Contracts*
- IAS 16 *Property, Plant and Equipment*
- IAS 18 *Revenue*
- IAS 19 *Retirement Benefit Costs*
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*
- IAS 22 *Business Combinations*
- IAS 23 *Borrowing Costs*

The IASC suffered an embarrassing setback in securing board approval of the 10 leaner standards. In line with the 1990 *Statement of Intent*, the exposure draft on inventories proposed the elimination of the last-in, first-out (LIFO) inventory method, but pressures began building from countries in which LIFO could be used for tax purposes only if it were allowed for financial reporting, and in the end the board failed by one vote to approve the dropping of LIFO. The US delegation, in a show of statesmanship, voted for dropping LIFO (as it had done on earlier occasions), but four countries — two European and two Asian — voted against, thus sealing the defeat of the proposal.<sup>10</sup> In the final inventories standard, therefore, LIFO was retained.

The 10 revised standards were then transmitted to IOSCO for endorsement. But, to the shock and dismay of the IASC's leadership, IOSCO announced that it was putting off endorsement of any further standards until the entire core set of 24 standards were completed to its satisfaction — contrary to earlier signals from IOSCO that its intention was to judge the standards in stages. After hearing the news, IASC's retiring chairman, Eiichi Shiratori, pointedly criticised the decision in a speech to IOSCO's annual conference in October 1994 (Shiratori, 1994).

Specifically, IOSCO notified the IASC that 14 standards were acceptable: IAS's 2, 8, 11, 16, 18, 20, 21, 22, 23, 24, 27, 28, 29 and 31 (IAS's 27 through 31 were issued between 1989 and 1991) — which included eight of the 10 standards in the Comparability/Improvements Project. The two standards from the project that it rejected were IAS 9 *Research and Development Costs* and IAS 19 *Retirement Benefit Costs*. Two other IASC standards were deemed to be unacceptable: IAS 10 *Contingencies and Events Occurring After the Balance Sheet Date* and IAS 17 *Accounting for Leases*. IOSCO also cited six standards requiring revision which the IASC was already addressing:

- IAS 1 *Disclosure of Accounting Policies*
- IAS 5 *Information to be Disclosed in the Financial Statements*
- IAS 12 *Accounting for Taxes on Income*
- IAS 13 *Presentation of Current Assets and Current Liabilities*
- IAS 14 *Reporting Financial Information by Segment*
- IAS 25 *Accounting for Investments*

In addition to these 'essential' issues, IOSCO noted a number of 'suspense' issues, including specialised industry practices, that it wished the IASC to take up but that would not be an obstacle to IOSCO's endorsement of the core standards.

In July 1995, the IASC's newly appointed Secretary-General, Sir Bryan Carsberg, announced a 'historic' understanding with IOSCO's Technical Committee. Both bodies agreed to aim for completion in mid-1999 of the IASC's work programme to revise the remaining core standards and a consequent decision by IOSCO on endorsement by the end of that year. Hence, a relationship that went slightly off track in 1994 was placed back on the rails the following year.

### *Emergence of the G4+1*

In 1994, the IASC began collaborating with four Anglo-American standard-setting bodies: the FASB, the UK Accounting Standards Board, the CICA's Accounting Standards Board, and the Australian Accounting Standards Board. The group, which came to be known as the G4+1, evolved out of a larger gathering of national standard setters that had been meeting annually since 1991.

The logic behind this collaboration is that the bodies' shared objectives and similar conceptual frameworks enable them to pursue common solutions to financial reporting issues, and thus promote international harmonisation. By working together from an early stage, it is hoped that the bodies will become committed to working cooperatively rather than competitively. Thus far, the G4+1, which meets three to four times a year (and recently added the New Zealand standard setter as a participant), has sponsored a half-dozen research studies based on views contributed by working parties composed of board members and senior staff from all of the bodies.

This collaboration has not been universally applauded. Some representatives from the European continent have viewed the G4+1 with suspicion, as an attempt by the Anglo-American countries' standard setters to gain undue leverage in the work of the IASC and in the harmonisation movement generally. Indeed, an effort has been made to launch an E5+2, with representatives from the five European delegations on the IASC board (the UK, the Netherlands, Germany, France, and the Nordic



Federation) in consultation with the European Commission and the private-sector *Fédération des Experts Comptables Européens*, based in Brussels.

*SEC Accepts Portions of Three IAS's*

Building on the precedent it set in 1993 by accepting IAS 7 for foreign registrants, the SEC issued rule proposals in April 1994 to accept portions of three further IAS's for foreign registrants:

IAS 21 *The Effects of Changes in Foreign Exchange Rates*

IAS 22 *Business Combinations*

IAS 29 *Financial Reporting in Hyperinflationary Economies*

The final rules were issued in December 1994. But the accepted portions of these standards, like IAS 7 on Cash Flow Statements accepted earlier, did not represent substantive departures from the evolving policy that the SEC's staff applied to foreign registrants. With regard to IASs 21 and 29, the SEC's staff had already adopted a policy of making it unnecessary for foreign registrants based in hyperinflationary economies, such as Mexico and Argentina, to convert the price-level-restated financial statements they were issuing in their own countries to un-restated financial statements (i.e., omitting the price-level restatements). The SEC's acceptance of IAS's 21 and 29 generalised this policy for foreign registrants with subsidiaries in hyperinflationary economies, in effect allowing the restate-translate procedure in place of translate-restate. However, the SEC rejected the option in IAS 29 that current cost be accepted in lieu of price-level-restated historical cost (SEC, 1994a).

On the subject of business combinations, for both domestic and foreign registrants the SEC's staff had been increasingly favouring a more limited availability of 'pooling of interests' treatment than under Accounting Principles Board (APB) Opinion No. 16, and the more restrictive 'uniting of interests' approach of IAS 22 would have been consistent with that view. Also, the SEC's staff had been increasingly requesting registrants to provide corroborative evidence to support an extended useful life for goodwill; therefore, IAS 22's limit of 20 years, compared to the protracted term of 40 years allowed by APB Opinion No. 17, would have been compatible with this position (SEC, 1994b). While the SEC characterised both of these decisions as 'streamlining financial

statement reconciliation requirements for foreign private issuers' (SEC, 1994a, p. 1), they did little other than codify previous interpretations by the SEC's staff. Nonetheless, as will be mentioned below, the SEC has made a number of substantive accommodations for foreign registrants.

### *EU Withdraws Standards Body Proposal*

A possible threat to the IASC's international supremacy disappeared in 1995 when the European Commission announced that it was abandoning consideration of a European accounting standard-setting body and instead it would support the IASC (see 'European Standards Idea Dropped by EC', 1995/96; 'EU Puts Weight Behind IASC', 1996). The European Union's 'directives' approach was found to be too slow and ponderous to deal with emerging accounting issues, and, indeed, several major topics (deferred taxes, leases and pensions) had not even been touched by the directives. Since the Commission's 1995 decision, the European representatives of the IASC board have met with the Commission's observer to the board prior to each board meeting in order to understand each other's positions on the agenda items and especially on the controversial issues.

### *IASC Accelerates its Work Programme*

At its March 1996 meeting, the IASC board voted to advance its deadline for completing the remaining core standards by 15 months: from the middle of 1999 to March 1998. IOSCO and the SEC publicly welcomed this decision. FASB Chairman Dennis R. Beresford, however, speaking at an annual conference of world standard setters in Copenhagen, criticised the IASC's new deadline as 'highly unrealistic' and 'hopelessly optimistic' in view of the heavy workload, including financial instruments, that lay ahead (Peterson, 1996).

Why did the IASC give itself only two years in which to complete its ambitious programme? The likely explanation is that it did not want to risk 'losing' a growing number of European multinationals that were bent on entering the New York capital market with or without IASC standards. Once they were to incur the cost of reconciling to US GAAP it was feared the companies would not seriously consider switching to

IASC standards. Because it was important to the IASC to have these companies 'on board', its process had to be seen as accelerated in order to place the completed standards before IOSCO and the SEC as soon as possible. Among the major enterprises leading the march to New York was the recently privatised Deutsche Telekom, which proposed to make an initial public offering of DM15 billion of equity securities in November 1996, of which DM4 billion was destined for the US market.

Drawing on the circumstances surrounding Daimler-Benz's historic listing on the NYSE in 1993, observers have speculated on the reasons for a multinational's decision to list in New York (see Radebaugh, Gebhardt and Gray, 1995). One suspects that, in addition to economic reasons, major overseas companies have been coming to believe that one of the hallmarks of a world-class multinational is to be traded in New York (see Biddle and Saudagaran, 1991). Recently, *The Wall Street Journal* editorialised that '[foreign] companies want not just exposure to U.S. money that a [New York] listing would bring, but the imprimatur of the NYSE for all it means to investors the world over' ('Selling the Nasdaq', 1998).

#### *SEC Announces Three 'Key Elements'*

With the acceleration of the IASC's deadline to March 1998, the SEC realised that it would soon be called upon to render judgement on the core standards. From the outset the SEC has been an active member of IOSCO's Technical Committee, and its Office of the Chief Accountant regularly submits comments on IASC exposure drafts. In June 1996, the Office of the Chief Accountant accelerated its involvement by beginning regular attendance at IASC board meetings as one of the IOSCO representatives. In addition, an IOSCO observer (sometimes from the SEC) attends all IASC steering committee meetings.

The SEC's major initiative during 1996, however, was its affirmation, in a press release dated 11 April, that it 'supports the IASC's objective to develop, as expeditiously as possible, accounting standards that could be used for preparing financial statements used in cross-border offerings' (SEC, 1997b, Appendix 5). It added:

From the Commission's perspective, there are three key elements to this program and the Commission's acceptance of its results:

- The standards must include a core set of accounting pronouncements that constitutes a comprehensive, generally accepted basis of accounting;
- The standards must be of high quality — they must result in comparability and transparency, and they must provide for full disclosure; and
- The standards must be rigorously interpreted and applied (SEC, 1997b, Appendix 5).

The release concluded with the following assurance:

As soon as the IASC completes its project, accomplishing each of the noted key elements, it is the Commission's intention to consider allowing the utilization of the resulting standards by foreign issuers offering securities in the U.S. (SEC, 1997b, Appendix 5).

Close observers of the SEC could imagine these three 'key elements' as ones the SEC would use to describe the FASB's standards as implemented by the SEC. Indeed, SEC Chairman Arthur Levitt said in a December 1996 speech that (Levitt, 1996) 'There's no doubt in my mind that [the IASC standards'] acceptability to US investors will depend on how well those standards measure up to our own'. In the same speech, Levitt said that an important message in the SEC's April press release was that 'acceptance of IASC standards by the SEC is not a foregone conclusion'. This admonition may have been made in response to the statement attributed to Secretary-General Carsberg three months earlier that the IASC is 'fairly confident' of the SEC's support of its standards for use by foreign companies listing on the NYSE ('IASC "Confident" of SEC's Support', 1996).

In June, the IASC's board decided to establish a scheme for issuing interpretations of its standards, obviously responding to the third of the SEC's three key elements. In September, the board authorised the creation of a Standing Interpretations Committee, whose recommendations are subject to approval by the board.



*Congress Pressures the SEC*

In October 1996, Congress passed the National Securities Markets Improvement Act (Public Law 104-290), which contained a section charging the SEC to support international accounting standards. (See the Appendix for the full text of the section.) This was Congress' first utterance on the subject, its main thrust being as follows:

It is the sense of the Congress that...the [Securities and Exchange] Commission should enhance its vigorous support for the development of high-quality international accounting standards as soon as practicable [and that the Commission should report to Congress not later than one year from enactment on] the outlook for successful completion of a set of international accounting standards that would be acceptable to the Commission for offerings and listings by foreign corporations in United States markets (Sec. 509).

As instructed by Congress, the SEC submitted a report to Congress in October 1997. Interestingly, the title of the report did not refer to international accounting standards but instead focused on 'Promoting the Global Preeminence of American Securities Markets' (SEC, 1997b). In its report, the SEC said that 'the IASC's efforts to date already have contributed significantly to raising the level of accounting standards worldwide and reducing the number of differences between international standards and accounting principles used in the United States' (1997b, p. 2). Nonetheless, it added, 'At this point, it is not clear what the Commission's final decision regarding the core standards project will be' (p. 2).

There is no doubt that<sup>4</sup> the NYSE had lobbied the section on international accounting standards into the 1996 law.<sup>11</sup> As indicated above, the NYSE had been complaining for years that the SEC's reconciliation requirement was perceived by many foreign companies as an obstacle to listing in New York, and it saw the IASC's core standards programme as a means of removing that obstacle.

The pace of increase in foreign listings on the NYSE during the 1980s was slow, and it thwarted the Exchange's ambition to be known as the premier international capital market. During the 1980s, the NYSE could claim fewer than 100 foreign listed companies on its roll, mostly Cana-

dian and UK. In the 1990s, the number of foreign listings increased at a faster rate and from a broader array of countries, but by the end of 1997 only 343, or 11 percent, of the 3,046 listed companies were of foreign origin ('NYSE Rings Out Record 1997', 1998). By contrast, at the end of 1997 the London Stock Exchange's main market had 526 foreign listings, which represented 20 percent of the 2,683 total listed companies. A comparison of the total market value of the equity capital of domestic and foreign companies listed on the two exchanges at the end of 1997 reveals the relative dominance of foreign listings in London compared to New York as well as London's larger market capitalization for foreign companies (figures supplied by the exchanges<sup>12</sup>):

	<b>New York</b>	<b>London</b>
<b>Domestic</b>	\$8.9 trillion	£1.3 trillion (\$2.1 trillion*)
<b>Foreign</b>	\$2.8 trillion	£2.4 trillion (\$3.8 trillion*)
(*) At an exchange rate of \$1.6/£1.		

#### *IASC Slips on Financial Instruments, Postpones Target*

During 1997 it became increasingly clear to IASC Secretary-General Carsberg that the topic of financial instruments was so complex and controversial that it would no longer be possible to complete even an interim international solution on recognition and measurement by the target of April (formerly March) 1998 for the completed core standards. In September, therefore, he announced that he would recommend that the IASC board adopt, as an interim step, the FASB's three standards and pending exposure draft on financial instruments, in order to meet the April 1998 target (see 'IASC Wiolds...', 1997). From all accounts, the board meeting in November was stormy, and Carsberg's proposal was rejected outright as an unwelcome intrusion of US standards. As a consequence, the IASC resumed the process of drafting its own interim international solution. As it cannot be presented to the board for final action until at least November 1998, this became the new target for completing the core standards.

*IASC Undertakes to Restructure Itself*

In September 1996, the IASC board set up a Strategy Working Party, one of whose tasks was to propose a new structure for the IASC. Two issues were to be addressed: the unwieldiness of board meetings, and the perceived need to involve national standard setters in the IASC's decision-making process.

On the first issue, something had to be done about the operation of the IASC board, for, at recent meetings, as many as 80 people — delegates and technical advisers, observers, and IASC staff — have had the privilege of the floor. Each of the 16 delegations of board members is entitled to bring up to two or three representatives and a technical adviser. One suggestion has been to replace the board with a bicameral body, which, as it happens, could provide a vehicle for bringing national standard setters into the picture.

During the 1970s the IASC, whose member institutions have always been professional accountancy bodies, did not have any direct contacts with national standard setters, but in the 1980s and 1990s Secretary-General David Cairns did much to develop and multiply these contacts (see Cairns, 1997b, pp. 329-332). Whereas, when the IASC was founded, the history of private-sector standard setting had been of initiatives taken by professional accountancy bodies (as noted above), by the mid-1990s three important standard setters had been formed which are independent of accountancy bodies: the FASB, the UK Accounting Standards Board, and the Australian Accounting Standards Board. Even the CICA's Accounting Standards Board is no longer composed solely of CICA members. As noted above, since 1994 these boards have been collaborating with the IASC under the aegis of the G4+1. Moreover, observers of the IASC have noticed that virtually all of its standards owe their origin to pronouncements (including drafts) issued by one or more of these national standard setters. Indeed, as Secretary-General Carsberg has said on several occasions, it is important to the future of the IASC that national standard setters remain strong.

The Strategy Working Party has been discussing ways of bringing national standard setters more integrally into the IASC's operation. Some believe that the national standard setters, owing to their resources, reputation and rich experience, could contribute in a major way to the future development and acceptance of IASC standards if they were to



send representatives to a proposed IASC Standards Development Committee, which would be authorised to prepare the standards. The delegates of the professional accountancy bodies, currently constituting the majority of the voting members of the unitary board, would instead serve on a Council that would oversee the Standards Development Committee. But the question that has been difficult to resolve is whether the Standards Development Committee or the Council would have the final right of approval over standards. Also at issue was whether a simple majority would suffice.

The professional accountancy bodies, which have dominated the board since its founding, have been loathe to be relegated to a supervisory Council unless it could control the work of the Standards Development Committee. For their part, the national standard setters, chiefly the G4, have been unwilling to have their representatives serve on a committee whose drafts could be overruled by a Council composed of representatives of professional accountancy bodies. Standard setters in the UK and Australia can recall all too well that their predecessors had been obliged to submit their recommended standards to governing councils of professional accountancy bodies for approval, and they had no wish to submit again to that indignity.

The G4 members also have a concern that they may come to represent only a minority of votes on a Standards Development Committee of, say, 10 or 12 members. For its part, the CICA has been contemplating the future role of its standard-setting body in the light of resource constraints and is considering a programme of more active harmonisation with the FASB and the IASC (see CICA Task Force on Standard Setting, 1997, chaps. 1-3). Also, the Australian government has given notice that it will propose legislation to tie its standard-setting body more tightly to the standards issued by the IASC (see CLERP, 1998); therefore, it may become less of a force in the development of national standards. Nonetheless, both the Canadian and Australian standard-setting bodies will continue to be active members of the G4. Hence, turf wars — professional accountancy bodies v. national standard setters, and G4 countries v. those outside the Anglo-American bloc — have so far prevented the Strategy Working Party from agreeing a draft recommendation for public comment.



Yet a dry run of sorts involving the integral participation of national standard setters in the work of the IASC is the Joint Working Group (JWG) that was set up on short notice in November 1997 to formulate a draft standard on financial instruments. Nine of the JWG's 10 members are the national standard setters (or other representatives) from Australia, Canada, France, Germany, Japan, New Zealand, the Nordic Federation, the US, and the UK, which represent eight of the 13 countries on the IASC's board. The JWG's chairman is Alex Milburn, a Canadian delegate on the board and former chairman of the Canadian standard setter.<sup>13</sup> Once a suitable draft standard is developed, the final decision will be taken by the board. If this experiment is seen to work well, it could become a model for the IASC's new structure.

### **WHAT WILL THE SEC DO, AND WHEN WILL IT DO IT?**

The SEC's decision on the acceptability of IASC standards will be taken only in regard to foreign private issuers. US listed companies are required to follow US GAAP, and Chairman Levitt has made it abundantly clear that the SEC will continue to rely on the FASB as the source of substantial authoritative support for GAAP (Levitt, 1996). The open question is whether foreign registrants that have adopted IASC standards will be exempt from reconciling their earnings and shareholders' equity to US GAAP.

Speculation is rampant on what the SEC may do. Two law professors, one a former SEC Commissioner, recently gave the following view:

The conclusion of much of the academic literature and many practitioners is that the Commission will eventually relax its insistence upon U.S. GAAP reconciliation for foreign companies (Fanto and Karmel, 1997, p. 73).

In a footnote, they added:

Although not mentioned except in academic writings or informally, the Commission must take this position to help its constituencies (e.g., stock exchanges and investment banks), which do not want to see their business in foreign securities move offshore (pp. 73-74, n. 73).

But on a major policy question that could set off international repercussions, and with a Chairman who has evinced a greater interest in accounting issues than any of his 23 predecessors, it is difficult to predict at what stage in the process he and other Commissioners will intervene. And in view of the NYSE's stake in the outcome, it is conceivable that further pressure may be brought by Congress, or at least by key members of Congress, on the Commission.

SEC Chairman Levitt, who has just been confirmed by the Senate for a second five-year term, may find himself under pressure by government policy makers, and by figures in international financial circles, to demonstrate vigorous support for the harmonisation movement — by accelerating the Commission's review procedures and giving ground to foreign registrants adopting IASC standards. His thinking may have been tipped by a quotation attributed to him in May 1994: 'My strategy is to see if we can use the tools available to us to embrace standards that are close enough to U.S. standards to be acceptable' (Gilpin, 1994).

The SEC's normal decision-making process would be for the Commissioners to await the staff's recommendations and then to act on any rule proposals that are to be issued. Recently, an official in the SEC's Office of the Chief Accountant described the drill as follows:

If, after assessment of the completed core standards, the SEC staff concludes that the current reconciliation requirements should be reduced or removed, the staff will need to bring a rule proposal to the Commission to amend the current filing requirements for foreign private issuers. If the Commission supports the staff's recommendations it would publish proposed amendments for public comment. The staff would then analyze the comments received and make final recommendations to the Commission, which would then be included, if approved by the Commission, in an adopting release. This procedure of announcing proposed rule changes, allowing time for public comment and then publishing final rules is mandated by US law and applies to any SEC rules and regulations (Tokar, 1998).

Last August it was announced that the SEC is giving thought to issuing a 'concept release' in early 1999. Somewhat in the nature of a 'trial

balloon', a concept release would explore alternatives for changing the current requirements without making specific proposals. The Commission would seek comment on the concepts and alternatives described in the release before considering any rule proposals (Hunt, 1998).

When judging the adequacy of the IASC's standards, the SEC's staff will take into account its previous comments on IASC exposure drafts, as well as the comments submitted by the FASB's staff, to the degree they were not reflected in the final standards. When commenting on IASC drafts, the SEC has found itself in an unaccustomed relationship with a standard setter in comparison with the 'oversight authority' it exercises over the FASB. In its October 1997 report to Congress, the SEC wrote:

Neither the core standards agreement nor IOSCO's participation in the IASC's standard-setting process dictate the outcome of the IASC's technical decisions. While the IASC is interested in obtaining input from IOSCO and its members during its deliberations, that input is not determinative of any of the IASC's decisions (SEC, 1997b, pp. 9-10).

It is likely that the SEC will invite the FASB to give advice in the course of its assessment of the IASC's core standards and, with that view in mind, the FASB is currently revising its comprehensive study of the comparison between IASC standards and US GAAP (see below), which struck some readers as designed to point out every conceivable difference.<sup>14</sup>

When one assesses the IASC's core standards, which still contain a number of allowed alternative treatments, it is well to remember that flexible standards with more than one option were prevalent in US GAAP as recently as the 1960s. Prior to the issue of a series of APB Opinions in 1966-70, US GAAP allowed optional treatments in a rather flexible format on accounting for business combinations, intangibles, leases, deferred taxes, pensions, and extraordinary items, as well as on funds statements. Moreover, the SEC did not support the APB's valiant attempt to prescribe only one method of accounting for the investment tax credit. In 1963, after the APB had approved only a single accounting treatment for the credit, the SEC insisted that an alternative treatment be allowed. In 1971, multiple treatments became enshrined in

Congressional legislation (see Zeff, 1972, pp. 191-221). It is easy to forget that the widespread availability of options and flexible treatment was once the rule in U.S. GAAP. (Indeed, options and flexibility may be found in U.S. GAAP today.)

### *IAS's v. US GAAP*

If the SEC proceeds on a 'business as usual' basis, what can be expected? Some IASC standards that are very similar to US GAAP (e.g., earnings per share) may be approved by the SEC perfunctorily, while others may be adopted in amended form — owing to a combination of unacceptable options, insufficient specificity and inadequate disclosure.

Several IASC standards would seem to raise substantive questions:

IAS 1 *Presentation of Financial Statements* contains a 'present fairly' override, comparable to the 'true and fair' override in the UK and Ireland. The SEC Chief Accountant has expressed the staff's 'significant concerns' about an override (SEC, 1997b, Appendix 7).

IAS 16 *Property, Plant and Equipment* permits an allowed alternative treatment of revaluation at fair value subsequent to acquisition, which would probably not be accepted by the SEC because it is not permissible under US GAAP.

IAS 17 *Accounting for Leases* uses qualitative criteria for classifying the finance and operating leases of a lessee which the SEC believe are too susceptible to discretionary interpretation by contrast with the FASB's quantitative criteria.

IAS 38 *Intangible Assets* requires the recognition of internally generated intangible assets, including development costs, when they meet specified criteria. The SEC's staff expressed its 'fundamental concerns' about this standard when it was in exposure, including its proposal to permit an unlimited useful life for both purchased and internally generated intangibles. An SEC official recently stated, 'While the IASC has conditioned this approach on development of a robust impairment standard [now IAS 36], it is difficult to believe that any impairment standard can be an effective backstop to an unlimited life' (Tokar, 1998).



On the other hand, the SEC has taken a relaxed position on another divergence:

IAS 31 *Financial Reporting on Interests in Joint Ventures* specifies proportionate consolidation, a method that is not generally permitted in the US, for jointly controlled entities. While one could have expected the SEC to insist on the allowed alternative treatment of the equity method, in actual fact the SEC will, in certain cases, disregard differences from US GAAP on this point (SEC, 1997b, p. 28). That this divergence is purely a matter of display and thus does not affect earnings or shareholders' equity (for purposes of a reconciliation to US GAAP) may explain the SEC's somewhat relenting position on the subject. The SEC has also made a number of other accommodations to foreign registrants (see SEC, 1997b, pp. 28-29; and Cochrane et al., 1996, pp. 251-252), including a policy of not mandating quarterly reports of foreign issuers.

Echoing a remark included in Chairman Levitt's December 1996 speech (quoted above), the SEC's October 1997 report to Congress said, 'One important, though not determinative, issue will be differences between international accounting standards and U.S. accounting standards' (p. 23). The SEC added that the FASB's punctilious comparison of IASC standards with US GAAP (Bloomer, 1996), which found 255 'variations' on matters of approach and/or guidance, 'will be an important tool for [the SEC's] assessment of the completed core set of standards' (p. 23). For its part, the IASC has been quick to cite the opinion of Morgan Stanley Dean Witter's equity research group that 'many investors would find most of [the 255 differences] meaningless' (1998, p. 2).

One can be optimistic, however, that the IASC's core standards project will, at the least, succeed in lightening the burden of the SEC's required reconciliation to US GAAP. For foreign companies that judiciously select the options in IASC standards that are embraced by the SEC, the number and materiality of the items requiring reconciliation should drop precipitately, and for some foreign companies the reconciliation may not be necessary at all. To be sure, a great deal depends on how closely a company's interpretation of an IASC standard conforms to the SEC's interpretation. Identical wording appearing in US GAAP and IASC standards can nonetheless be open to different interpretations.<sup>15</sup> The

SEC may also decide that US GAAP governs foreign registrants' financial statements on matters not addressed by IASC standards.

### *Timing*

On the matter of timing, it seems likely that IOSCO's Technical Committee, assisted by Working Party No. 1, will conduct its assessment of the completed core standards in tandem with the SEC's own assessment. The Technical Committee makes its decisions by consensus, which means by unanimous vote. The members of the Working Party, including the SEC, have been monitoring the IASC's standards as they evolve, so the process will not be undertaken *de novo*. Nonetheless, the SEC's review process will be lengthy and detailed, and considerable time will be needed for composing rule proposals, analyzing the comments received, and formulating the final rules. A clue to the amount of time required for this process is suggested by the SEC's experience with the adaptation of the three IASC standards in 1994. When the SEC adapted portions of IAS 22 and IAS's 21/29 for use by foreign registrants, eight months elapsed between publication of the rule proposal and promulgation of the final rule, and this does not take into account the substantial time required to frame the rule proposal and to secure the approval of the Chairman and the other Commissioners. It seems likely that several years will be required for the SEC to complete its assessment of the entire set of 23 core standards that will be presented for IOSCO's endorsement in 1998/99. Once the SEC's final rules are issued, its Division of Corporation Finance will, of course, begin scrutinising foreign companies' filings for conformity with US GAAP as modified by the SEC's rules adapting IASC standards.

## **THE FUTURE**

In a recent paper, Paul Pacter, currently the International Accounting Fellow at the IASC and formerly a project manager with the FASB, speculated on whether the IASC should become the *supremo* standard setter or continue to be a harmoniser. 'IASC', he said, 'has slowly been evolving from the latter to the former'. He added:

A harmonizer approach leaves national accounting standards as the primary accounting literature in a country and national

standard-setters with the primary responsibility for developing standards. IASC provides a forum for the debate and, through its standards, narrows the range of options open to the national standards setters (Pacter, 1998, p. 20).

After noting that national standard setters suffer the weakness of being overly protective of their own solutions, Pacter concluded:

Harmonization of diverse national standards is fraught with insurmountable obstacles. It is not the way to go into the next century. A single, global set of accounting standards will best serve investors, and realistically it will take a single, supreme standards board to do the job (p. 21).

But to attempt to chart the IASC's future by reference to its track record during the last decade is also fraught with difficulties. Much of the motive power behind the IASC's ambitious and energetic programme to complete the core standards has been fuelled by the desire of many of its financial backers to gain access to the US capital market without needing to reconcile to US GAAP. Whether the IASC's programme will continue to flourish after the reconciliation becomes a less fearsome issue remains to be seen. Moreover, as has been suggested, the resources and expertise of national standard setters in countries such as the US, Canada, the UK and Australia have been indispensable to the IASC's success. In future years, the standard setters in such countries as France and Germany may come to play a comparable role. It is difficult to contemplate the future of the IASC without the support of strong national standard setters. It would seem to be essential that the IASC bring national standard setters into its operation if it seeks to continue to have a major impact on the financial reporting accepted in major world capital markets. In the light of this analysis, it would seem that the IASC should continue to be regarded as a harmoniser, not a global standard setter.

## NOTES

<sup>1</sup> The author is grateful to a great many readers for comments on earlier drafts. Special thanks are due to David Cairns and Chris Nobes for their extensive comments. They are not, however, responsible, for what remains. Much of the factual material in this paper is drawn from *IASC Insight* (formerly known as *IASC News*), the IASC's newsletter.

<sup>2</sup> See Torres (1990), Power (1992), Cochrane (1994), Cochrane, Shapiro and Tobin (1996), and 'NYSE Chief Complains...' (1996). References to further pieces in the financial press are given in Saudagaran and Biddle (1994, p. 194, ftn 7). For a limited empirical study that provides support for the NYSE position, see Fanto and Karmel (1997). Saudagaran and Biddle (1994) found that financial disclosure levels do influence the decision to list on a foreign stock exchange.

<sup>3</sup> Telephone interviews with Ralph E. Walters, 7 May 1998, and with Paul G. Cherry, 19 June 1998. Cherry was then chief accountant of the OSC.

<sup>4</sup> Letter to the author from David Cairns, dated 16 June 1998.

<sup>5</sup> For evidence of SEC interest, see the remarks of SEC Chief Accountant Edmund Coulson (Collins, 1989a; 1989b).

<sup>6</sup> For fuller statements on the work of the SEC, see Skousen (1991), Zeff (1995) and Herz, Dittmar, Lis, Decker and Murray (1997).

<sup>7</sup> For a complete discussion of the work of the FASB, see Miller, Redding and Bahnson (1998).

<sup>8</sup> Such a move could incur considerable cost. Under Internal Revenue Code Sec. 367, moving a U.S. parent company offshore is a taxable transaction which could lead to an assessment of additional taxes at both the corporate and shareholder level. I am grateful to Lee Seidler for alerting me to this tax consequence.

<sup>9</sup> An expanded discussion of the IASC's relations with IOSCO may be found in Cairns (1997b, pp. 337-346; and 1997c). These articles are also a good source on the institutional history of the IASC, as viewed by its Secretary-General from 1985 to 1995. Another perspective on the IASC's institutional history may be found in Flower (1997).

<sup>10</sup> Letter from David Cairns, dated 16 June 1998, and telephone interviews with Ronald J. Murray, 17 June 1998, and with Paul G. Cherry, 19 June 1998. Murray and Cherry were members of the US and Canadian delegations, respectively, when the LIFO matter was decided.

<sup>11</sup> This assertion is based on interviews with parties on both sides of the transaction.



<sup>12</sup> The term 'trillion' refers to the US definition, with 12 zeroes. The figures for foreign companies do not reflect an adjustment for cross-holdings in Japanese companies.

<sup>13</sup> It is interesting to note that six of the 10 places on the JWG were filled from the G4 countries plus New Zealand, which recently became part of the group.

<sup>14</sup> For a critical assessment of the FASB's study, see Cairns (1997a).

<sup>15</sup> The author has been informed by a Big Five audit firm that, despite the adoption in the Philippines of a standard on deferred taxes that is quite similar to FASB Statement No. 109, some interpretations of the Philippine standard that diverge from those of Statement 109 have made it necessary, in some circumstances, for Philippine companies to reconcile to US GAAP for deferred taxes in their SEC filings.

## **APPENDIX**

### **NATIONAL SECURITIES MARKETS IMPROVEMENT ACT OF 1996 (ENACTED INTO LAW ON 11 OCTOBER 1996)**

#### *Sec. 509. Promoting Global Preeminence of American Securities Markets.*

It is the sense of the Congress that —

(1) the United States and foreign securities markets are increasingly becoming international securities markets, as issuers and investors seek the benefits of new capital and secondary market opportunities without regard to national borders;

(2) as issuers seek to raise capital across national borders, they confront differing accounting requirements in the various regulatory jurisdictions;

(3) the establishment of a high-quality comprehensive set of generally accepted international accounting standards in cross-border securities offerings would greatly facilitate international financing activities and,

most significantly, would enhance the ability of foreign corporations to access and list in United States markets;

(4) in addition to the efforts made before the date of enactment of this Act by the [Securities and Exchange] Commission to respond to the growing internationalization of securities markets, the Commission should enhance its vigorous support for the development of high-quality international accounting standards as soon as practicable; and

(5) the Commission, in view of its clear authority under law to facilitate the access of foreign corporations to list their securities in United States markets, should report to the Congress, not later than 1 year after the date of enactment of this Act, on progress in the development of international accounting standards and the outlook for successful completion of a set of international standards that would be acceptable to the Commission for offerings and listings by foreign corporations in United States markets.

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