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Becoming One: The SEC Should Join the World in Adopting the International Financial Reporting Standards

MARK J. HANSON*

I. INTRODUCTION

The International Financial Reporting Standards (“IFRS”), formerly the International Accounting Standards (“IAS”), has achieved the status of a worldwide accounting standard. Beginning this year, IFRS will become the official accounting standard of the European Union (“E.U.”).¹ Moreover, close to one hundred countries around the world, including Australia,² Russia³ and New

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1. Council Regulation 1606/2002, On the Application of International Accounting Standards, 2002 O.J. (L 243) 1, 2 (EC); *see also* Press Release, Int’l Accounting Standards Bd., IASB Chairman Welcomes the EU’s Decision to Adopt International Accounting Standards (Jun. 7, 2002), <http://www.iasb.org/docs/press/2002pr08.pdf>. Those companies that both currently trade in the U.S. and use U.S. generally accepted accounting principles (“GAAP”) or companies that have issued debt and not equity instruments will not have to comply with IFRS until January 1, 2007. *Id.* Additionally, even before the actual vote, Austria, Belgium, Finland, France, Germany, Italy and Luxembourg allowed listed companies to prepare their financial statements with IFRS. *Id.*

2. Press Release, Int’l Accounting Standards Bd., IASB Chairman Welcomes Australia’s Move to Adopt International Accounting Standards by 2005 (July 3, 2002), <http://www.iasb.org/docs/press/2002pr11.pdf>.

3. The Russian Duma preliminarily approved IFRS in November 2004. *See Country and Regional Updates: Russian Federation, IAS PLUS* (Deloitte Touche Tohmatsu), Apr. 2005, available at <http://www.iasplus.com/country/russia.htm>. A recent article from *Vedomosti*, Russia’s main financial paper, reported that approval of IFRS had come to a “standstill.” *Id.* It seems that the Russian business community did not want to enact IFRS because of technical difficulties, and the business community felt that there were no incentives to increase the transparency of Russia’s accounting system. *Id.*

Zealand, currently use or will use IFRS.⁴ Canada also anticipates using IFRS as well. The accounting regulator of Canada has proposed making IFRS Canada's official accounting standard.⁵ With so many countries adopting or about to adopt this one standard, international convergence of accounting standards has increasingly become a subject of discussion within the U.S.⁶ Additionally, many interested parties around the globe are wondering how the U.S. will respond to IFRS and accounting convergence.

The former United States Securities and Exchange Commission ("SEC") Chairman, William Donaldson, advocated eliminating the U.S. Generally Accepted Accounting Principles ("U.S. GAAP") reconciliation requirement,⁷ which would allow foreign issuers to use IFRS in their U.S. regulatory filings.⁸ Moreover, the SEC's Chief Accountant, Donald T. Nicolaisen, is also on record stating that there will come a time when foreign issuers will no longer have to reconcile their financial statements to U.S. GAAP.⁹ Mr. Nicolaisen proposed a timetable for the SEC

4. *Use of IFRSs for Reporting by Domestic Listed Companies, by Country and Region Status as of 2005*, IAS PLUS (Deloitte Touche Tohmatsu), available at <http://www.iasplus.com/country/useias.htm>.

5. See *Country and Regional Updates: Canada*, IAS PLUS (Deloitte Touche Tohmatsu), Jan. 2006, available at <http://www.iasplus.com/country/canada.htm>.

6. Susan Koski-Grafer, Senior Assoc. Chief Accountant, U.S. Sec. & Exch. Comm'n, Remarks at the University of South Florida Program: Understanding the Financial Infrastructure for Globalization (Feb. 4, 2005), <http://www.sec.gov/news/speech/spch020405skg.htm> ("Awareness of the importance of international accounting standards has grown as the markets have become more globalized.").

7. Foreign issuers listed in the United States are allowed to prepare their financial statements with their home accounting standard or IFRS, but must reconcile their accounting statements to U.S. GAAP. This involves showing the differences in accounting treatment between the foreign issuers accounting and U.S. GAAP. See *infra* Part II.B for a discussion about the current accounting regulations that foreign issuers must meet.

8. Kenji Taneda, *Sarbanes-Oxley, Foreign Issuers and United States Securities Regulation*, 2003 COLUM. BUS. L. REV. 715, 751-52 (2003) (explaining that William Donaldson made such a statement while he was the head of the New York Stock Exchange).

9. Donald T. Nicolaisen, Chief Accountant, U.S. Sec. & Exch. Comm'n, Remarks Before the IASB Meeting with World Standard-setters (Sept. 28, 2004), <http://www.sec.gov/news/speech/spch092804dtn.htm>:

My personal view is that if things continue as they have been going – if the IASB operates as a strong independent standard-setter and continues to develop and issue high quality standards, if the commitment to quality application of IFRS remains, and if good progress is made in accounting convergence and the development of an effective global financial reporting infrastructure – then I believe that the SEC will be able to eliminate our reconciliation requirement.

to approve IFRS by at least 2009, yet was unclear as to the precise date.¹⁰ The fate of the reconciliation requirement will depend on the quality of the large influx of European issuers' financial statements using IFRS for the first time in 2005.¹¹

This Article addresses the question of whether the SEC can presently adopt IFRS for foreign issuers. Part II begins by introducing the history of IFRS and the International Accounting Standards Board ("IASB"), the organization that promulgated the standards. Part II also introduces the topic of accounting standards convergence and its impact on foreign issuers in U.S. securities markets.

Part III argues the SEC's failure to adopt IFRS because of its reliance on the perceived advantages of U.S. GAAP is misguided. By showing that U.S. GAAP has caused damages to the U.S. economy through securities fraud and a decline in foreign listings on American stock exchanges, this Article illustrates U.S. GAAP's shortcomings in the U.S.'s financial reporting needs.

Id. The former FASB chairman, Edmund L. Jenkins, also recognized the inevitability of IAS. See James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1247 (1999).

10. Donald Nicolaisen, *A Securities Regulator Looks at Convergence*, 25 NW. J. INT'L L. & BUS. 661, 686 (2005). Additionally, Donald Nicolaisen stated:

My personal view is that if things continue as they have been going—if the IASB operates as a strong independent standard-setter, if the commitment to quality application of IFRS remains, and if good progress in [sic] made in accounting convergence and the development of an effective global financial reporting infrastructure—then “*in this decade*,” the SEC will be able to eliminate the reconciliation.

Donald T. Nicolaisen, Chief Accountant, U.S. Sec. & Exch. Comm'n, Remarks Before the Public Hearing on the IASC Constitution Review (June 3, 2004) (emphasis added), <http://www.sec.gov/news/speech/spch060304dtn.htm> (emphasis added). Chairman Donaldson has stated that the reconciliation requirement could be eliminated as early as now or by 2009 at the latest. Press Release, U.S. Sec. & Exch. Comm'n, Chairman Donaldson Meets with EU International Market Commissioner McCreevy (Apr. 21, 2005), <http://www.sec.gov/news/press/2005-62.htm> (last visited Apr. 22, 2005).

11. Scott A. Taub, Deputy Chief Accountant, U.S. Sec. & Exch. Comm'n, International Convergence and Public Oversight of Accounting and Auditing Standards (May 20, 2004), <http://www.sec.gov/news/speech/spch052004sat.htm>:

But now that it is clear that the IASB is capable of and committed to putting out high-quality standards, and has strong expertise, independence and due process, the SEC staff is moving on to consider other issues that might stand in the way of dropping the reconciliation. One of the larger hurdles is that there are currently less than 50 US registrants that use IFRS for their primary financial statements. Obviously, that will change in 2005, and we need to be ready to address that, and to take advantage of the knowledge that can be gained from looking at such a large number of IFRS-based financial statements.

Id.

Part IV argues IFRS should be adopted by the SEC and Part V sets forth and explains the numerous benefits adoption would confer on both the U.S. and the world. Part VI reviews future difficulties that may, however, prevent IFRS from achieving the status of a global accounting standard.

II. SETTING THE STAGE FOR THE DEBATE ABOUT THE INTERNATIONAL FINANCIAL REPORTING STANDARDS

A. *The Formation Of The Standards Setter And The Standard: The International Accounting Standards Board And The International Financial Reporting Standards*

Today's accounting techniques have a long history stretching from 1494 to the present.¹² While IFRS and the IASB are more recent developments, both have undergone gradual evolutions from humble origin to their status as a worldwide accounting standard and standards setter. IFRS are the product of the IASB, which until recently was known as the International Accounting Standards Committee ("IASC").¹³

The IASC was established in 1973 through the agreement of nine national accounting bodies.¹⁴ The IASC began as a part-time standards setter, with limited resources and an insufficient infrastructure.¹⁵ Commentators criticized the IASC's structure as an impediment to it becoming a worldwide accounting standards setter.¹⁶ Because of these criticisms, the IASC implemented a

12. Bernhard Grossfeld, *Global Accounting: Where Internet Meets Geography*, 48 AM. J. COMP. L. 261, 270-73 (2000).

13. The IASB's mission is to bring about convergence of worldwide accounting standards. See Int'l Accounting Standards Bd., About Us, <http://www.iasb.org/about/index.asp> (last visited Mar. 19, 2005).

14. CLARE ROBERTS ET AL., *INTERNATIONAL FINANCIAL ACCOUNTING: A COMPARATIVE APPROACH* 133 (Prentice Hall 2002). The nine national accounting bodies were: Australia, Canada, France, Germany, Japan, Mexico, Holland, the United Kingdom (jointly with Ireland) and the United States. *Id.*

15. *Id.* at 136 (noting that the IASC described itself as a "low budget organization").

16. See Charles Canfield, Comment, *FASB v. IASC: Are the Structure and Standard Setting Process at the IASC Adequate for the Securities and Exchange Commission to Accept International Accounting Standards for Cross-Border Offerings?*, 20 NW. J. INT'L L. & BUS. 125 (1999). The author commends the IASC for its achievement despite little resources and a limited staff. *Id.* at 141. But, unless the IASC reforms and restructures itself, it will not be able to achieve its goal of becoming a global standards setter. *Id.* at 141-42. See also Stephen A. Zeff, *U.S. GAAP Confronts the IASB: Roles of the SEC and the European Commission*, 28 N.C. J. INT'L L. & COM. REG. 879, 885 (2003). Former SEC Chief Accountant, Lynn Turner, commented that the IASC needed to be an independent

strategy to restructure itself.¹⁷ By 2001, the IASC had transformed into the IASB, a full-time professional accounting standards setter.¹⁸

During this transformation, the IASB adopted a new constitution,¹⁹ which created a board that would develop and issue interpretations about IFRS.²⁰ Aside from the board, other units within the IASB would fill out its structure. First, nineteen trustees would make up the main governing body.²¹ Second, the Standards Advisory Council would deal with macro issues relating to IFRS.²²

full-time accounting body with a significant research staff. *Id.* Further, Mr. Turner stated that if the IASC remained a part-time standards setter with an inadequate structure, any future accounting standards promulgated by the IASC would have no legitimacy in the eyes of investors worldwide. *Id.*

17. CHRISTOPHER NOBES & ROBERT PARKER, *COMPARATIVE INTERNATIONAL ACCOUNTING 101* (Prentice Hall 2004). In 1997, the IASC formed a standard working party that reexamined the IASC's structure and strategy. *Id.* Its proposal, "Shaping IASC for the Future," was published in 1998. *Id.* The proposal stated the following reasons for restructuring the IASC into a full-time standards setter: (1) reducing the load on part-time Board representatives, (2) enabling a wider group of countries and organizations to be members of the Board, and (3) increasing the degree of partnership with national standard-setters so as to accelerate worldwide convergence of standards. *Id.* at 102. See also Press Release, Int'l Accounting Standards Comm., IASC's Strategy Working Party Issues its Report to the IASC Board: "Recommendations on Shaping IASC for the Future," (Dec. 6, 1999), <http://www.iasb.org/docs/press/2000pr14.pdf>.

18. See Press Release, Int'l Accounting Standards Comm., Trustees Initiate New Structure, Consider Standard Advisory Council (Mar. 15, 2001), <http://www.iasb.org/docs/press/2001tr01.pdf>.

19. KURT P. RAMIN, *INTERNATIONAL ACCOUNTING STANDARDS EXPLAINED 77* (John Wiley & Sons 2000).

20. DELOITTE TOUCHE TOHMATSU, *INTERNATIONAL FINANCIAL REPORTING STANDARDS: A PRACTICAL GUIDE 10, 12* (3d ed. 2002), available at <http://www.iasplus.com/dttdpubs/ifrsguide2002full.pdf> [hereinafter *DELOITTE PRACTICAL GUIDE*]. There would be fourteen board members, with twelve working full-time. *Id.* at 10. The foremost qualification to become a member of the IASB Board was technical expertise. *Id.* The fourteen-member board was a compromise between having a small technocratic executive board and a large representative supervisory body. NOBES & PARKER, *supra* note 17, at 102.

21. *DELOITTE PRACTICAL GUIDE*, *supra* note 20, at 9. The trustees are responsible for issues relating to appointing members to the board, approving the annual budget, and reviewing broad strategy issues. The Trustees meet twice a year and are responsible for fundraising. ROBERTS ET AL., *supra* note 14, at 134. To ensure that there is diversity in terms of geographic representation, six Trustees are required to come from North America, six from Europe, four from Asia/Pacific and three from any other area of the world. *Id.*

22. *DELOITTE PRACTICAL GUIDE*, *supra* note 20, at 11. The SAC meets three times a year to advise the Board on its priorities, inform the Board of the implications of the proposed standards, and give advice to the Board and to the Trustees. *Id.* The purpose of the SAC is to provide a forum for participation by organizations and individuals from a wide range of interests and geographic representations. ROBERTS ET AL., *supra* note 14, at 136.

Finally, the International Financial Reporting Interpretation Committee ("IFRIC") would assist the board in interpreting IFRS.²³

Just like the IASB, IFRS evolved over the years. IFRS began as a recommendation from the International Association of Securities Regulators ("IOSCO").²⁴ In 1989, IOSCO's Working Party No.1 (SC 1) prepared a report entitled "International Equity Offers,"²⁵ which called for a single worldwide securities disclosure document that would use internationally accepted accounting standards.²⁶ IOSCO turned to the IASC to develop this complete set of international accounting standards.²⁷

This project became known as the "Core Standards Project."²⁸ Working together to complete the core set of accounting standards,²⁹ the IOSCO informed the IASC of what key accounting provisions were needed.³⁰ Together the IOSCO and the IASC developed the IAS,³¹ and on May 17, 2000, issued the Sydney 2000 release that endorsed the completed set of IAS.³²

23. DELOITTE PRACTICAL GUIDE, *supra* note 20, at 11. Until 2002, this was known as the Standard Interpretations Committee. *Id.* IFRIC produces a draft interpretation for public comment from which it prepares a final interpretation. *Id.*; ROBERTS ET AL., *supra* note 14, at 136. The Board must approve the final interpretation in order for it to go into effect. DELOITTE PRACTICAL GUIDE, *supra* note 20, at 11.

24. See OICU-IOSCO, IOSCO HISTORICAL BACKGROUND, <http://www.iosco.org/about/about.cfm?whereami=page15> (last visited March 19, 2005). IOSCO was formed in 1974, and now has 181 members that regulate 90 percent of the world's securities markets. *Id.* IOSCO's mission is to assemble together its members' agencies to promote high standards of regulation and to unite their efforts to establish standards. See OICU-IOSCO, General Information on IOSCO, <http://www.iosco.org/about/> (last visited Mar. 19, 2005).

25. U.S. Sec. & Exch. Comm'n, Report on Promoting Global Preeminence of American Securities Markets (Oct. 1997), available at <http://www.sec.gov/news/studies/acctgsp.htm> [hereinafter Report on Promoting Global Preeminence of American Securities markets].

26. *Id.*

27. *Id.*

28. David S. Ruder et al., *Creation of World Wide Accounting Standards: Convergence and Independence*, 25 NW. J. INT'L L. & BUS. 513, 528 (2005).

29. Report on Promoting Global Preeminence of American Securities markets, *supra* note 25.

30. Janice Grant Brunner, Comment, *All Together Now? The Quest for International Accounting Standards*, 20 U. PA. J. INT'L ECON. L. 911, 918 (1999).

31. See RAMIN, *supra* note 19, at 63.

32. *Id.* at 64. See also Press Release, Int'l Accounting Standards Comm., IOSCO Endorses IASC's Core Standards (May 17, 2000), <http://www.iasb.org/docs/press/2000pr14.pdf>. In 2005, IOSCO reaffirmed its support for IFRS. Press Release, Technical Comm. of the Int'l Org. of Sec. Comm'n, Statement on the

Since 2000, the IASB continues to work on IFRS through their "Improvements Project," which focuses on improving the quality of IFRS and increasing compatibility with U.S. GAAP.³³

B. The Concept Of Convergence And Its Impact On Global Accounting Standards

Because of the world's divergent accounting standards, convergence is an increasingly important topic within international accounting circles. In terms of defining convergence, SEC Commissioner Roel Campos recently described convergence as, "[T]he movement of two or more sets of standards toward each other at a relatively high level, producing identical or nearly identical principles of regulatory purpose."³⁴ To achieve convergence and enjoy its maximum benefits, the world's accounting, auditing, and disclosure standards must become increasingly similar.³⁵

Converging financial disclosure standards has been tried before. Europe began working on accounting convergence with its 1965 Fourth Directive.³⁶ As for the U.S., a type of convergence for the textual disclosures of financial documents was started between the U.S. and Canada through the U.S.-Canadian Multijurisdictional Disclosure System ("MJDS") treaty.³⁷ MJDS is founded on a concept called national recognition.³⁸ National

Development and Use of International Financial Reporting Standards in 2005, (Feb. 2005), http://www.iasb.org/uploaded_files/documents/10_286_ioscopd182-100205.pdf.

33. Sir David Tweedie & Thomas R. Seidenstein, *Setting a Global Standard: The Case for Accounting Convergence*, 25 NW. J. INT'L L. & BUS. 589, 596 (2005).

34. Roel C. Campos, Comm'r, U.S. Sec. & Exch. Comm'n, Speech by SEC Commissioner: The Global Marketplace and a Regulatory Overview, (Sept. 17, 2004), <http://www.sec.gov/news/speech/spch091704rcc.htm>.

35. See Taub, *supra* note 11. Right now, the International Auditing and Assurance Standards Board ("IAASB") is working on promulgating and implementing International Auditing Standards ("ISAs"). See IFAC-Int'l Auditing & Assurance Standards Bd., About IAASB, <http://www.ifac.org/IAASB/About.php#1> (last visited Apr. 2, 2005). Currently, 70 countries have adopted ISAs or said that their auditing standards are substantially similar. See IAASB Fact Sheet, *available at* http://www.ifac.org/MediaCenter/files/IAASB_Fact_Sheet.pdf *1 (last visited July 22, 2006).

36. NOBES & PARKER, *supra* note 17, at 96-99. The Fourth Directive dealt with accounting concepts such as valuation, formats of published financial statements and disclosure requirements. *Id.* See also ROBERTS ET AL., *supra* note 14, at 215-20. There was a later Seventh Directive that was more controversial. *Id.*

37. Troy L. Harder, *Searching for a Level Playing Field: The Internationalization of U.S. Securities Disclosure Rules*, 24 HOUS. J. INT'L L. 345, 352 (2002).

38. Campos, *supra* note 34.

recognition means that an issuer, exchange or other market participant, regulated by their home country will not be subject to regulation in a second country regardless of the quality of the regulation in the home country.³⁹ The MJDS treaty provided that the U.S. and Canada would mutually recognize each other's registration statements prepared in accordance with the other country's financial reporting standards.⁴⁰ Consequently, Canada reorganized its securities regulatory system to conform almost exactly to that of the U.S.⁴¹ Nevertheless, very little equity has been raised under MJDS because Canadian corporations must reconcile their accounting disclosures to U.S. GAAP.⁴² As a result, there has been talk about suspending the MJDS agreement.⁴³

Even with this setback, the U.S. has shown continued interest in accounting convergence. Congress initially became interested in accounting convergence by passing the Capital Markets Efficiency Act of 1996.⁴⁴ In part, the Act required the SEC produce a study on the efforts to develop international accounting standards.⁴⁵ Within this study, the SEC made the commitment to actively participate in the core standards project and to support the formation of international accounting standards. After the completion of the study, many SEC commissioners issued statements supporting global accounting convergence because of its numerous benefits for the world's capital markets.⁴⁶

Even with the U.S.'s support of accounting convergence, there has been a clash between the E.U.'s recently adopted IFRS accounting standard and the U.S. GAAP accounting standard. The crux of the problem has been which political entity would move its accounting standards closer to the other.⁴⁷ Both the U.S. and the

39. See Harder, *supra* note 37, at 351. However, national recognition usually cannot happen unless the regulatory standards of the two countries are substantially similar. *Id.* at 352.

40. Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market—A Proposal*, 66 FORDHAM L. REV. 1785, 1792 (1998).

41. *Id.*

42. *Id.* at 1793.

43. Harder, *supra* note 37, at 352.

44. Pub. L. No. 104-290, 110 Stat. 3416 (1996).

45. See Scott B. Novak, *A Step Toward Globalization: The Move for International Accounting Standards*, 9 IND. INT'L & COMP. L. REV. 203, 207-08 (1998).

46. See also Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 10; Cynthia A. Glassman, Comm'r, U.S. Sec. & Exch. Comm'n, Annual Conference Institute of International Bankers (Mar. 1, 2004), <http://www.sec.gov/news/speech/spch030104cag.htm>.

47. See Nicolaisen, *supra* note 9. Recently Charlie McCreevy, the European Commissioner for Internal Market and Services, said: "But this is not a one-way street – it

E.U. stated that they want convergence to be a two-way street.⁴⁸ Recently, both former SEC Chairman Donaldson and E.U. Internal Market Commissioner Charles McCreevy agreed to work closely to converge their respective accounting standards.⁴⁹

Europe was quick to take on accounting convergence through the promotion of two new directives:⁵⁰ the "Prospectus Directive"⁵¹ and the "Transparency Directive."⁵² Under these two directives, the E.U. charged the Committee of European Securities Administrators ("CESR") to determine whether the other major global accounting standards, Canadian GAAP,³ Japanese GAAP, and U.S. GAAP, were equivalent to IFRS.⁵³ Recently, CESR stated that all three of these accounting standards were considered equivalent to IFRS.⁵⁴ CESR, however, made the equivalence of U.S. GAAP contingent on the U.S. adopting a policy of expensing stock options.⁵⁵

Because CESR found U.S. GAAP to be equivalent to IFRS, American companies listed in Europe are not required to reconcile their financial statements to IFRS.⁵⁶ Despite CESR's gesture, foreign issuers listed in the U.S. are required to reconcile their

is only reasonably for European companies to expect that US regulators will make similar efforts to judge the equivalence of our international standards with US GAAP, and once this is done, to release companies from the costly burdens of converting standards." Charlie McCreevy, European Comm'r for Internal Mkt. & Servs., *Competitiveness and Growth in the EU Through the Development of an Integrated Capital Market and Banking System* (Apr. 1, 2004), <http://www.iasplus.com/europe/0504mccreevyicaew.pdf>.

48. See Nicolaisen, *supra* note 9.

49. Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 10.

50. Comm. of Eur. Sec. Reg., *Concept Paper on the Equivalence of Certain Third Country GAAP and on the Description of Certain Third Countries Mechanisms of Enforcement of Financial Information 5* (Oct. 2004), available at http://www.cesr-eu.org/data/document/04_509.pdf.

51. For the E.U. Prospectus Directive, any third country issuer (a non-E.U. issuer) who has its securities listed on an E.U. stock exchange or wishes to make a public offering in Europe will be required after January 1, 2007 to produce its financial statements using either IFRS or with an accounting standard equivalent to IFRS. *Id.*

52. Similarly, under the Transparency Directive, any third issuer that has its securities traded on an E.U. exchange has to produce annual and semi-yearly statements (presumably as of fall 2006) with either IFRS or an equivalent standard. *Id.*

53. *Id.*

54. Comm. of Eur. Sec. Reg., *Technical Advice on Equivalence of Certain Third Country GAAP and on Description of Certain Third Country Mechanisms of Enforcement of Financial Information 3*, 22-30 (June 2005), available at http://www.cesr-eu.org/data/document/05_2306.pdf.

55. *Id.*

56. Alexander Schaub, *The Use of International Accounting Standards in the European Union*, 25 *Nw. J. INT'L L. & BUS.* 609, 613 (2005) (citing Article 7 of the Prospective Directive).

financial statements to U.S. GAAP.⁵⁷ The SEC, as the U.S.' primary financial regulator,⁵⁸ continues to assess whether IFRS could be used in the U.S. In 2000, the SEC issued a concept release that would terminate the reconciliation requirement and recognize IFRS for foreign issuers listed in the U.S.⁵⁹ As of yet, the U.S. never followed up on its 2000 concept release.

The SEC staff, however, has been anything but silent on the issues of adopting the IFRS and the topic of convergence.⁶⁰ Yet any action on the part of the U.S. to allow IFRS to be used by foreign issuers still seems to be put off possibly until 2009.⁶¹ In the meantime, the Financial Accounting Standards Board ("FASB"), the U.S. accounting standards setter, has played a significant role in global accounting convergence issues.⁶² The FASB worked with the IASB on convergence issues, and signed the Norwalk Agreement, in which both organizations agreed to work together to promote convergence.⁶³

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

58. NOBES & PARKER, *supra* note 17, at 176.

59. International Accounting Standards, Act Release Nos. 33-7801, 34-42430, International Series No. 1215; 65 Fed. Reg. 8896 (Feb. 23, 2000) (codified at 17 C.F.R. pt. 230, 240) [hereinafter Concept Release].

60. In the meantime, however, the IASB and its US counterpart, the FASB, have been working towards making the reconciliation less onerous, by working to eliminate differences between US GAAP and IFRS to the greatest extent possible. The IASB and the FASB agreed formally in October 2002 to work towards convergence in their standards. The two Boards are now working together on several major projects, and they have essentially decided to coordinate agendas, so that any major project that one Board takes up will also be taken up by the other Board. In addition, the two Boards have been working on 'short-term convergence,' which involves quickly converging in certain areas to whichever Board's standard is better.

Taub, *supra* note 11.

61. Press Release, U.S. Sec. & Exch. Comm'n, *supra* note 10.

62. Letter from Fin. Accounting Standards Bd. to Comm. of European Sec. Regulators, CESR Equivalence Questionnaire (Feb. 10, 2005), <http://www.cesr-eu.org/> (FASB's response to CESR's request for information on U.S. GAAP and its equivalence with IAS/IFRS) [hereinafter CESR Questionnaire]. In 1936, the SEC delegated its accounting authority to the American Institute of Certified Public Accountants ("AICPA"). *Id.* In 1973, AICPA delegated this authority to the FASB. *Id.* See also 15 U.S.C. § 77s(a) (2005); 15 U.S.C. § 78m(b)(1) (2005).

63. That agreement calls for cooperation between the two organizations in achieving international accounting convergence. Fin. Accounting Standards Bd. and the Int'l Accounting Standards Bd., Memorandum of Understanding, "The Norwalk Agreement," (Oct. 29, 2002), <http://www.fasb.org/news/memorandum.pdf>. That agreement provided that both Boards would "(a) make their existing financial reporting standards fully compatible as soon as is practical and (b) to coordinate their future work programs to

Despite talk in the U.S. about convergence of accounting standards, at this time, foreign issuers are required to fulfill the U.S. GAAP reconciliation requirement. Absent an exemption, every U.S. securities offering must register with the SEC.⁶⁴ When foreign private issuers choose to list their securities in the U.S., they must follow certain disclosure-based regulations⁶⁵ as set forth in the Securities Act of 1933⁶⁶ and the Securities Exchange Act of 1934.⁶⁷ Furthermore, Regulation S-X sets out the form and content requirements that foreign issuers must follow when preparing their financial statements.⁶⁸

Although the SEC allows foreign private issuers to prepare their financial statements in accordance with U.S. GAAP or with any other comprehensive accounting standard (including IFRS),⁶⁹ foreign issuers must also provide the SEC with an audited reconciliation to U.S. GAAP.⁷⁰ While there are some exceptions to the SEC's reconciliation requirement,⁷¹ the cost of compliance is

ensure that once achieved, compatibility is maintained." *Id.* Both Boards also agreed to coordinate their agendas, and to undertake a joint project dealing with major accounting issues along with short-term projects where one Board's accounting standard would be adopted because it was better than the other Board's standard. *Id.*

64. Concept Release, *supra* note 59, at 8899.

65. Because there is an inconsistency between guiding the invisible hand of capitalism and allowing civil servants to dictate how companies can raise capital, developed countries' securities laws are disclosure based rather than merit-based. Cox, *supra* note 9, at 1200. The fundamental theoretical underwriting disclosure-based securities regulation is that through adequate disclosures, investors will have the requisite information they need to make informed investment decisions. Jennifer O'Hare, *Director Communications and the Uneasy Relationship Between the Fiduciary Duty of Disclosure and the Anti-Fraud Provisions of the Federal Securities Laws*, 70 U. CIN. L. REV. 475, 479 (2002). A merit based review approach would condition securities' registration on their meeting a standard of investment worthiness or merit. *Id.* Most states have gone towards a disclosure-based approach, with Illinois eliminating their merit-based review in the 1980s. Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2392-93 (1998). U.S. securities laws provide investors disclosures when they are voting their securities, tendering their securities, or trading their securities in the open market. *Id.*

66. 15 U.S.C. § 77a (2005). For an initial public offering, foreign issuers need to be registered under the 1933 Act by using forms such as a F-1. See 17 C.F.R. § 239.31 (2005).

67. 15 U.S.C. § 78a (2005). Furthermore, Form 20-F is used as an initial registration statement under the Exchange Act, and as an annual report form for foreign private issuers in order to file their annual reports. See 17 C.F.R. § 249.220f (2005).

68. 17 C.F.R. § 210.1-01 (2005).

69. Concept Release, *supra* note 59, at 8899.

70. *Id.*

71. *Id.* The SEC has also made a number of accommodations for foreign issuers. These include "no requirement that quarterly reports be filed; offerings document financial statements updated on a semi-annual, rather than quarterly, basis; exemption

significant.⁷² Consequently, many foreign issuers refuse to list in the U.S. because of the reconciliation requirement.⁷³ As a result, convergence is not achieved.

One possible reason for the U.S.' reluctance to converge could be the SEC's perception that U.S. GAAP remains the best accounting standard for investor protection. This, however, may no longer be true.

III. U.S. GAAP SHOULD NOT BE A ROADBLOCK FOR THE SEC TO ADOPT IFRS

Although SEC Chief Accountant Nicolaisen set a timetable regarding IFRS approval, some commentators believe the SEC will never adopt IFRS because the SEC believes that U.S. GAAP is the world's "golden standard."⁷⁴ Moreover, the SEC may use the rigor of U.S. GAAP, not as the baseline to judge the acceptability of IFRS,⁷⁵ but rather to ensure that IFRS will always be found wanting.

The SEC would be misguided if they refuse to adopt IFRS based on the fictional superiority of U.S. GAAP. U.S. GAAP has increasingly come under fire for its shortcomings. First, U.S. GAAP's rigorous accounting standards have failed to prevent widespread accounting scandals.⁷⁶ Second, American securities exchanges have, as a result, suffered economic losses from a decline in foreign issuer listings because the SEC continues to require reconciliation to U.S. GAAP.⁷⁷

from the proxy rules; and aggregate executive compensation disclosure. Harder, *supra* note 37, at 358.

72. Sherbet, *supra* note 57, at 876.

73. *Id.* at 875. See also James A. Fanto & Roberta S. Karmel, *A Report on the Attitudes of Foreign Companies Regarding a U.S. Listing*, 3 STAN. J.L. BUS. & FIN. 51, 66 (1997) (finding that 51 percent of foreign issuers feel that the reconciliation required with U.S. GAAP is too costly and time consuming.) The professors note that U.S. GAAP alone is not the only reason why foreign issuers don't list their securities. U.S. GAAP is just one of many reasons why foreign issues don't list. *Id.* at 66-67. Cf. Pat McConnell, *Practical Company Experience in Entering U.S. Markets: Significant Issues and Hurdles from the Advisor's Perspective*, 17 FORDHAM INT'L L.J. 120, 122-24 (1994) (arguing that when a foreign issuer appreciates the strengths of U.S. GAAP that they do not feel the reconciliation requirement as a disadvantage).

74. Brunner, *supra* note 30, at 913.

75. Cox, *supra* note 9, at 1228.

76. See *infra* Part III.A.1.

77. See *infra* Part III.B.

A. U.S. GAAP Has Not Enhanced Investor Protection

Formerly, there were fundamental reasons why the SEC wanted to preserve U.S. GAAP for foreign issuers. U.S. accounting standards have been different from the rest of the world because U.S. securities markets have been historically and materially different.⁷⁸ Because American disclosure requirements before the Great Depression failed, the U.S. has since operated under a rigorous securities disclosure regime.⁷⁹ Today, the U.S. continues to tout U.S. GAAP's rigorous line item accounting standards as the world's "most complete and well developed."⁸⁰

It has been argued that any foreign accounting standard that does not measure up to U.S. GAAP's rigorous line-item disclosure standards may run afoul of accounting fraud or irregularities.⁸¹ This problem occurred during the 1993 Daimler-Benz listing on the New York Stock Exchange.⁸² Additionally, more Americans than ever before are invested in the stock market.⁸³ As a result, any accounting system must have American investor confidence in mind.⁸⁴ The American public demands a "gold accounting standard" to protect their investments. Moreover, one of the SEC's key missions is to provide for investor protection.⁸⁵

78. Irina Shirinyan, *The Perspective of U.S. Securities Disclosure and the Process of Globalization*, 2 DEPAUL BUS. & COM. L.J. 515, 553 (2004).

79. The SEC has maintained the efficiency and integrity of the American securities markets through full and fair disclosure. 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). The SEC repeatedly emphasized the goal of maximizing market integrity and investor protection by increasing disclosure requirements. *Id.* at 308. As Justice Brandeis has said, "sunlight is the best of disinfectants." LOUIS BRANDEIS, *OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT* 92 (National Home Library Foundation ed. 1933).

80. See U.S. Sec. & Exch. Comm'n, Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System, <http://www.sec.gov/news/studies/principlesbasedstand.htm> [hereinafter Principles-Based Study].

81. See Sherbet, *supra* note 57, at 881-86.

82. *Id.*

83. Harvey L. Pitt, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the September Symposium on Corporate Governance and Accounting Reform (Sept. 20, 2002), available at <http://www.sec.gov/news/speech/spch584.htm> ("Investing in the stock market today isn't a luxury, or a preoccupation of the idle rich; it's a necessity for all of us, and that's why a majority of Americans are now invested in our stock markets.").

84. Concept Release, *supra* note 59, at 8897.

85. Nicolaisen, *supra* note 10, at 666.

Even if American investors cannot understand the technical nuances of U.S. GAAP, they can still depend on financial analysts to become aware of every intricacy of a corporation through the U.S. GAAP's rigorous line-item details. If a financial analyst finds a problem within the company's financial statements, the analysts' employer, an investment bank or institutional investor, would start to sell off their holdings in that company. Consequently, the company's stock price declines.

When the average investor notices the company's declining stock price, they conclude that the company has a problem. Without U.S. GAAP, research analysts are hard-pressed to make their investment decisions without the prodigious amount of information they can get from financial statements prepared with U.S. GAAP. However, relying on U.S. GAAP's rigorous line item disclosures can create a false sense of security. U.S. GAAP might disclose a lot of information, but the quality of U.S. GAAP's disclosures raises a serious red flag. This situation is evidenced by U.S. GAAP's failure to prevent the systematic accounting scandals of a few years ago.

1. U.S. GAAP Failed to Prevent Serious and Widespread Financial Scandals

A key for investor protection is whether an accounting standard can prevent widespread accounting fraud. As a result of recent accounting scandals,⁸⁶ U.S. GAAP has come under increased scrutiny because it may have directly caused the scandals.⁸⁷ U.S. GAAP allowed accountants to practice "regulatory arbitrage."⁸⁸ Regulatory arbitrage is the practice of structuring an inappropriate transaction that still fulfills U.S. GAAP disclosure requirements.⁸⁹ For instance, accountants during the Enron period used regulatory arbitrage to manipulate their client's financial statements to comply with the letter but not the intent of the law.⁹⁰

Looking at the Enron scandal, it is clear that U.S. GAAP rules pertaining to Special Purpose Entities ("SPEs") were poorly drafted.⁹¹ Enron was able to materially overstate its earnings by

86. Tweedie & Seidenstein, *supra* note 33, at 589.

87. William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents*, 48 VILL. L. REV. 1023, 1045 (2003).

88. *Id.* at 1044.

89. *Id.*

90. *Id.* at 1041.

91. *Id.*

not being required to consolidate the earnings results of its SPEs with its own results.⁹² To add insult to injury, FASB went out of its way to bless these SPEs.⁹³

Some commentators argue that U.S. GAAP should not be blamed for Enron-type debacles because companies like Enron broke the law.⁹⁴ Whether companies that practiced regulatory arbitrage such as Enron were at fault however is beside the point: the fact remains that if U.S. GAAP holds itself out to be the world's gold standard, U.S. GAAP has the onus to prevent, as best as it can, any accounting manipulation.⁹⁵

Yet U.S. GAAP failed to prevent Enron accountants from "cooking the books," and allowed the whole accounting industry to become noncompliant.⁹⁶ GAAP does not require financial statements to reflect the best, or even particularly good, accounting.⁹⁷ Only minimum thresholds of acceptable accounting are actually required.⁹⁸

Recently, important regulatory officials have picked up on the fallacies of U.S. GAAP. Former SEC Commissioner Harvey Pitt alluded to the shortcomings of U.S. GAAP.⁹⁹ Congress also has questioned U.S. GAAP by looking to change the U.S. accounting system with their request that the SEC produce a study on the feasibility of a principles-based accounting system.¹⁰⁰

92. *Id.* at 1040.

93. George Mundstock, *The Trouble with FASB*, 28 N.C. J. INT'L L. & COM. REG. 813, 836 (2003).

94. The problem, these commentators agree, was that Enron did not follow the accounting rules. Bratton, *supra* note 87, at 1041. Enron failed to follow three distinct rules promulgated by FASB. First, under FAS No. 140, Enron would have needed to consolidate the SPEs "LJM I" and "LJM II" due to violating the three percent rule. *Id.* Second, Enron violated FAS No. 57 by contracts between Enron and the LJM SPEs, which were "related party transactions." *Id.* at 1042. Third, Enron violated FAS No. 5 by not reporting a loss contingency because it wanted to retain its credit rating. *See id.* at 1042-43. Alternatively, some commentators point to special financial relationships that external auditors maintained with their clients as the root cause of recent accounting scandals. *Id.* at 1030-31. Some of these special relationships included providing consulting services for financial statements that these auditors would later audit. *Id.* at 1031.

95. *Id.* at 1041.

96. *See* Mundstock, *supra* note 93, at 815-16.

97. *Id.* at 816.

98. *Id.*

99. "Today, disclosures are made not to inform, but to avoid liability. We need to move to a system of "current" disclosure. The present system, which has been in effect for 67 years, doesn't provide for 'current disclosure.' Financial disclosures are dense, impenetrable." Harvey L. Pitt, Chairman, U.S. Sec. & Exch. Comm'n, Regulation of the Accounting Profession (Jan. 17, 2002), <http://www.sec.gov/news/speech/spch535.htm>.

100. Principles-Based Study, *supra* note 80.

In that study, the SEC examined U.S. GAAP's rule-based accounting system. The SEC found three major shortcomings with U.S. GAAP.¹⁰¹ The shortcomings were:

[n]umerous bright-line tests, which ultimately can be misused by financial engineers as a roadmap to comply with the letter but not the spirit of the standards;

[n]umerous exceptions to the principles purportedly underlying the standards, resulting in inconsistencies in accounting treatment of transactions and events with similar economic substance; and

[a] need and demand for voluminously detailed implementation guidance on the application of the standards, creating complexity¹⁰² in and uncertainty about the application of the standard.

Clearly, one may reasonably conclude that U.S. GAAP hindered those who needed disclosure, such as the individual investor, and helped those who wished to manipulate their financial disclosures, such as Enron. While some commentators note that complex accounting standards are no different than rules in other areas of the law,¹⁰³ the SEC concluded that change is necessary.¹⁰⁴

The SEC found that the U.S. should move towards a principles-based over a rules-based accounting system.¹⁰⁵ The SEC, however, noted that principles-based accounting does not mean principles-only accounting, where there would be overly general principles with little-to-no guidance.¹⁰⁶ The SEC concluded that the

101. *Id.*

102. *Id.*

103. One commentator stated that there is a general trend throughout business law that formally short and general statements become overly complicated rules. Bratton, *supra* note 87, at 1050. For example, simple principles in the Old Uniform Partnership Act evolved into complex rules with the Revised Uniform Partnership Act. *Id.* In the case of accounting, technical rules may be required. U.S. GAAP governs homogeneous, recurring accounting situation where accountants need clear instructions of how to apply accounting rules to specific fact patterns. *Id.* at 1049. Additionally, a rule-based accounting system is more conducive to having an organization like FASB give interpretations of technical and specific issues. *Id.* at 1051-52.

104. Principles-Based Study, *supra* note 80.

105. *Id.*

106. [A] principles-only approach (which some have suggested as the meaning of the terms principle-based accounting standards) typically provides insufficient guidance to make the standards reliably operational. As a consequence, principles-only standards require preparers and auditors to exercise significant judgment in applying overly-broad standards to more specific transactions and events, and often do not provide a sufficient structure to frame the judgment

optimal accounting system lay somewhere between overly complex rules and overly general principles, which the SEC called an “objective-oriented” accounting system.¹⁰⁷ The approach would have an appropriate level of specificity with few exceptions, along with an appropriate amount of implementation guidance.¹⁰⁸

2. IFRS Surpasses U.S. GAAP as an Enforcement Tool to Prevent Accounting Fraud

Another key to investor protection is whether an accounting standard can be effectively used as an enforcement tool to counteract accounting fraud. Originally, U.S. GAAP provided some advantages in the area of securities enforcement. Because U.S. GAAP is rules-based, explicit accounting rules made it easier for accountants and auditors¹⁰⁹ to say no to possible underhanded

that must be made. The result of principles-only standards can be a significant loss of comparability among reporting entities. Furthermore, under a principles-only standard setting regime, the increased reliance on the capabilities and judgment of preparers and auditors could increase the likelihood of retrospective disagreements on accounting treatments. In turn, this could result in an increase for both companies and auditors in litigation with both regulators and the plaintiffs' bar.

Id.

107. *See infra* note 108.

108. In our minds, an optimal standard involves a concise statement of substantive accounting principle where the accounting objective has been included at an appropriate level of specificity as an integral part of the standards and where few, if any, exceptions or conceptual inconsistencies are included in the standards. Further, such a standard should provide an appropriate amount of implementation guidance give the nature of the class of transactions or events and should be devoid of bright-line tests. Finally, such a standard should be consistent with, and derive from, a coherent conceptual framework of financial reporting.

Principles-Based Study, *supra* note 80. Both U.S. GAAP and IFRS did not fit this optimal model. U.S. GAAP had some sections similar to principles. *Id.* Such examples include use of an asset/liability view of SFAS No. 141, which requires recognition of all assets and liabilities acquired in the business combination. *Id.* Likewise, there is an absence of bright line rules in SFAS No. 142, which contain no maximum amortization period for intangible assets. *Id.* Still, the SEC felt there were many provisions within U.S. GAAP that were overly rule-based. *Id.* Bright line U.S. GAAP provisions include consolidation, pensions and postretirement benefits, and accounting for income taxes. *Id.* Interesting, the SEC did not consider IFRS to be a principles-based accounting system. *Id.* The individual IFRS provisions were either overly rule-based or overly principle-only based. *Id.* Accordingly, one could question whether the SEC would want to give any credence to IFRS.

109. In the U.S., auditors examine financial statements with supplemental regulators such as the SEC. Bratton, *supra* note 87, at 1029-30. Outside the U.S., external auditors are usually the sole agents to secure compliance with accounting standards. Zeff, *supra* note 16, at 881.

accounting.¹¹⁰ Securities enforcement agencies like the SEC or the Department of Justice also benefited from having precise rules when preparing their securities fraud cases.¹¹¹

While U.S. GAAP has a long history of technical interpretation that can aid in applying technical standards, principles, on the other hand, are applied flexibly, giving managers and auditors a wide selection of accounting treatments.¹¹² Thus, using principles could lead to a loss of transparency within a company's financial statements¹¹³ and lead to a decreased level of reporting detail.¹¹⁴

Nevertheless, IFRS would still fulfill the advantages that accountants, auditors, and securities enforcement agencies have come to expect from U.S. GAAP. Principles-based accounting standards allows companies with "good stories to tell" to disclose their financial information in a clear and transparent manner.¹¹⁵ Under current standards, issuers using U.S. GAAP are allowed to disclose the bare minimum required by the line-item disclosure system.¹¹⁶ However, with IFRS, if the whole company's financial picture seems inaccurate, accountants and auditors could refuse to sign off on those financial statements.

Additionally, accounting precedent would be unnecessary in a principles-based accounting system because each company's financial statement would be different. Having explicit rules and precedent could also constrain companies from disclosing their full financial picture. While prosecutors cannot point to a specific rule *per se*, if the issuer's financial statements show intent for a lack of compliance, they may bring an enforcement action. Securities enforcement agencies then will be able to cast a wider net in a principles-based accounting system by capturing many more companies who are committing fraud intentionally, complying only with the letter of the law.

110. See Bratton, *supra* note 87, at 1049-50.

111. Both agencies would want to point to a violation of a specific rule to establish their case. Defendants under a principle-based system can make any number of arguments that their accounting was in good faith. Further, defendants can argue that they did not violate an established rule. Building a case on a violation of a "gut-check" seems to be very tenuous.

112. Bratton, *supra* note 87, at 1047.

113. *Id.*

114. *Id.*

115. Principles-Based Study, *supra* note 80.

116. See Bratton, *supra* note 87, at 1041-45.

Still, the possibility remains that accountants and companies would find violating principles to be just as easy (or easier) than violating the line-item standards of U.S. GAAP. To counteract putative accounting violations, the SEC has suggested two gatekeepers that could step up and prevent such accounting fraud.¹¹⁷ The first gatekeeper is the independent auditor and the audit committee.¹¹⁸ The second gatekeeper would be the enforcement agencies such as the Department of Justice and the SEC.¹¹⁹

Unlike accounting conduct before the Enron scandal, these two gatekeepers would need to be diligent in their duties.¹²⁰ Moreover, the SEC has stated that it will no longer be timid in holding auditors or audit committees responsible.¹²¹ These two gatekeepers, by being in the front lines of securities enforcement, will predominately be the ones to stop accounting fraud. Because these actors are embedded inside the corporation, they are better able to circumvent any potential underhanded accounting.

B. U.S. GAAP Has Hindered The U.S. Securities Markets' Competitive Advantage

Our world, unlike any other time in history, has become globally integrated. Global corporations increasingly cross-list their securities in foreign securities markets.¹²² Of all the world's markets, many foreign issuers initially consider listing in the U.S.¹²³ The U.S. has the most efficient capital markets in the world.¹²⁴ No other market allows an issuer to gain access to more investable capital at a lower cost.¹²⁵ Foreign issuers who list in the U.S. receive advantages of increased market value and greater access to the

117. Principles-Based Study, *supra* note 80.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. Concept Release, *supra* note 59, at 8896. See also Cox, *supra* note 9, at 1219. Professor Cox states that companies seek a secondary listing in a foreign securities market for the ability to gain access to a broader pool of investors and sources of capital. *Id.* Moreover, by having a secondary listing, a foreign company insulates itself from the market risks that may affect their domestic markets. *Id.*

123. See Sherbet, *supra* note 57, at 875.

124. *Id.* See also Tweedie & Seidenstein, *supra* note 33, at 594 (finding 46 percent of the world's market capitalization in 2003 was in the U.S.).

125. Cox, *supra* note 9, at 1219.

U.S. consumer markets.¹²⁶ Still, only when the benefits of listing on a U.S. securities exchange outweigh its costs will foreign issuers choose to list their securities.

America's financial markets no longer operate in a vacuum. What was once U.S. hegemony in terms of dominating the world's capital markets is now being successfully challenged. U.S. stock exchanges such as the New York Stock Exchange ("NYSE"), the American Stock Exchange¹²⁷ and NASDAQ all compete internationally for listings. While no foreign stock exchange equals the combined volume of the U.S. exchanges,¹²⁸ American stock exchanges have been facing significant competition.¹²⁹

Foreign issuers once limited to the U.S. securities market to find adequate capital now have more options.¹³⁰ Global exchanges such as the London Stock Exchange ("LSE"), the Nikkei and the Euronext¹³¹ have become alternatives to U.S. stock exchanges.¹³² Americans have expressed fear that because of U.S. GAAP, U.S. security exchanges may not be able to adequately compete with the European exchanges.¹³³ If U.S. GAAP remains, their fear may be realized.

In 2000, the NYSE had a total of 434 foreign companies listed on its exchange with sixty new listings.¹³⁴ From 2000, there has been a gradual decline in the number of new listings on the NYSE.

126. Companies that do engage in a secondary listing will experience, at least early on, an increase in the market value of their securities. *Id.* at 1217. Besides the capital raising benefits, foreign issuers receive many more benefits by just being listed in the U.S. *See id.* at 1217-23. Listing in the U.S. can help a foreign company expedite their consumer's products entry into the U.S. market. *See id.* at 1220. Companies also seek entry into the U.S. markets for specific business reasons, industry-specific reasons, and to expand their U.S. shareholder base. Fanto & Karmel, *supra* note 73, at 63.

127. *Cf.* Harder, *supra* note 37, at 374 ("The world's securities markets operate in a competitive environment whereby each country competes for a company's listing.").

128. NOBES & PARKER, *supra* note 17, at 7 (finding that in 2003 the combined foreign listings on both the NYSE and NASDAQ were 843).

129. *See infra* notes 128-130 and accompanying text.

130. *Cf.* Harder, *supra* note 37, at 375 (stating that currently only the U.S., U.K., and to a more limited extent Germany have the financial infrastructure in place to provide relatively low cost of capital and can compete for multinational listings).

131. Euronext is the merger of the Amsterdam, Brussels, Paris, LIFFE (London International Financial Futures and Options Exchange) and Portuguese stock exchanges. *See* Euronext, Euronext History, <http://www.euronext.com> (last visited Mar. 14, 2006).

132. *See id.*

133. *See* Richard C. Breeden, *Foreign Companies and U.S. Securities Markets in a Time of Economic Transformation*, 17 *FORDHAM INT'L L.J.* 77, 77, 83 (1994).

134. New York Stock Exch., Non-U.S. Additions and Removals 2000, <http://www.nyse.com/pdfs/00foradds040224.pdf> (last visited Mar. 6, 2006).

There were fifty-one new listings in 2001,¹³⁵ thirty-three new listings in 2002,¹³⁶ sixteen new listings in 2003,¹³⁷ twenty new listings in 2004,¹³⁸ nineteen new listings in 2005,¹³⁹ and only four new listings so far in 2006.¹⁴⁰

Foreign competition for new listings may not be the only reason for the decline the NYSE has experienced. There has been a worldwide recession that started in 2000, and later exacerbated by the September 11, 2001 terrorist attacks.¹⁴¹ Still, from 2000 to 2005, the total number of foreign issuers listed on the NYSE increased only from 434 to 450.¹⁴² Additionally, there has actually been a decline in the number of new foreign listings from 2002-2005, when there was a reported worldwide economic recovery.¹⁴³

However, while there has been a decline of foreign listings on the NYSE, the LSE has not been experiencing the same trend.¹⁴⁴ As of January 31, 2005, there were 469 foreign companies from fifty-seven countries listed on the LSE.¹⁴⁵ While NYSE and NASDAQ both had slight declines in the number of listings from 2005 to 2006, the LSE has had over an 8 percent increase in the number of listings.¹⁴⁶ One of the marketing ploys that the LSE has

135. New York Stock Exch., Non-U.S. Additions and Removals 2001, <http://www.nyse.com/pdfs/01foradds030113.pdf> (last visited Mar. 16, 2006).

136. New York Stock Exch., Non-U.S. Additions and Removals 2002, <http://www.nyse.com/pdfs/02foradds030113.pdf> (last visited Mar. 16, 2006).

137. New York Stock Exch., Non-U.S. Additions and Removals 2003, <http://www.nyse.com/pdfs/foradds031231.pdf> (last visited Mar. 16, 2006).

138. New York Stock Exch., Non-U.S. Additions and Removals 2004, <http://www.nyse.com/pdfs/foradds041228.pdf> (last visited Mar. 16, 2006).

139. New York Stock Exch., Non-U.S. Additions and Removals 2005, http://www.nyse.com/pdfs/05foradds_1230.pdf (last visited Aug. 1, 2006).

140. New York Stock Exch., Non-U.S. Additions and Removals 2006, http://www.nyse.com/pdfs/foradds_030206.pdf (last visited Aug. 1, 2006).

141. See Early 2000s recession, available at http://en.wikipedia.org/wiki/2001_recession (last visited July 22, 2006).

142. The number of foreign issuers listed on the NYSE was 462 in 2001, 473 in 2002, 467 in 2003, 460 in 2004 and 450 so far in 2005. See *supra* notes 134-140.

143. *Id.*

144. Jim Saxton, *Greenspan Always on the Money*, PHILADELPHIA INQUIRER, Feb. 21, 2006, at B02.

145. See *Non-U.K. Companies Listed on the London Stock Exchange*, IAS PLUS (Deloitte Touche Tohmatsu), Jul. 2005, available at <http://www.iasplus.com/stats/lonintl.pdf> (last visited Mar. 16, 2006).

146. See *Equity, Number of Listed Companies*, IAS PLUS (Deloitte Touche Tohmatsu), <http://www.iasplus.com/stats/wfeintl.pdf> (last visited Aug. 1, 2006). In 2005-2006, the NYSE had a 1.4 percent decrease, while the LSE saw an 8.4 percent increase in the number of listings. *Id.*

been using is the high cost of complying with U.S. securities regulations.¹⁴⁷

It can be surmised that Sarbanes-Oxley Rule 404,¹⁴⁸ coupled with the reconciliation requirement to U.S. GAAP, are the main culprits behind foreign issuers' refusal to list their securities in the U.S. In fact, the SEC held a conference for the purpose of looking into SOX 404's high cost of compliance.¹⁴⁹ The SEC should be just as quick to react to the problems posed by the reconciliation requirement. The negative listing trend of the NYSE could easily be reversed, but the SEC should expedite its implementation of IFRS.¹⁵⁰

Because of these two problematic situations, the SEC must critically look at whether IFRS should be adopted. The SEC's intention behind the reconciliation requirement was not to provide heightened disclosure, but rather to provide American investors with all the high-quality information they may need to make an investment decision.¹⁵¹ But as we have seen, U.S. GAAP's rigorous disclosure standards do not advance investor protection. Moreover, continued reliance on U.S. GAAP may continue to frustrate foreign issuers so that they refuse to list their securities in the U.S. The U.S. financial markets may not be able to afford having the approval of IFRS postponed until 2009. The SEC, as the next section shows, is in a position to adopt IFRS now.

147. Romano, *supra* note 65, at 2419 ("Other data suggestive of the costliness of reconciliation are that the London Stock Exchange lists five times the number of foreign firms that the NYSE lists.").

148. Section 404 of the Sarbanes-Oxley Act requires "companies that file annual reports with the [United States Securities and Exchange] Commission to report on management's responsibilities to establish and maintain adequate internal control over the company's financial reporting process, as well as management's assessment of the effectiveness of those internal controls. Section 404 and the Public Company Accounting Oversight Board require the accounting firm that audits the company's financial statements to report on management's assessment, as well as on the effectiveness of the company's controls." Press Release, U.S. Sec. & Exch. Comm'n, Commission Seeks Feedback and Announces Date of Roundtable on Implementation of Sarbanes-Oxley Internal Control Provisions (Feb. 22, 2005), <http://www.sec.gov/news/press/2005-20.htm>.

149. *See id.*

150. *See* Isaac C. Hunt, Jr., *It's a Small World After All: The SEC's Role in Securities Regulation Globalization*, 51 ADMIN. L. REV. 1105, 1114 (1999) ("Richard Grasso, [former] chairman of the New York Stock Exchange (NYSE), reportedly predicted a twenty percent increase in the NYSE's capitalization if the United States accepts international accounting standards.")

151. Concept Release, *supra* note 59, at 8899.

IV. WHY IFRS CAN AND SHOULD BE ADOPTED BY THE SEC

For some, adopting IFRS may look like revolutionary change. U.S. GAAP has been the primary accounting standard for generations.¹⁵² American accountants are already comfortable with U.S. GAAP.¹⁵³ They can use their specialized knowledge of the line-item rules to charge high fees or to create different accounting products for their clients. The SEC may want to retain U.S. GAAP because they would have more control over those standards than IFRS.

Yet, irrespective of these interest groups' rationales, IFRS can and should currently be adopted in the U.S. First, the U.S. has already adopted uniform textual disclosure for financial statements.¹⁵⁴ Second, the actual differences between U.S. GAAP and IFRS have been fundamentally reduced.¹⁵⁵ Finally, IFRS has fulfilled all the requirements laid out by the SEC in order to be adopted.¹⁵⁶

A. There Is Prior Precedent For Adopting A Uniform Global Disclosure Standard

Adopting a uniform international accounting standard should not, however, be regarded as a revolutionary change for the U.S. There has already been international convergence of the textual disclosures within U.S. financial statements. In 2000, the U.S., along with many other countries¹⁵⁷ adopted the International Disclosure Standards ("IDS").¹⁵⁸ The IDS standards were promulgated by IOSCO to develop a generally accepted body of

152. See Ethiopis Tafara, Dir., Office of Int'l Affairs, U.S. Sec. & Exch. Comm'n, Remarks before the Federation of European Accountants: International Financial Reporting Standards and the US Capital Market (Dec. 1, 2005), <http://www.sec.gov/news/speech/spch120105et.htm>.

153. See Harder, *supra* note 37, at 375 (stating that all participants including financial professionals will have to learn new sets of rules that may carry significant costs, but these costs may be seen as an investment that will result in the benefits of increased comparability between domestic and foreign issuers).

154. See Part IV.A.

155. See Part IV.B.

156. See Part IV.C.

157. See Samuel Wolff, *Implementation of International Disclosure Standards*, 22 U. PA. J. INT'L ECON. L. 91, 91, 95-104 (2001) (listing nations such as Argentina, Australia, Germany, Singapore, Switzerland and the U.K.).

158. See International Disclosure Standards Securities Release No. 33-7745, 64 Fed. Reg. 53900 (Sept. 30, 2000) [hereinafter IDS Release]. IOSCO encouraged its members to take whatever steps were necessary to implement IDS. See *id.* at 53901.

non-financial disclosure standards used by foreign issuers in cross-border listings.¹⁵⁹

In the U.S., IDS provisions were included in the revised Form 20-F.¹⁶⁰ However, the SEC still included additional textual disclosure for such information as quantitative and qualitative disclosures about market risk.¹⁶¹ Still, the intent for adopting IDS was to reduce barriers for cross-border offerings and listings in the U.S.¹⁶² The U.S. must have felt that the textual disclosures afforded in IDS were sufficient to protect shareholders. The adoption of IDS should have set the stage for adopting IFRS. Some of the comments in letters received by the SEC for the IDS release stated that adopting international accounting standards is more important than adopting IDS.¹⁶³ The reasoning in those letters was, if the SEC could adopt IDS, why not IFRS?

Clearly there are logical inconsistencies for disclosure documents to include IDS but not IFRS. First of all, it would seem that the SEC's intention to reduce the burdens of cross-listing securities by having uniform textual disclosure would be mitigated by retaining the U.S. GAAP reconciliation requirement for financial disclosure. Secondly, the resulting financial document will invariably have a somewhat chaotic mix of uniform textual disclosures and various other accounting disclosures.

But only by having uniform textual and financial disclosure can global corporations realize the full benefits of convergence.¹⁶⁴ Adopting just IDS and not IFRS hints of a SEC double standard. The U.S. adopted IDS only two years after IOSCO introduced the

159. Wolff, *supra* note 157, at 92.

160. IDS Release, *supra* note 158, at 53900.

161. *See id* at 53903.

162. *Id.* at 53900 ("Many of our initiatives for foreign issuers have had the goal of reducing barriers to cross-border offerings and listings in the United States, while preserving or enhancing existing investor protection.").

163. *Id.* at 53901.

164. There has been academic argument to create a Global Prospectus. *See* Geiger, *supra* note 40, at 1788-89, 1799-800. For non-global securities offerings and listings, this prospectus would include a textual descriptions of the issuer's business, management, securities, and the details of the offering. *Id.* at 1799. The financial statements would be prepared in accordance with IAS. *Id.* Multinational offerings would wrap-around the basic form, but would includes the "language" of each market in which the offering is conducted. *Id.* Each jurisdiction's national regulator would review the Global Prospectus. *Id.* But there would be a Global Coordinator who would monitor the implementation, interpretation and enforcement of the various national regulators. *Id.* at 1800.

standards.¹⁶⁵ The U.S. still has not reacted to IFRS despite IOSCO's endorsement of the standards in 2000.¹⁶⁶

B. Differences Between U.S. GAAP And IFRS Have Been Reduced Or Eliminated

One roadblock to achieving worldwide accounting standards has been the perceived difference between IFRS and U.S. GAAP.¹⁶⁷ After all, divergence in accounting standards may have come about because accounting regulations mirror those who they are meant to protect. America and Britain have dispersed shareholder ownership,¹⁶⁸ while other European countries have a more concentrated corporate ownership of blockholders.¹⁶⁹ The rigorous standards of U.S. GAAP developed in order to protect dispersed investors by disclosing all possible financial information to ensure corporate accountability.¹⁷⁰ Opaque European accounting standards developed because there were fewer minority shareholders, thus there was little need for a rigorous accounting system.¹⁷¹ Furthermore, financial reporting for European countries was developed to protect creditors, and for

165. See Wolff, *supra* note 157, at 91; IDS Release, *supra* note 158.

166. See RAMIN, *supra* note 19 and text.

167. *Id.* at 79 ("The most fundamental of obstacles to achieving harmony is the size of the present differences between the accounting practices of different countries.")

168. John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. Rev. 641, 641 (1999). A question remains whether Britain can be considered a part of the dispersed shareholder ownership model. See Manning Gilbert Warren III, *Global Harmonization of Securities Laws: The Achievements of the European Communities*, 31 HARV. INT'L L.J. 185, 194 (1990). Even as late as the 1980s, only three percent of the British public owned company shares. *Id.* The authors noted that Britain's securities markets had been influenced by the concentrated securities ownership model on the Continent. *Id.* Further, the author pointed out that in Britain there was a predominance of bank lending over securities offerings, and that the general public had an aversion to the risks of securities investments. *Id.*

169. See Coffee, *supra* note 168, at 642. This type of governance is also called the blockholder and/or cross-shareholder system. *Id.* This ownership model is common across both Europe and Asia. *Id.* The Continental model is the world's dominant shareholder ownership model. See *id.* at 641-42 n.2. The typical blockholder would be described as bank-centered capital markets of Germany and Japan. *Id.* at 643.

170. *Id.* at 643-44.

171. HARRY I. WOLK ET AL., ACCOUNTING THEORY: A CONCEPTUAL AND INSTITUTIONAL APPROACH 658 (1984). This is usually the case because Continental corporations want certain interest groups to have limited knowledge of the corporation. Some examples include keeping information from employees because management may not want to increase compensation.

governments to exercise their power as tax collectors and controllers of the economy.¹⁷²

Despite these backgrounds, many of the differences between the world's accounting standards have now been eliminated through the advent of IFRS. In the U.S., some of those who want to preserve U.S. GAAP may still argue there are significant differences remaining that warrant maintaining the status quo. However, this may no longer be true. Already, FASB and the IASB are working to reduce the differences between IFRS and U.S. GAAP.¹⁷³ More importantly, many of the differences that once existed between IFRS and U.S. GAAP have been eliminated.¹⁷⁴

In 2002, a major effort to reduce the differences between U.S. GAAP and IFRS began with the Norwalk Agreement entered into by the FASB and the IASB.¹⁷⁵ Both the FASB and the IASB agreed to work together to make their respective accounting standards compatible as soon as possible.¹⁷⁶ To do this, the IASB and FASB have been conducting "joint projects"¹⁷⁷ to reduce differences with such issues as revenue recognition,¹⁷⁸ business combinations,¹⁷⁹ and to also build a common conceptual

172. NOBES & PARKER, *supra* note 17, at 23.

173. See *infra* notes 175-182 and accompanying text.

174. See Robert H. Herz & Kimberley R. Petrone, *International Convergence of Accounting Standards – Perspectives from the FASB on Challenges and Opportunities*, 25 NW. J. INT'L L. & BUS. 631, 651-52 (2005).

175. See *id.* at 642-43. The Norwalk Agreement was recently reaffirmed by the IASB. See Press Release, International Accounting Standards Board, US FASB and IASB reaffirm commitment to enhance consistency, comparability and efficiency in global capital markets (Feb. 27, 2006) (noting a new memorandum of understanding between the IASB and the FASB).

176. *Id.*

177. See Convergence with the International Accounting Standards Board (IASB), Financial Accounting Standards Board, http://www.fasb.org/intl/convergence_iasb.shtml (last visited Mar. 27, 2005).

178. The concept of revenue recognition is fundamental to accounting. See Project Updates: Revenue Recognition, Financial Accounting Standards Board, http://www.fasb.org/project/revenue_recognition.shtml (last visited Feb. 6, 2006). As a result, both Boards are currently working on a revenue recognition joint project. *Id.* The project's objective is to develop a comprehensive statement on revenue recognition that is conceptually based, and framed in terms of principles. *Id.* Both Boards have agreed on working criteria of when to recognize revenue. *Id.* Further, the Boards have tentatively agreed on such matters as a definition of revenue, issues relating to contractual rights and obligations, and the fair value of assets and liabilities. *Id.*

179. See Project Updates Business Combinations, Financial Accounting Standards Board, http://www.fasb.org/project/bc_purchmethod.shtml. (last visited Feb. 6, 2006). This is the second phase of the convergence of IFRS and U.S. GAAP's treatment of mergers

framework between IFRS and U.S. GAAP.¹⁸⁰ To deal with the individual differences between the two accounting standards that may be more easily reconciled, both boards have agreed to work on short-term convergence projects.¹⁸¹ To facilitate convergence, both boards have representatives implanted in each other's organization.¹⁸²

Because of the hard work of the IASB and FASB, many of the accounting differences between IFRS and U.S. GAAP have been eliminated.¹⁸³ One example of such difference had been in the area of business combinations. Previously, there was a difference between IFRS and U.S. GAAP regarding when a corporation could engage in uniting of interest or pooling accounting for a merger or acquisition.¹⁸⁴ Now both IFRS and U.S. GAAP prohibit uniting of interests, and just allow the acquisition treatment.¹⁸⁵ Because of successes like this, the IASB and FASB have agreed to continue on working on more projects to reduce additional differences.¹⁸⁶

C. IFRS Has Fulfilled All The Mandates The SEC Has Required

and acquisitions. The objectives of the project are to revise the existing guidance related to the application of the purchase method of accounting to (1) improve the transparency of information provided to users of financial statements, (2) improve the internal consistency of the procedures and consistency of that guidance with the conceptual framework, and (3) promote the international convergence of accounting standards by working with the IASB. *See id.* The end result will be that both IFRS and U.S. GAAP will have similar standards for business combinations including that acquisitions be measured at fair value. *Id.*

180. *See* Project Updates Conceptual Framework, Financial Accounting Standards Board, http://www.fasb.org/project/conceptual_framework.shtml. (last visited Feb. 6, 2006); Press Release, International Accounting Standards Board, US FASB and IASB publish first draft chapters of joint conceptual framework (July 6, 2006) (announcing the publication of the first two chapters of the enhanced conceptual framework).

181. *See* Project Update Short Term International Convergence, Financial Accounting Standards Board, http://www.fasb.org/project/short-term_intl_convergence.shtml. (last visited Feb. 6, 2006). The current projects include, inventory costs, asset exchanges, accounting changes, earnings per share, and balance sheet classification. *Id.* Either board will see whether they can amend their standards, and if they cannot they will communicate to the other board the rationale. *See id.*

182. *See* Convergence with the IASB, *supra* note 177.

183. Herz & Petrone, *supra* note 174, at 651-52.

184. Brunner, *supra* note 30, at 926-28.

185. PricewaterhouseCoopers, *Similarities and Differences: A Comparison of IFRS and U.S. GAAP* 30, available at http://www.pwcglobal.com/gx/eng/about/svcs/corporatereporting/SandD_04.pdf (last visited Mar. 28, 2006).

186. Herz & Petrone, *supra* note 174, at 648-50 (resolving such differences in accounting treatment of income taxes along with research and development).

For Adoption

Initially, the SEC expressed reservations regarding why IFRS might not be developed enough to become an international accounting standard.¹⁸⁷ Still in 1996, the SEC laid out three requirements that it would use to judge whether IFRS could be considered for adoption for foreign issuers.¹⁸⁸ The three requirements were:

1. The standards should include a core set of accounting pronouncements that constitute a comprehensive, generally accepted basis of accounting.
2. The standards must be of high quality—they must result in comparability and transparency, and they must provide for full disclosures. Investors must be able to meaningfully analyze performance across time periods and among companies.
3. The standards must be rigorously interpreted and applied. If accounting standards are to satisfy the objective of having similar transactions and events accounted for in similar ways—whenever and wherever they are encountered—auditors and regulators around the world must insist on rigorous interpretation and application of those standards. Otherwise, the comparability and transparency that are the objectives of common standards will be eroded.¹⁸⁹

Since 1996, IFRS has undergone radical changes.¹⁹⁰ Arguably, if IFRS fulfilled all three of these requirements, it would be ripe for adoption by the SEC. In its concept release, the SEC made clear that these three standards would be the ones they would use to judge whether IFRS could and should be adopted.¹⁹¹ Now, IFRS arguably has met all three necessary requirements in order to be adopted.

1. IFRS Constitutes A Comprehensive Core Set Of Accounting Standards

First, the SEC looked at whether IFRS constituted a comprehensive body of accounting principles for enterprises

187. Report on Promoting Global Preeminence of American Securities markets, *supra* note 25.

188. *Id.*

189. *Id.* While these requirements were given nearly a decade ago, the SEC did reiterate in their IAS concept release these standards would be used to judge IFRS. Concept Release, *supra* note 59, at 8900.

190. See Tweedie & Seidenstein, *supra* note 33.

191. Concept release, *supra* note 59, at 8900.

undertaking cross-border offerings and listings.¹⁹² Toward this end, the IASB has been working on producing a core set of accounting standards for nearly a decade.¹⁹³ In 2000, the original core standards project obtained the approval of IOSCO.¹⁹⁴ Recently, the IASB revised many of its IAS and adopted new IFRS.¹⁹⁵ In all, there are six IFRS and forty-one IAS covering the full range of accounting topics from business combinations to agriculture.¹⁹⁶ It would seem that IFRS is now significantly comprehensive. Still, there is no way to know what the SEC meant by a “comprehensive” set of accounting standards.

Clearly, accounting standards setting is an ongoing process that is not locked to a specific point in time.¹⁹⁷ Thus, the E.U. and Australia would never have adopted IFRS if they were not comprehensive.¹⁹⁸ Moreover, the SEC has stated that the IASB has issued accounting standards that covered many major topical areas.¹⁹⁹ The FASB has twice compared U.S. GAAP to IFRS.²⁰⁰ If the IFRS were not comprehensive, a comparison between these two accounting standards would be impossible.²⁰¹

Corporate feedback would undoubtedly be important in ascertaining whether IFRS is comprehensive. One recent study shows that 61 percent as compared to 23 percent of European CFOs prefer IAS to their national GAAP.²⁰² By a smaller margin, 49 percent as compared to 23 percent of European CFOs prefer IAS to U.S. GAAP.²⁰³ This small window into the minds of European CFOs shows that at the very least IFRS and U.S. GAAP

192. See *supra* notes 44 through 45 and text.

193. See *supra* notes 28 through 31 and text.

194. See *supra* note 32 and text.

195. See *supra* note 33 and text.

196. See Summaries of International Financial Reporting Standards, <http://www.iasplus.com/standard/standard.htm> (visited Mar. 23, 2005).

197. Cox, *supra* note 9, at 1210.

198. *Id.*

199. First Time Application of International Financial Reporting Standards, Securities Act Release No. 33-8397, 69 Fed. Reg. 12904, 12905 n.13. (Mar. 11, 2004)

200. The IASC – U.S. Comparison Project: A Report on the Similarities and Differences Between IASC Standards and U.S. GAAP (Carrie Bloomer ed., 2d ed. 1999).

201. See PricewaterhouseCoopers, *supra* note 185, at 32-38 (discussing IFRS current rules for revenue recognition and expense recognition).

202. See PricewaterhouseCoopers, *International Accounting Standards in Europe, 2005 or Now?* 16 available at [http://www.pwc.com/extweb/onlineforms.nsf/\(aid\)/6D8D185AA6B11BF680256F95004B6F7C/\\$file/pwc_2005ReadyorNot.pdf](http://www.pwc.com/extweb/onlineforms.nsf/(aid)/6D8D185AA6B11BF680256F95004B6F7C/$file/pwc_2005ReadyorNot.pdf) (visited Mar. 17, 2005)

203. *Id.*

are on the same playing field. With the positive words of both the SEC and European CFOs, it is hard to conclude that IFRS still constitutes an incomplete accounting standard.

2. IFRS Is A High Quality Accounting Standard

Next, can we assume that if IFRS are comprehensive, that they are also of high quality?²⁰⁴ The IASB's Chairman, Sir David Tweedie, acknowledges the importance of high-quality accounting standards. Far from having "watered down" principles, Sir David Tweedie stated that IFRS would be a "single set of high quality global financial reporting standards" that would become nothing less than the "gold standard" for worldwide accounting.²⁰⁵ The IASB has stated it will not draft faulty or ineffective accounting provisions in order to ensure convergence.²⁰⁶

The SEC's attitude about IFRS' quality seems, in fact, to have changed. When the SEC wrote its report for the Market Improvement Act, the SEC noted that IAS still had some quality concerns.²⁰⁷ Since this report was written in 1997, the IASB has revamped IFRS through its "Improvements Project."²⁰⁸ The

204. The SEC uses the term "high quality" as a means to say how closely IFRS resemble U.S. GAAP. ROBERTS ET AL., *supra* note 14, at 137.

205. Sir David Tweedie, Chairman, Int'l Acct. Standards Bd., Statement Before the Committee of Banking, Housing and Urban Affairs, 107th Cong. (2002), <http://www.iasplus.com/ifric/ifricissues.htm> ("[N]o national standard setter is in a position to set accounting standards that can gain acceptance around the world.").

206. Statement of Paul A. Volcker, Chairman of the Trustees of the International Accounting Standards Committee, before the Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the U.S. House of Representatives, (June 7, 2001) *available at* http://www.iasb.org/uploaded_files/documents/8_128_060701vo.pdf (visited March 20, 2005).

207. Because the IASC standards tend to be less detailed and provide less explicit guidance than U.S. GAAP, some amount of additional guidance is likely to be needed. The issue is whether the additional interpretive issues are so significant that the core standards are not operational – either they cannot be rigorously interpreted and applied, or require such a volume of additional interpretive guidance that endorsement would not represent a significant improvement in the efficiency of cross border capital flows.

Report on Promoting Global Preeminence of American Securities markets, *supra* note 25.

208. The IASB Improvements project was central to IASB's strategy to raise the quality and consistency of IFRS financial reporting. The project was meant to address the concerns, questions and criticisms raised by securities regulators about IFRS. It removed a number of options continued in IAS that caused uncertainty and reduced comparability. Some commentators had reservations about IFRS optional treatment. The Improvements project was one step in a larger goal to have a platform of high quality, improved standards by March 2004. *See* Press Release, International Accounting Standards Board

Improvements Project has been part of a larger goal of improving the quality of standards by March 2004, ahead of the E.U. implementation of IFRS in 2005.²⁰⁹ The SEC reacted positively to both IASB's ability as an accounting standards setter, and the specific IFRS provisions.²¹⁰ Moreover, a member of the SEC's chief accountant's office has stated that the IFRS standards have reached a high-quality status.²¹¹

The remaining issues regarding adoption relate to whether IFRS can be consistently applied, can be transparent, and can provide full disclosure.²¹² The fact that IFRS is a principles-based accounting standard would seem to mitigate against having a consistent application for all companies. Yet in practice this does not have to be the case.

When preparing a financial statement based on principles-based standards, an accountant would take a step back and see if the financial statement represents the companies' total financial picture.²¹³ Every company's statement will be different. The SEC's study on principles-based accounting standards made clear that each company should look to its own companies' picture and not follow strict formulaic rules.²¹⁴ However, there very well might be many similarities between financial statements of companies within the same industry. A minimum standard of disclosure may develop, therefore, within that specific industry.

As for transparency and full disclosure, such standards suggest that an investor will see a clear and complete picture of the company.²¹⁵ An accounting system based on principles would appear, in the end, to encourage this type of accounting

Issues Wide-Ranging Improvements to Standards (Dec. 18, 2003) available at http://www.iasb.org/news/iasb.asp?showPageContent=no&xml=10_33_29_18122003.htm (visited Mar. 27, 2005).

209. *Id.*

210. "But now that it is clear that the IASB is capable of and committed to putting out high-quality standards, and has strong expertise, independence and due process, the SEC staff is moving on to consider other issues that might stand in the way of dropping the reconciliation [requirements]." Taub, *supra* note 11.

211. *Id.*

212. *Id.*

213. Bernhard Grossfeld, *Comparative Corporate Governance: Generally Accepted Accounting Principles v. International Accounting Standards?*, 28 N.C. J. INT'L L. & COMM. REG. 847, 861-62 (2003).

214. Principles-Based Study, *supra* note 80.

215. *Id.*

treatment—more so than utilizing strict line-item rule disclosures.²¹⁶

Finally, the SEC is on record as having criticized the numerous occasions of non-compliance with IFRS.²¹⁷ However, after recent accounting scandals involving U.S. GAAP, the SEC's argument no longer has much traction.

3. IFRS Can Be Rigorously Interpreted and Applied

Even if an accounting standard is comprehensive and of high quality, unless the standard is rigorously interpreted and applied, accounting standards will neither achieve comparability nor transparency.²¹⁸ All accounting standards need a sufficient level of implementation guidance.²¹⁹ The SEC, in 2000, was concerned the IASB provided less implementation guidance than U.S. GAAP.²²⁰

The SEC's criticisms appear unfounded, and may actually hurt rather than help to ensure that IFRS is interpreted appropriately. Even the SEC staff has recognized that having complex interpretation standards will not further the IFRS' goal of becoming a principles-based accounting standard.²²¹

It is a truism that "over-information kills information."²²² Currently, accounting interpretations under U.S. GAAP are problematic because of U.S. GAAP's four levels of hierarchy.²²³

216. *Id.*

217. Concept Release, *supra* note 59, at 8902.

218. One of the areas that the SEC will be looking at under the interpretation standard is the interpretative role of the standards-setter—in this case the IASB. *Id.* at 8902. The SEC is looking for consistent application and for the IASB to identify and address interpretative questions expediently. *Id.*

219. *Id.* at 8902.

220. When there is not as much implementation guidance, comparability can be achieved with principle-based standards through common interpretation and practice by companies and auditors. *Id.* However, the SEC noted an unfavorable experience with this type of approach when accounting standard setting was done by the Accounting Principles Board. *Id.* at n.30 and accompanying text.

221. "In addition, if the IASB is to maintain its policy of keeping its standard [at] a fairly high 'principles-based' level – with less detail than might be the norm under US GAAP, for example – it will be true that for some issues, the standard-setter will not provide guidance." Taub, *supra* note 11.

222. Grossfeld, *supra* note 213, at 853. ("The Generally Accepted Accounting Principles seem to have run out of control by frenzy for details and by paper overload. We are lost in papers.")

223. Category (a) consists of FASB statements of financial accounting standards and interpretations, accounting principles board opinion, and AICPA accounting research bulletins. CESR Questionnaire, *supra* note 62. Category (b) consists of FASB technical bulletins and, if cleared by FASB, AICPA industry audit and accounting guides and

Too much detailed guidance such as the former can hinder the professional judgment of the accountant.²²⁴ Moreover, professional judgment on the ground level is critical to the success of a principles-based accounting standard.²²⁵

Professional judgment, under a principles-based standard, involves producing financial statements that represent the company's overall economic reality.²²⁶ Investors want a complete picture of the company, and too much interpretative guidance would hinder this interest. The SEC noted that professional judgment cannot be substituted with a myriad of rules and interpretations.²²⁷

Thus, there is no one-size-fits-all accounting standard that can cover every conceivable transaction for every type of business. The IASB should not follow in the steps of the FASB by providing an excessive amount of guidance. The IASB has stated that it will not adopt detailed guidance because it "may obscure, rather than highlight, the underlying principle."²²⁸ Also, the SEC has concluded that adding layers of interpretation guidance may be unfruitful.²²⁹

AICPA statements of positions. *Id.* Category (c) consists of AICPA accounting standards executive committee ("AcSEC") practice bulletins that have been cleared by FASB, and consensus positions of FASB's emerging issues task force. *Id.* Category (d) includes AICPA accounting interpretations, FASB implementation guides, FASB staff positions, and practices that are widely recognized and prevalent either generally or in the industry. *Id.* If an accountant cannot find anything within the established accounting literature for the specific situation, SAS 69 allows the use of accounting literature. *Id.* (including such as FASB concepts statements, APB statements, AICPA issues papers, IFRS, governmental accounting standards, pronouncements of other professional associations or other accounting publications (textbooks, handbooks, and articles)).

224. Principles-Based Study, *supra* note 80.

225. *Id.*

226. *Id.*

227. There were three reasons why rules can never make up for professional judgment. *Id.* at 16. First, no standard setter could identify all possible business situations to which accounting standards could be applied. *Id.* Second, overly-specific accounting standards cannot foresee the company's specific knowledge. Too many rules and varying interpretations could prevent the disclosure of valuable information that would otherwise be disclosed when a company reports under a principles-based standard. *Id.* Third, no amount of rules or interpretations can eliminate professional judgment. *Id.*

228. Tweedie, *supra* note 205.

229. Regarding the [accounting] guidance itself, clearly, the standard setters, should provide *some* implementation guidance as a part of a newly issued standard. We believe, however, that the amount of detail provided by the standard setter under an objectives-oriented regime would likely be less than that provided under a rules-based regime. Otherwise, the guidance would quickly transform what could be an objectives-oriented regime back into a rules-based regime, with all the consequent disadvantages.

It is likely that companies would be more forthcoming under a principles-based accounting standard, and provide clearer and more transparent information to investors.²³⁰ Moreover, by having a less detailed accounting structure,²³¹ more people, including investors, could use the information.²³¹ By having just the right amount of interpretation guidance, the IASB will give accountants guidance on significant issues, yet allow them to exercise professional judgment over reporting the company's financial picture.

Even though widespread use of IFRS has just begun, the IASB, along with other audit firms, has designed IFRS training programs.²³² If the U.S. adopted IFRS, the Emerging Issues Task Force ("EITF") could give implementation guidance.²³³

V. ADOPTING IFRS WILL BRING NUMEROUS BENEFITS TO THE U.S. AND THE WORLD

The adoption of IFRS will be a political process.²³⁴ On the one hand, Mr. Nicolaisen's recent comments indicate that the SEC will adopt IFRS for foreign issuers by eliminating the reconciliation requirement. The SEC has begun making the transition to IFRS as easy as possible for foreign issuers.²³⁵ The SEC issued a rule adopting a new General Instruction G to Form 20-F, allowing a one-time accommodation for foreign issuers using IFRS.²³⁶

On the other hand, U.S. financial regulators may have reservations about adopting an alien accounting system such as IFRS for U.S. corporations. U.S. GAAP has been regulated by various American accounting organizations since 1936.²³⁷

Principles-Based Study, *supra* note 80 (emphasis in original).

230. EITF addresses certain implementation issues as they arise. The IASB Chairman noted that EITF would have to address far fewer issues in order for the principles-based accounting standards to turn into line-item rules. EITF would then have to reject the accounting profession requests to provide detailed guidance on various issues. *Id.*

231. *Id.*

232. Taub, *supra* note 11.

233. Principles-Based Study, *supra* note 80.

234. Cox, *supra* note 9, at 1245.

235. *Id.* at 1223.

236. First Time Application of International Financial Reporting Standards, Securities Act Release No. 33-8567, 70 Fed. Reg. 20674-75 (May 20, 2005). This accommodation allows foreign issuers using IFRS for the first time in 2005 to file two years rather than the required three years of statements of income, changes in shareholders' equity and cash flows preparation. *Id.* at 20675.

237. In 1936, the SEC delegated its accounting authority to the American Institute of Certified Public Accountants ("AICPA"). CESR Questionnaire, *supra* note 62. In 1971,

American regulators, such as the SEC and FASB, would be hard-pressed to give up any accounting standard they have created—especially one that they perceive to be the best accounting system in the world. Also, the SEC's accounting staff plays a significant role behind-the-scenes designing the accounting standards that are implemented by FASB²³⁸ such as placing matters on FASB's agenda, raising specific points to be addressed for a proposed standard, and setting parameters as to what a specific accounting provision should allow.²³⁹

However, since 1996, Congress has required the SEC to enhance its support for the development of international accounting standards.²⁴⁰ Aside from such congressional mandate, there are numerous reasons why the SEC should support adopting IFRS.

First, adopting a principles-based standard would show the U.S. wants an accounting policy that is investor-centered rather than accountant-centered. U.S. GAAP has created a system where business transactions have become more complex because of regulatory arbitrage.²⁴¹ With IFRS, principles will improve investors' access to information for making investment decisions.²⁴² IFRS will reduce the complexity of financial statements and enhance transparency. Thus, auditors will have an easier time probing, and can ask more germane questions about a company's accounting treatment.²⁴³ Financial statements will finally focus on the economic substance and reality of a company and its transactions, while closing loopholes that U.S. GAAP allowed.²⁴⁴

Moreover, continued reliance on U.S. GAAP perpetuates a false sense of security because Americans believe an abundance of rules will protect them.²⁴⁵ As has been shown, more rules do not equal more disclosure. Principles will provide better security for the American public because of their adaptability. A principle can be adopted more quickly when a new financial product comes on

AICPA delegated this authority to the FASB. *Id.* See also, 15 U.S.C. § 77s(a) (2005); 15 U.S.C. § 78m(b)(1) (2005).

238. Zeff, *supra* note 16, at 888.

239. *Id.*

240. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, § 509(4), 110 Stat. 3416, 3449 (1997).

241. Principles-Based Study, *supra* note 80.

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

the market than attempting to draft a complex rule de novo.²⁴⁶ Even if a principle has not been adopted, the conceptual framework of a principles-based accounting system creates an environment ensuring full disclosure of a company's total financial picture.²⁴⁷

Furthermore, there are a host of positive benefits if the U.S. would adopt IFRS for domestic issuers.²⁴⁸ First, investors can easily compare the financial statements of global companies using the same accounting standards.²⁴⁹ By having just one accounting standard, investors can compare companies' financial records regardless of whether they originate from Russia or the U.S.²⁵⁰ Since investors want to gain the maximum return on their investments, they will no longer need to limit their investment opportunities to one company or one country. Capital will be more accurately and efficiently allocated to those companies that deserve further investment.²⁵¹

Also, not all accounting standards are created equal. IFRS could have a more substantial impact for emerging countries and markets than any other accounting standard. IFRS is more likely to be adopted by emerging markets as an international accounting standard than a national accounting standard such as U.S. GAAP.²⁵² Developing countries with inadequate accounting standards could change to a more advanced global accounting

246. *Id.*

247. *Id.*

248. Sir David Tweedie quoted Bob Herz, former Chairman of FASB that the U.S. has a chance to "kill three birds with one stone." This would include "improving U.S. reporting, simplifying U.S. standards and standard setting, and offering U.S. market participation the benefits of international convergence." *Statement of Sir David Tweedie, Chairman, International Accounting Standards Board, Before the S. Comm. of Banking, Housing and Urban Affairs*, 108th Cong. 4 (2004), available at http://www.iasb.org/uploaded_files/documents/8_129_040909-dpt.pdf. Also, if a domestic issuer prepares a financial statement with two accounting standards, and there is a significant difference in operating results, the domestic issuers credibility with the markets would be effected. Report on Promoting Global Preeminence of American Securities markets, *supra* note 25.

249. Brunner, *supra* note 30, at 915-16 & n.19.

250. NOBES & PARKER, *supra* note 17, at 78-79.

251. Ruder et al., *supra* note 28, at 514.

252. "[N]o national standard setter is in a position to set accounting standards that can gain acceptance around the world." *Statement of Sir David Tweedie, Chairman, International Accounting Standards Board, Before the Committee of Banking, Housing and Urban Affairs*, 107th Cong. 3 (2002) available at http://www.iasb.org/uploaded_files/documents/8_129_020214-dpt.pdf.

standard overnight.²⁵³ Fast-growing nations such as China and Eastern Europe could adopt IFRS as a “quick-fix” to their inadequate accounting standards developed during a period of economic stagnation.²⁵⁴

If IFRS becomes a success within the E.U. and elsewhere, countries hurt by corruption, such as Latin American countries, may find it easier to adopt IFRS instead of reforming their home accounting standards.²⁵⁵ Most importantly, countries that continue to have inadequate accounting standards will have devalued securities.²⁵⁶ To stay competitive for investments, these countries will have added pressure to reform or change their accounting systems or risk having investments go to countries with better accounting practices.²⁵⁷ In the end, successful courting of global investments will produce tremendous benefits.

253. During the 1990s, countries such as Nigeria, Malaysia and Singapore adopted IASs with little amendments to their own national standards. NOBES & PARKER, *supra* note 17, at 86. Adopting IAS was a cheaper route for these developing nations than preparing their own standards, and made investment easier for domestic and foreign companies in these developing nations. *Id.* Moreover, adopting IAS avoided the politically unattractive alternative of adopting either U.S. GAAP or U.K. GAAP. *Id.* Moreover, the IASB’s original purpose included promulgating standards for use by developing countries that did not have an established standard-setting body. See Report on Promoting Global Preeminence of American Securities Markets, *supra* note 25, at 8.

254. NOBES & PARKER, *supra* note 17, at 86. As of February 2006, The People’s Republic of China promulgated an entirely new set of accounting standards, bringing the Chinese accounting standards into substantial compliance with IFRS, except for related party transactions and impairments. *Statement of Sir David Tweedie, Chairman, International Accounting Standards Board, Before the Committee of Banking, Housing and Urban Affairs, June 14, 2006, available at* http://www.iasb.org/uploaded_files/documents/10_874_STATEMENTOFSIRDAVIDTWEEDIE.pdf

255. Ronald MacLean Abaroa, *Towards 2005: Profits, People, and the Future of the Regulatory State in the Free Market Model*, 30 LAW & POL’Y INT’L BUS. 131, 136 (1999) (arguing that adopting international accounting standards would be helpful for smaller and more corrupt prone countries because people in those countries will have access to information and technologies otherwise unavailable to them and will avoid the temptation of corruption).

256. Investors who perceive *ex ante* that a particular market poses a higher instance of fraud, manipulation, unfairness or general uncertainty regarding the trustworthiness of financial information for securities will discount the price of each security in that market by a greater amount than a comparable security in a market where they believe there is a lower incidence of such abuses or disclosure deficiencies.

Cox, *supra* note 9, at 1201.

257. And, at the extreme, if as a result of companies using weak or incomplete accounting standards it becomes excessively time-consuming or difficult for investors to distinguish good investment opportunities from bad, investors may choose instead to invest in what they consider to be safer opportunities rather

Adopting IFRS will produce critically important cost savings.²⁵⁸ Before IFRS, foreign issuers incur tremendous cost in listing in a number of countries with different accounting standards.²⁵⁹ With just one accounting standard, companies could easily list their securities on multiple exchanges in multiple countries. Companies will be able to access capital from multiple markets. If there is a particular part of the world where markets are having a financial downturn, a company could easily seek capital in another market.²⁶⁰

For individual investors, there would be a greater chance for diversification. Similarly for such investors, if one part of the world was having financial difficulties, having stock in companies from around the globe would provide much needed diversification to their portfolios.

VI. THE FUTURE CHALLENGES THAT IFRS MUST FACE AS A GLOBAL ACCOUNTING STANDARD

Beyond the controversy on whether the U.S. should adopt IFRS for foreign issuers, there is a growing debate of whether the IASB can handle the challenges that come with being a global accounting standards setter. Already, the IASB has faced two critical issues that have challenged its legitimacy.

First, IFRS may never become a worldwide accounting standard if different countries adopt IFRS in a piecemeal fashion. Second, the IASB must ensure that it maintains its independence from those who contribute monetarily to its organization.²⁶¹

A. *Can IFRS Survive Its First Challenge To Its Independence And Integrity?*

Many who have supported global convergence of accounting standards by adopting IFRS might not feel the same when it is actually applied. A key question for any accounting standards

than in particular securities which may actually offer greater reward. Nicolaisen, *supra* note 10, at 663.

258. See Brunner, *supra* note 30, at 916-18.

259. *Id.* at 911-12, n.3.

260. Consistent accounting standards will bolster investor confidence. During the 1997-98 Asian financial crisis, many investors were unnerved that there were no warning signals from the financial statements of quite a few companies that collapsed. See Marcel Ospel, *America Holds the Key to Accounting Harmony*, FIN. TIMES, Sept. 3, 2004, at 17. Because of the collapse of many companies, Asian companies decided to adopt IFRS. *Id.*

261. *Id.*

setter is whether they can handle the political pressure that comes along with promulgating an unpopular accounting standard. Such an incident has already come to pass with the controversy over IAS 32 and IAS 39.²⁶² These two provisions²⁶³ deal with the treatment of financial instruments such as derivatives.

In terms of accounting treatment under IFRS, these financial instruments need to be reported at fair or market value on their balance sheets.²⁶⁴ Previously in Europe, these instruments were reported based on original cost, then progressively reduced by depreciation.²⁶⁵ European banks and insurance companies preferred the previous accounting treatment because it allowed them to use derivatives to guard against economic fluctuations within foreign exchange or interest rates.²⁶⁶ But European banks have argued that these financial instruments, when reported under the IFRS standard of fair value, will create excessive volatility on their balance sheets and income statements.²⁶⁷ The banks complained that IAS 32 and 39 were overly complicated and needed to be reformed.²⁶⁸

As a result, there has been a French-led revolt joined by such countries as Belgium, Italy, Portugal, and Spain against IAS 32 and 39.²⁶⁹ The premise of this revolt appears to be that European banks were used to having control over their accounting standards because of their enormous influence.²⁷⁰ These banks were accustomed to having a dialog with their home country standard setter before any new accounting measure was enacted.²⁷¹ The

262. Andrew Parker, *EU Plans on Accounting under Threat*, FIN. TIMES, Jan. 2, 2003, at 4.

263. *Id.*

264. See HENNIE VAN GREUNING, INTERNATIONAL FINANCIAL REPORTING STANDARDS: A PRACTICAL GUIDE 202-04 (2005).

265. Robert Bruce, *International Financial Reporting Standards-Riding the Fair Value Roller Coaster*, FIN. TIMES, Apr. 23, 2004, at 4.

266. *Id.* at 5.

267. *Id.*

268. Sir David wrote to the European Parliament that IAS 39's complexity resulted from its "attempt to bridge the worlds of traditional cost-based accrual accounting and a system that is more reliant on market values." See *Written Statement of Sir David Tweedie Chairman, International Accounting Standards Board, to the Committee on Economic and Monetary Affairs of the European Parliament*, http://www.iasb.org/uploaded_files/documents/8_129_040922-dpt.pdf (Sep. 22, 2004).

269. Parker, *supra* note 262, at 4.

270. Bruce, *supra* note 265, at 5.

271. *Id.* This argument comes in spite of the fact that in 2000, the Basel Committee on Banking Supervision, an international organization of bank regulators, endorsed IFRS and

result was that the E.U. adopted IAS 39, but without the controversial derivatives standard.²⁷² With this setback, the IASB had planned to confront the E.U. and E.U. commissioner Charles McCreevy over the rejection of IAS 39.²⁷³ The IASB was still under the impression that the core of IFRS will remain the same.²⁷⁴

However, fractures have developed as a result of the IAS 32 and IAS 39 revolt. The first fracture regards the composition of the IASB. The E.U. is calling for an overhaul of the IASB structure because of its dominance by Anglo-Saxons, whom Europeans consider to be imposing their foreign accounting methods upon the Continent.²⁷⁵ For these Continental countries, IFRS seems to be the Trojan Horse to obtain Anglo-American accounting standards inside the Continental system through a more respectable international façade.²⁷⁶

Because the E.U. is the largest economic block to adopt IFRS, the E.U. believes their representatives on the IASB board should be increased from its current representation of four members.²⁷⁷ The U.S., which has not adopted IFRS, has four representatives as well. The Europeans argue that the American presence on the board should be reduced for not implementing IFRS.²⁷⁸ Despite the U.S.' present negative stance on IFRS, the original purpose of granting the U.S. four seats was to encourage convergence.²⁷⁹ Thus, reducing American seats could pose problems for future convergence. Further, reducing the number of Americans on the IASB board will make the U.S. feel slighted and future accounting convergence may not come to fruition.

worked with the IASB on IAS 39. Press Release, Basel Committee Supports IAS in Report to G7 (Apr. 7, 2000), <http://www.iasb.org/docs/press/2000pr10.pdf>.

272. Barney Jopson, *IASB to Confront EU over Rejection*, FIN. TIMES, Jan. 24, 2005, at 24.

273. *Id.*

274. Paul A. Volcker, Remarks at the 150th Anniversary Conference of the Institute of Chartered Accountants of Scotland: Reasserting Truth in a Post-Enron World (Oct. 22, 2004), available at http://www.iasb.org/uploaded_files/documents/8_128_041022-pav.pdf ("The reservations about parts of IAS 39 should not and has not, it seems to me, diminished in any way the commitment within the European Union, and particularly the European Commission, to support the concept of international standards.").

275. *New Transatlantic War - An Accounting: Battle Over International Standards Threatens Convergence*, FIN. TIMES, Mar. 10, 2005, at 18.

276. NOBES & PARKER, *supra* note 17, at 86.

277. Tobias Buck & Barney Jopson, *EU Steps Up Accounts Pressure*, FIN. TIMES (London), Mar. 10, 2005, at 1.

278. *Id.*

279. *Id.*

As for the second possible fracture, an issue remains whether accounting convergence can be maintained when Europe engages in a “piecemeal rejection” of a key IFRS provision, such as IAS 39.²⁸⁰ This issue raises the important point that a private accounting standards setter needs to maintain its independence from political influences.²⁸¹ Unfortunately, in the IAS 39 instance, the IASB capitulated and has adopted a modified version of IAS 39, which takes into account the E.U. criticisms.²⁸² This revision went forward despite the fact that the original IAS 39 accounting standard was used in the U.S., and the fact that the Accounting Standards Board of Japan commended the original standard’s treatment of derivatives.²⁸³

Unquestionably, the goal of uniform worldwide accounting standards will be undermined when different parts of the world cannot agree on one uniform set of standards. History may repeat itself: instead of having various national accounting standards, there may be different implementations of IFRS by different countries. Also, convergence could be hindered if differing national securities regulators have divergent enforcement for similar cases.²⁸⁴

280. Campos, *supra* note 34.

281. *Statement of Paul A. Volcker before the S. Governmental Affairs Subcomm. on Financial Management, the Budget and International Security*, 108th Cong. (2004), http://www.iasb.org/uploaded_files/documents/8_128_040420-pav.pdf (“The net result of politicized national decision would be to weaken, perhaps irreparably, one of the foundation stones of effective accounting practices in a rapidly globalizing world economy.”).

282. See Press Release, IASB, IASB Issues Amendment to the Fair Value Option in Financial Instruments Standards, *available at* http://www.iasb.org/news/iasb.asp?showPageContent=no&xml=10_435_29_16062005.htm (last visited Sept. 6, 2006) (dealing with the Fair Value Option issue of IAS 39); Commission Regulation (EC) No 2106/2005 of 21 December 2005, *available at* <http://www.iasplus.com/europe/0512ias39forecast.pdf> (last visited September 6, 2006) (dealing with the Cash Flow Hedge Accounting of Forecast Intragroup Transactions issue of IAS 39).

283. See IASB, *ASBJ Comments on the Publication of Revised IAS 32 and 39 Accounting Standards for Financial Instruments* (Jan. 15, 2004), http://www.iasb.org/news/other.asp?showPageContent=no&xml=10_59_27_15012004.htm.

284. Concept Release, *supra* note 59, at 8903-04. But this problem is starting to be addressed. National regulators are setting up processes that would encourage consultations amongst each other to reduce multiple interpretations of IFRS. Taub, *supra* note 11. Both IOSCO and CESR are working on how to deal with possible divergence interpretations. *Id.* CESR has proposed Enforcement Standard No. 2 that would establish a set of standards for enforcement activities. Press Release, Committee of European Securities Regulators, Co-ordinating Enforcement of Financial Information, *available at* http://www.cesreu.org/index.php?page=contenu_search_res&searchkeyword=Press+Relea

Whatever the future may hold, the IASB must be vigilant to ensure worldwide harmonization comes to fruition, and to maintain its legitimacy as a standard setter. Accounting standards constantly evolve, and there is a good chance that IFRS treatment of derivatives will change to produce a uniform disclosure level. But when one area of the world can cause a change in accounting standards because of reservations, other parts of the world will surely follow.

B. The IASB Must Maintain Its Integrity From Those Who Want To Influence It

Another important issue regarding the IASB's legitimacy is its independence from influence. Donald Nicolaisen stressed that if a standards setting board is not independent, the quality of the standards will be undermined and called into question.²⁸⁵ One example may be that interest groups are more likely to affect a national accounting regulators' decision as to how accounting standards are drafted and adopted. On the other hand, it would seem that worldwide accounting regulators would be more immune from local political pressures and policies.²⁸⁶ However, a problem of independence may exist because of how the IASB is funded.

While the FASB receives funding by an assessment on SEC registrants, the IASB depends on private donations.²⁸⁷ The problem with private donations is that companies and accountants might contribute to the IASB in order to influence its decision-making. There is evidence that Enron had thought about donating money to the IASB in order to gain clout.²⁸⁸

se&doonly=all&searchdatefromday=20&searchdatefrommonth=4&searchdatefromyear=2004&searchdatetoday=23&searchdatetomonth=4&searchdatetoyear=2004&x=47&y=12 (Apr. 22, 2004). This would also create an enforcement database that would include information of past and current enforcement actions within the E.U. *Id.*

285. Donald T. Nicolaisen, Remarks before the Public Hearing on the IASC Constitution Review (June 3, 2004), <http://www.sec.gov/news/speech/spch060304dtn.htm>.

286. *Statement of Sir David Tweedie, Chairman, International Accounting Standards Board, Before the Committee of Banking, Housing and Urban Affairs*, 107th Cong. 3 (2002), http://www.iasb.org/uploaded_files/documents/8_129_020214-dpt.pdf.

287. See 15 U.S.C. § 7219 (2005); *Statement of Sir David Tweedie, Chairman, International Accounting Standards Board, Before the Committee of Banking, Housing and Urban Affairs*, 107th Cong. 3 (2002), http://www.iasb.org/uploaded_files/documents/8_129_020214-dpt.pdf.

288. Michael Peel & Peter Speigel, *Enron Looked to Buy Influence over Accounting*, FIN. TIMES, Feb. 14, 2002, at 1.

Therefore, the IASB should have adequate funding in order to allow it to make unpopular decisions. Also, the IASB must be careful from whom they accept donations because even the appearance of partiality could affect the legitimacy of IFRS. While the IASB is currently considering alternative funding mechanisms,²⁸⁹ they should consider alternative means to raise funds such as mandatory fees being paid by global corporations or accounting firms that use IFRS.

VII. CONCLUSION

Despite the historical proliferation of numerous accounting languages, the world may soon speak with one accounting language. The SEC adoption of IFRS is critical because the U.S. dominates the world's capital markets. If the SEC adopts IFRS for foreign issuers, the convergence of worldwide accounting standards may come to fruition. But for that to happen, IFRS must pass through the perceived roadblock of the superiority of U.S. GAAP.

As has been shown, despite the rigors of U.S. GAAP, the U.S. capital markets have been hit hard twice. First, the American economy has been hit with numerous accounting scandals due to companies and their accountants manipulating the line-item standards of U.S. GAAP. Second, American stock exchanges, such as the NYSE, have seen the number of foreign issuers listings decrease, most likely because of the cost of both Sarbanes-Oxley Section 404 and the high cost of the U.S. GAAP reconciliation requirement.

Despite the fact that IFRS is a new accounting standard, it can and should be adopted in its current form. To begin with, IFRS follows the precedent laid down with IDS in achieving a uniform financial disclosure standard for the world's capital markets. Secondly, many of the prior differences between U.S. GAAP and IFRS have either been eliminated or are currently being eliminated. Finally, IFRS has fulfilled all three requirements laid down by the SEC in order to be adopted.

When the U.S. adopts IFRS, both the U.S. and the world's economy will enjoy the numerous benefits that having a high-quality worldwide accounting standard can bring. All these benefits, though, may be in vain if IFRS is adopted in a piecemeal

289. Nicolaisen, *supra* note 10, at 676 n.37.

fashion around the world. Having numerous interpretations and adoptions of IFRS may be akin to the story of the Tower of Babel. The IASB must be vigilant in ensuring that differences in both interpretations and enforcement are reduced. Finally, the IASB must make sure it retains the status of an independent accounting standards setter or risk the fate of becoming irrelevant. Corporations and regulatory authorities have growing confidence that the IASB can handle these challenges. These actors anxiously anticipate the day that capital can finally flow seamlessly around the world.