# SEARCHING FOR A LEVEL PLAYING FIELD: THE INTERNATIONALIZATION OF U.S. SECURITIES DISCLOSURE RULES

## I. THE INTERNATIONALIZATION OF THE WORLD'S SECURITIES MARKETS

> *"The only real impediments to a global market are regulatory, not technological. Specifically, what is lacking is an appropriate regulatory framework for that market to operate in."*[1]

As a result of recent technological innovations—namely the Internet and telecommunications devices—the world's securities markets have become increasingly international.[2] On-line trading of securities has broken down the barriers of space and time by allowing domestic investors access to foreign securities,[3] and cross-border securities transactions[4] have become

1. Laura S. Unger, The Global Marketplace, Ready or Not Here it Comes, Remarks at the Third National Securities Trading on the Internet Conference (Jan. 24, 2000), *at* http://www.sec.gov/news/speech/spch344.htm.

2. Amir N. Licht, *Genie in a Bottle? Assessing Managerial Opportunism in International Securities Transactions*, 2000 COLUM. BUS. L. REV. 51, 56; *see also* Uri Geiger, *The Case for Harmonization of Securities Disclosure Rules in the Global Market*, 1997 COLUM. BUS. L. REV. 241, 243. Mr. Geiger notes that capital market imbalances and deregulation have also contributed to the internationalization of the world's securities markets. *See id.* at 250-57; *see generally* John C. Coffee, *Brave New World?: The Impact(s) of the Internet on Modern Securities Regulation*, 52 BUS. LAW. 1195 (1997) (discussing the positive implications of the Internet on securities regulation in comparison to prior technological advances).

3. *See* Kenneth W. Brakebill, Note, *The Application of Securities Laws in Cyberspace: Jurisdictional and Regulatory Problems Posed by Internet Securities Transactions*, 18 HASTINGS COMM. & ENT. L.J. 901, 910 (1996).

4. This Article uses the terms "cross-border securities transactions" or "cross-border offerings" interchangeably to mean the buying and selling of stocks listed or quoted on foreign markets by investors of one country. *See* Licht, *supra* note 2, at 56.

commonplace.[5] Most of the laws governing the trading of securities, however, were developed by individual countries prior to such internationalization.[6] As a result, each nation regulates its securities markets in different ways, and the differences in the amounts and types of disclosure required by the various countries' regulatory agencies are often significant.[7] Such differences may, and often do, result in an uneven playing field for companies attempting to raise capital in a foreign market and for domestic investors who wish to diversify their portfolios by investing in foreign entities.[8]

In response, the U.S. Securities and Exchange Commission (SEC), along with the other major regulatory agencies of the world, has made attempts at internationalizing securities disclosure rules in order to provide investors with comparable information when making investment decisions.[9] Mandatory

5. A total of 23.3 billion shares of non-U.S. stocks were traded on the New York Stock Exchange in 2000, an increase of 53% from 1999. Further, the dollar value of shares of non-U.S. companies traded on the New York Stock Exchange as a percentage of the total was 10.3% in 2000, as compared to 7.7% for 1999. NEW YORK STOCK EXCHANGE, FACT BOOK FOR THE YEAR 2000, at 3 (2001), *at* http://www.nyse.com. Between 1995 and 2000, over 800 foreign companies registered securities with the U.S. Securities and Exchange Commission. SEC Div. of Corporate Fin., INTERNATIONAL FINANCIAL REPORTING AND DISCLOSURE ISSUES, Part I (May 1, 2001), *at* http://www.sec.gov/divisions/corpfin/internatl/issues0501.htm [hereinafter INT'L DISCLOSURE ISSUES].

6. *See generally* Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207 (1999) (presenting a summary of the regulatory systems currently operating in the world's major markets).

7. *See id.* at 208-09 (referring to the situation as "regulatory disharmony"); *see also* Geiger, *supra* note 2, at 245 (noting that disclosure and information costs are the most significant costs with respect to international securities offerings).

8. Although it is another consequence of the internationalization of the world's securities markets, this Article will not address the issue of which regulatory agency has jurisdiction over transnational securities transactions. *See generally* James D. Cox, *Choice of Law Rules for International Securities Transactions?*, 66 U. CIN. L. REV. 1179 (1998) (analyzing two choice of law alternatives); Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927 (1994) (suggesting a limit on the jurisdictional reach of U.S. securities laws using Regulation S as a model); Regulation S – Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.901-.904 (2000).

9. *See*, *e.g.*, INTERNATIONAL DISCLOSURE STANDARDS, Securities Act Release No. 7745, 64 Fed. Reg. 53,900, 53,901 (Oct. 5, 1999) [hereinafter Release No. 7745];

disclosure, or the movement toward "corporate transparency," has been cited by commentators as providing three main benefits: making markets more fair for investors, decreasing risk to investors, and allocating capital resources more efficiently.[10] Disclosure also imposes its own costs,[11] which at times can be so significant as to create a disincentive to companies seeking capital from securities markets.[12] Securities regulation agencies, therefore, have the task of defining what level of disclosure is necessary to confer such benefits on its constituent investors without imposing too great a burden on issuers.

This Article first provides a brief introduction into the major theories of international securities regulation. An understanding of these theories is necessary to appreciate the current disparity among the world's regulatory regimes and how a globalized market system should most efficiently be regulated.

This Article next presents a background of the current regulatory environment in the United States. Part III discusses the securities disclosure regulations to which both domestic issuers and foreign companies listing in the United States are subject. In particular, this section points out the accommodations the SEC has made to foreign issuers in an attempt to encourage them to list on U.S. markets. This part also explains what changes the current regulatory system is undergoing in an attempt to internationalize disclosure rules.

Part IV of this Article identifies the practical effects of differences in disclosure standards for domestic and foreign issuers. It does this by providing real world examples of what has happened when a foreign company, formerly subject only to

International Accounting Standards, Securities Act Release No. 7801, 65 Fed. Reg. 8896, 8896-97 (Feb. 23, 2000) [hereinafter Release No. 7801].

10. Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 MICH. L. REV. 2498, 2533 (1997). *But see* Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2373 (1998) (noting that there is little evidence that the benefits of mandatory disclosure outweigh the costs).

11. *See* Fox, *supra* note 10, at 2550-54 (examining disclosure costs to private individuals, classes of issuers and the economy as a whole).

12. *See* John Floegel, Comment, *Equity Financing for Public Corporations: Reasons and Methods to Encourage It*, 138 U. PA. L. REV. 1411, 1439 (1990).

its home country disclosure regime, becomes subject to the more demanding regulatory environment of the United States.

Part V analyzes in depth the SEC's recent adopted and proposed regulatory changes: the International Disclosure Standards and the International Accounting Standards. This analysis compares the international and U.S. standards and identifies the major differences. With exposure to these differences, the reader can see that the regulatory agencies of the world have much to do before a truly uniform system of securities disclosure can be adopted.

Finally, this Article proposes that the disclosure requirements of domestic and foreign issuers in the United States must be harmonized before any attempts at harmonizing securities regulations on a global basis can be accomplished. Part VI urges the SEC to remain active in efforts to harmonize international securities regulations but, at the same time, to be mindful of the competitive disadvantage in which its home country issuers are being placed.

## II. THEORIES OF INTERNATIONAL SECURITIES REGULATION

As a result of the disparate times and circumstances under which the various financial markets of the world were born, each nation developed its own regulatory regime to govern its markets in relative isolation.[13] With the recent increase in cross-border securities transactions has come increased scholarly and self-analysis among the world's regulatory agencies as to what is the most appropriate way to regulate the markets that facilitate these transactions: the current competitive environment or one of international harmony?[14]

### A. *Competition*

In a regulatory competition framework, jurisdictions compete to attract market participants by offering them the

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13. *See* Steinberg & Michaels, *supra* note 6, at 208-09.

14. Lawrence J. White, *Competition versus Harmonization—An Overview of International Regulation of Financial Services*, *in* INTERNATIONAL FINANCIAL MARKETS: HARMONIZATION VERSUS COMPETITION 5, 6-7 (Claude E. Barfield ed., 1996).

most efficient regulatory environment in which to operate.[15] Theoretically, regulatory competition results in a "race to the top."[16] This is Adam Smith's theoretical "invisible hand of the market"[17] in which absent any transaction costs or similar barriers, buyers and sellers will seek the most efficient market in which to do business.[18] Jurisdictions with disclosure requirements that are seen as too demanding will be avoided by issuers because compliance costs will outweigh the benefits of the additional information.[19] Similarly, jurisdictions with lax regulatory environments will be avoided by investors because the risk of too little information exceeds the cost-saving benefits realized by the seller.[20] The theoretical result is that markets will engage in a contest to become the most efficient environment in which to trade securities.[21]

Many commentators, however, have expressed concern that regulatory competition will instead lead to a "race to the bottom" by encouraging markets to decrease disclosure requirements and thereby attract more issuers.[22] Such a trend may already be occurring: when the United States lowered its disclosure standards for foreign issuers in 1994, the United Kingdom

15. Geiger, *supra* note 2, at 268.

16. *See* Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation in a Global Capital Market*, 65 FORDHAM L. REV. 1855, 1870-72 (1997).

17. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 456 (R.H. Campbell et al. eds., 1976) (1776).

18. *See* Choi & Guzman, *supra* note 16, at 1870.

19. *Id*.

20. *Id.*

21. *See* Romano, *supra* note 10, at 2361, 2418 (advocating that an approach similar to the current system of state competition for corporate charters be extended to interstate and international securities transactions, whereby issuers would be able to choose their governing disclosure rules from among a variety of state and national regimes).

22. *See*, *e.g.*, Geiger, *supra* note 2, at 272-95 (noting that perfect markets exist only in theory and that the reality of transaction costs and market failures creates the need for government intervention to foster economic efficiency); Licht, *supra* note 2, at 108-11 (arguing that the "race to the top" theorists ignore the threat of managerial opportunism in supporting a regulatory "hands-off" policy); Fox, *supra* note 10, at 2503 n.5 (proposing that allowing issuers the freedom to choose their regulatory jurisdiction would be undesirable).

responded by lowering its own disclosure standards for foreign companies, and Japan announced it would do the same.[23] The very fear of a race to the bottom is what brought about the enactment by the United States of its securities regulations in the 1930's.[24] Prior to the uniform levels of disclosure brought by these federal securities laws, issuers could choose among the various states' disclosure standards,[25] a situation analogous to today's international regulatory environment.[26] Opponents of regulatory competition argue that investors bear the brunt of the costs of low levels of disclosure that result from this race to the bottom.[27]

### *B. Harmonization*

In general, two types of international harmonization of securities disclosure rules exist: reciprocity and commonality.[28] Despite their differences, both share the common goal of conforming differing regulatory regimes rather than pitting them against each other in competition.

#### *1. Reciprocity*

Under a reciprocity agreement, one regulatory jurisdiction accepts the disclosure level of another jurisdiction, requiring foreign issuers to comply only with the disclosure requirements of their home countries.[29] The main advantages of reciprocity are decreased transaction costs for foreign issuers and increased choices available to investors;[30] however, reciprocity is usually

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23. *See* Geiger, *supra* note 2, at 254-58, 293.

24. *Id*. at 293; *see infra* Part II.A.

25. Geiger, *supra* note 2, at 293.

26. *See* Choi & Guzman, *supra* note 16, at 1856-57.

27. Geiger, *supra* note 2, at 291. *But see* Choi & Guzman, *supra* note 16, at 1874-83 (proposing that, due to differences in goals and incentives among issuers, investors, and markets, the current regulatory environment results in neither a race to the bottom nor a race to the top but rather increased diversity among national regulatory regimes).

28. Geiger, *supra* note 2, at 271.

29. Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 907 (1998).

30. *Id.*

limited to jurisdictions which have similar regulatory regimes and comparable disclosure requirements.[31] In fact, the U.S.-Canadian Multi-jurisdictional Disclosure System (MJDS) is the only current example of the SEC accepting disclosure documents that meet the standards of another country.[32] Due to the high levels of disclosure required by the SEC, it is unlikely the SEC will find many other candidates with which to participate in a similar agreement.[33] Moreover, the SEC has indicated a desire to end the MJDS and encourage Canada to join the efforts to internationalize securities disclosure rules.[34]

As part of the ongoing unification of the European Union countries (EU), a securities industry harmonization plan was enacted in 1992.[35] One of the directives under the plan includes mutual recognition of member countries' existing securities

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31. *See* Geiger, *supra* note 2, at 271-72; David S. Ruder, *Reconciling U.S. Disclosure Policy with International Accounting and Disclosure Standards*, 17 NW. J. INT'L L. & BUS. 1, 8 (1996); *see also* James D. Cox, *Rethinking U.S. Securities Laws in the Shadow of International Regulatory Competition*, 55 LAW & CONTEMP. PROBS. 157, 177-79 (1992) (citing situations in which the United States should defer to foreign securities regulations).

32. Steinberg & Michaels, *supra* note 6, at 255.

33. *See* Ruder, *supra* note 31, at 8 (noting that the differences between the regulatory systems of the United States and those of most other countries are so great that similar reciprocal systems are not viable). In fact, the project that resulted in the MJDS was originally intended to include the United Kingdom as well. *See* Facilitation of Multinational Securities Offerings, Securities Act Release No. 6568, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,743, at 87,319 (Feb. 28, 1985). A later SEC release provided that only Canada had been chosen as its first partner in such a reciprocal agreement in part because of its "well-developed, sophisticated and reliable system . . . ." Securities Act Release No. 6879, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,701, *at* 81,112 (Oct. 10, 1990).

34. *See* Barrie McKenna, *U.S. Wants to End Canada's Special Status for Disclosure: SEC Rule Change Would Treat Canadian Firms like Other Foreign Issuers*, GLOBE & MAIL (Toronto), Oct. 7, 1999, at B3 (quoting Paul Dudek, SEC Director of International Corporate Finance: "We feel that the MJDS does not serve a large audience and it would be best if all foreign companies would comply to the same disclosure standards"); *see also* John Partridge, *Dealers Take Aim at Plan to Impede U.S. Financing*, GLOBE & MAIL (Toronto), Dec. 4, 1999, at B1 (reporting that a group of Canadian investment dealers have organized to prevent the SEC from terminating the MJDS).

35. *See generally* David Reid & Andrew Ballheimer, *The Legal Framework of the Securities Industry in the European Community Under the 1992 Program*, 29 COLUM. J. TRANSNAT'L L. 103 (1991).

regulations.[36] This mutual recognition, however, is subject to several important limitations and exemptions that limit its ability to function as a true harmonization plan. Because the EU plan also includes provisions requiring only minimum common disclosure standards, member states may have differing levels of disclosure requirements, similar to the current regulatory competition environment.[37] These differences in standards, combined with the mutual recognition approach, may result in "regulatory arbitrage" whereby an issuer will initially register its securities in the state with the lowest disclosure requirements and then obtain listing in nations with more stringent requirements via mutual recognition.[38] Evidence of the EU plan producing a version of the race to the bottom already exists: in 1990 the International Stock Exchange in London relaxed its relatively strict admission requirements in anticipation of such regulatory arbitrage.[39]

*2. Commonality*

The objective of commonality, or cooperation, is the development of a common set of regulations to be used in all international offerings.[40] Commonality requires the modification or replacement of existing regulatory regimes with rules that are the same as those for other countries.[41] As a result, relatively strong regulatory agencies, such as the SEC, may have trouble giving up either actual or perceived power.[42]

Harmonization through commonality is thought to reduce

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36. *Id.* at 127-29.

37. *See* Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market—A Proposal*, 66 FORDHAM L. REV. 1785, 1789-91 (1998).

38. *Id.* at 1790-91. *See generally* Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563 (1998) (positing that regulatory arbitrage is already occurring with securities that are listed in multiple countries).

39. *See* Reid & Ballheimer, *supra* note 35, at 126.

40. Steinberg & Michaels, *supra* note 6, at 236.

41. Geiger, *supra* note 2, at 272.

42. *See id*. at 299 (noting that harmonization of standards is "likely to raise strong political resistance from domestic governments fearing the loss of their sovereign powers").

the cost of capital for both issuers and investors.[43] Issuers incur significant costs when offering securities in foreign markets because they have to reconcile their home country accounting and disclosure documents with each foreign country in which they wish to offer securities.[44] For investors, the cost of information is the most significant cost of trading in securities.[45] By creating a uniform set of accounting and disclosure standards, commonality reduces these costs, thereby making issuing and investing across borders more advantageous.[46]

Historical, cultural, economic, and legal differences among the various markets and their regulatory agencies pose roadblocks to efforts to harmonize international securities laws.[47] Additionally, the theoretical benefits of regulatory competition—increased efficiency through a race to the top—are absent in a regulatory monopoly. Despite the obstacles, however, the current efforts of the world's securities regulators have been focused on achieving such harmonization of disclosure and accounting rules.[48]

Commonality, via a common prospectus, was proposed in the same 1985 SEC release that resulted in the MJDS.[49] However, this approach was abandoned in favor of reciprocity.[50] It remains to be seen whether true commonality will become a reality among the major securities markets.

43. *See id.* at 305-10.

44. A recent survey of foreign issuers listed on U.S. markets showed over half of the respondents citing non-financial disclosure requirements as the most important difficulty in the U.S. listing, with the required reconciliation of their financial statements to U.S. GAAP being a close second. *See* 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 (1997).

45. Geiger, *supra* note 2, at 308.

46. *Id.*

47. *See* Steinberg & Michaels, *supra* note 6, at 237.

48. *See infra* Part III.B.

49. Release No. 6568, *supra* note 33, at 87, 322-23.

50. *See* Release No. 6879, *supra* note 33, at 81,112.

## III. BACKGROUND AND RECENT DEVELOPMENTS IN SECURITIES REGULATION

> *"We are at a unique moment in our markets' history—a point of passage between what they have been and what they will become."*[51]

### A. The Current Regulatory Environment

Virtually all securities markets today are regulated on a national basis.[52] Until recently, entities seeking to raise capital looked almost exclusively to their home countries; thus, differing regulatory schemes mattered little.[53] Cultural and historical influences played a large part in shaping each country's regulatory structure. For example, the belief that lax disclosure standards contributed to the Great Depression resulted in the United States adopting strict disclosure requirements.[54] Conversely, in Germany, where companies in need of capital have traditionally looked to banks rather than the public via a stock market, the regulatory framework governing securities lags behind that of the United States.[55]

Full disclosure and the concept of registration are the primary tenets of U.S. securities regulation.[56] In response to the stock market crash of 1929 and the perceived fraud and excesses that caused it, Congress passed the Securities Act of 1933[57] ("Securities Act") and the Securities Exchange Act of 1934[58]

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51. Securities and Exchange Commission Chairman Arthur Levitt, *The Future of our Markets: Dynamic Markets, Timeless Principles*, Speech at the Columbia School of Law (Sept. 23, 1999), *in* 2000 COLUM. BUS. L. REV. 1, 1.

52. Steinberg & Michaels, *supra* note 6, at 208.

53. James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 COLUM. L. REV. 1200, 1204 (1999).

54. *Id.*

55. James H. Freis, Jr., *An Outsider's Look into the Regulation of Insider Trading in Germany: A Guide to Securities, Banking, and Market Reform in Finanplatz Deutschland*, 19 B.C. INT'L & COMP. L. REV. 1, 14-15 (1996).

56. Steinberg & Michaels, *supra* note 6, at 210.

57. 15 U.S.C. §§ 77(a)-77(bbbb) (1994). Under Section 77sss of the Securities Act, the SEC is given authority to promulgate rules for the Act's implementation. 15 U.S.C. § 77sss (1994). These rules are published in Part 230 of Title 17 of the Code of Federal Regulations.

58. 15 U.S.C. §§ 78(a)-77(kk) (1994). Under Section 78w of the Exchange Act,

("Exchange Act").[59] These two acts have grown to what is considered to be the world's most demanding securities disclosure regime.[60]

The Securities Act requires that, absent an exemption, every offer and sale of a security through interstate commerce must be registered with the SEC.[61] Further, at the time of the initial public offering of securities, the issuer must deliver a prospectus providing details of the issuer and the offering to potential purchasers of the securities.[62]

The Exchange Act requires all companies that have sold securities in a public offering to file annual and periodic reports with the SEC.[63] In general, the annual report requires audited financial statements and other non-financial disclosures and

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the SEC is given authority to promulgate rules for the Act's implementation. 15 U.S.C. § 78w (1994). These rules are published in Part 240 of Title 17 of the Code of Federal Regulations.

59. *See* Elisabeth Keller & Gregory A. Gehlmann, Introductory Comment, *A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 329, 339 (1988).

60. In fact, the SEC has been criticized for its excessive disclosure requirements, which some perceive as being beyond what is necessary to protect investors. *See* Steinberg & Michaels, *supra* note 6, at 247.

61. *See* 15 U.S.C. § 77e(a) (1994). The statute provides:

> Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—
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> (1) to make use of any means or instrument of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or
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> (2) to carry or cause to be carried through the mails or interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

*Id.*

62. 15 U.S.C. §§ 77e(b), 77j(a), 77j(c) (1994). The information required in the registration statement generally includes audited financial statements of the issuer, information related to the offering itself, and information about the issuer and the securities offered. Steinberg & Michaels, *supra* note 6, at 212-13. Non-financial information that must be included in SEC filings includes, *inter alia*, a description of the company and its securities, the terms of the offering, the capitalization of the company, market and dividend information, risks associated with the company and the offering, a detailed description of the business, an identification of the directors and executive officers, any related party transactions, the principal stockholders, and a narrative discussion of the company's financial condition and results of operations. *Id.* at 213 n.32.

63. 17 C.F.R. §§ 240.13a-1, -13 (2000).

must be filed within ninety days after the issuer's fiscal year-end.[64] Further, quarterly reports must be filed within forty-five days after the end of each of the first three fiscal quarters of the company's fiscal year and contain unaudited financial statements and disclosures updating the company's activities since the last annual or quarterly report.[65] Finally, the issuer must file reports after the occurrence of specified events within five to fifteen days after their occurrence.[66]

The SEC depends on the Financial Accounting Standards Board (FASB) to formulate the accounting standards to be used in preparing the financial statements for use in SEC documents.[67] The FASB, through its seven full-time members of accounting scholars and former accounting professionals,[68] is the primary provider of authoritative accounting pronouncements in the United States.[69] The FASB's pronouncements are the principal sources of U.S. generally accepted accounting principles (GAAP).[70]

The above regulations apply to both domestic U.S. issuers and foreign issuers listing on U.S. markets.[71] Because the U.S.

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64. 17 C.F.R. §§ 210, 229.101-103, 229.301-305, 229.401-405, 229.601, 240, 249.310 (2000); SEC Form 10-K, *at* http://www.sec.gov/divisions/corpfin/forms/10k.htm (last updated June 27, 2000).

65. 17 C.F.R. §§ 210, 229.101-103, 229.301-305, 229.401-405, 229.601, 240, 249.308a (2000); SEC Form 10-Q, *at* http://www.sec.gov/divisions/corpfin/forms/10q.htm (last updated June 20, 2000).

66. 17 C.F.R. § 240.13a-11 (2000); SEC Form 8-K, *at* http://www.sec.gov/divisions/corpfin/forms/8-k.htm (last updated June 27, 2001). Events which must be disclosed include: (1) changes in control of the issuer; (2) major acquisitions or dispositions of assets; (3) bankruptcy of the issuer; (4) changes in the issuer's certifying accountant; and (5) resignations of the issuer's directors. *Id*.

67. Cox, *supra* note 53, at 1205-06.

68. In order to ensure independence and objectivity in their decision-making, members of the board must sever all ties with their employers. THE IASC-U.S. COMPARISON PROJECT: A REPORT ON THE SIMILARITIES AND DIFFERENCES BETWEEN IASC STANDARDS AND U.S. GAAP 43 (Carrie Bloomer ed., 1996) [hereinafter IASC-U.S. PROJECT].

69. *Id*. at 55.

70. *Id*. at 3 n.1. U.S. GAAP is made up of pronouncements promulgated by the FASB, the SEC, and the American Institute of Certified Public Accountants, each with different levels of authority. *Id*. at 98. For an illustration of the hierarchy of U.S. GAAP, see *id*. at 99.

71. *See* INT'L DISCLOSURE ISSUES, *supra* note 5, at Part I.

disclosure rules are much stricter than those of most other countries, the SEC has enacted accommodations to encourage foreign companies to list on U.S. exchanges.[72] Under the Securities Act, the SEC adopted Forms F-1, F-2, and F-3 to be used by foreign issuers[73] in place of the standard registration forms used by domestic issuers.[74] Further, Form 20-F replaces the annual report required to be filed under the Exchange Act.[75] Among the accommodations provided to foreign issuers are the following:

- no requirement that quarterly reports be filed;
- offering document financial statements updated on a semi-annual, rather than a quarterly, basis;
- exemption from the proxy rules;[76]
- aggregate executive compensation disclosure, rather than individual disclosure;
- the possible use of home country GAAP without reconciliation to U.S. GAAP;[77] and
- a six-month deadline, rather than the ninety-day deadline for domestic issuers, to file annual

72. *See* Steinberg & Michaels, *supra* note 6, at 247-48. The foreign issuer rules "are part of the ongoing efforts of the [SEC] to ease the transition of foreign companies into the U.S. disclosure system." Securities Act Release No. 7053, [1993-1994 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 85,331, at 85,203 (Apr. 19, 1994).

73. This Article uses the term "foreign issuers" to include only "foreign private issuers" as defined in Rule 405 under the Securities Act and Rule 3b-4 under the Exchange Act. *See* 17 C.F.R. §§ 230.405, 240.3b-4 (2000). Only companies qualifying as foreign private issuers are eligible for the beneficial treatment discussed in the text following. *See id.*; *see also* Release No. 7745, *supra* note 9, at 53,901 (explaining that the definition of foreign private issuer was revised as of September 30, 2000, to be based more closely on the percentage of securities beneficially owned by U.S. residents). To qualify as a foreign private issuer, less than fifty percent of a company's outstanding voting securities may be beneficially owned by U.S. residents or (a) no more than fifty percent of its officers and directors may be U.S. citizens, (b) no more than fifty percent of its assets may be located within the United States, and (c) its business must be administered principally at a location outside the United States. *See id.* at 53,905 n.30.

74. *See* 17 C.F.R. §§ 239.31-.33 (2000).

75. *See* INT'L DISCLOSURE ISSUES, *supra* note 5, Part I.

76. *See* 17 C.F.R. §§ 240.14a-1 to .14b-2 (2000).

77. *See* INT'L DISCLOSURE ISSUES, *supra* note 5, Part I.

reports.[78]

These accommodations, especially the exemption from reconciling foreign country GAAP financial statements to U.S. GAAP, may hamper a potential investor's ability to compare a foreign issuer's financial condition to that of a domestic competitor.[79]

### *B. International Disclosure Standards*

In 1998, the International Organization of Securities Commissions (IOSCO), an organization made up of regulatory agencies from ninety-one countries with the objective of promoting high standards in the securities industry,[80] released the International Disclosure Standards (IDS), a set of non-financial disclosure standards aimed at facilitating cross-border offerings through the use of a single disclosure document.[81] The idea behind the IDS is to create a prospectus that can be used by an issuer to sell stock in any foreign market, eliminating the problems and costs associated with complying with multiple securities regulations.[82] IOSCO has encouraged its members to accept disclosure documents prepared in accordance with the IDS.[83] In November 1999, the IOSCO Technical Committee Working Group on Multinational Disclosure and Accounting conducted a survey to determine the extent to which the IOSCO members had implemented the IDS.[84] The survey showed that

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78. *Compare* 17 C.F.R. § 249.220f *with* 17 C.F.R. § 249.310 (2000). The SEC has contemplated shortening the Form 20-F filing deadline to five months or less. *See* Securities Act Release No. 7606A, 63 Fed. Reg. 67,174, 67,240 (proposed Dec. 4, 1998). However, the recent changes to Form 20-F made no changes to the filing deadlines. *See infra* text accompanying notes 86-87.

79. *See supra* notes 7-12 and accompanying text.

80. *See* INT. ORG. OF SEC. COMM., OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION (1998), *at* http://www.iosco.org/docs-public/1998-objectives.html.

81. INT. ORG. OF SEC. COMM., INTERNATIONAL DISCLOSURE STANDARDS FOR CROSS-BORDER OFFERINGS AND INITIAL LISTINGS BY FOREIGN ISSUERS (1998), *at* http://www.iosco.org/docs-public/1998-intnl_disclosure_standards.html [hereinafter INTERNATIONAL DISCLOSURE STANDARDS].

82. *See supra* notes 43-46 and accompanying text.

83. *See* INTERNATIONAL DISCLOSURE STANDARDS, *supra* note 81, Part I.

84. *See* TECHNICAL COMM. OF THE INT. ORG. OF SEC. ORG., REPORT ON IMPLEMENTATION OF INTERNATIONAL DISCLOSURE STANDARDS (2000), *at* http://www.

sixteen of the seventeen respondents either currently accept documents prepared in accordance with the IDS from foreign issuers or planned to do so beginning in 2000.[85]

In 1999, the SEC indicated its support for the IDS by adopting revised disclosure rules for foreign issuers to replace most of the non-financial disclosure requirements of Form 20-F.[86] These changes were effective for all foreign issuers currently listed in the United States and those in the process of offering their securities as of September 30, 2000.[87]

### C. International Accounting Standards

In an attempt to promote uniformity in international accounting standards, the accounting standards-setting bodies of ten countries formed the International Accounting Standards Committee (IASC) in 1973.[88] The organization is currently composed of financial personnel from more than eighty countries and one hundred accounting organizations.[89] In 2001, the organization created the International Accounting Standards Board (IASB), made up of accounting professionals and scholars from around the world, to develop and administer a uniform set of international financial accounting standards.[90]

In 1993, IOSCO agreed on "the necessary components of a reasonably complete set of accounting standards that would comprise a comprehensive body of principles for enterprises

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iosco.org/docs-public-2000/2000-internal_disclosure.html [hereinafter REPORT ON IMPLEMENTATION].

85. *Id.*

86. Release No. 7745, *supra* note 9, at 53,900. For a summary of the changes to Form 20-F, *see generally* Sandra Folsom Kinsey, *New Rules for Foreign Private Issuers*, 14 INSIGHTS 9 (2000). Note that the IDS only contain non-financial disclosure standards, and the rules requiring reconciliation of the issuer's home country GAAP financial statements to U.S. GAAP remain unchanged. Release No. 7745, *supra* note 9, at 53,900.

87. *See* Release No. 7745, *supra* note 9, at 53,906. The new provisions of the IDS, as adopted by the SEC, are examined in more detail *infra* Part V.A.

88. Cox, *supra* note 53, at 1207.

89. Janice Grant Brunner, *All Together Now? The Quest for International Accounting Standards*, 20 U. PA. J. INT'L ECON. L. 911, 912 (1999).

90. *See IASB Meets and Greets to Discuss Future Plans*, INT'L ACCT. BULL., May 31, 2001, *at* 2001 WL 13316122; *Stanford Professor Named to International Accounting Standards Board* (Jan. 25, 2001), *at* http://www.gsb.stanford.edu/news/barth.html.

undertaking cross-border offerings and listings."[91] In 1999, the IASC released a core set of forty accounting standards, the International Accounting Standards (IAS).[92] IOSCO endorsed the IAS in May 2000, with the recommendation that all its members allow the use of the standards in cross-border offerings.[93] In February 2000, the SEC approved a concept release on the IAS, soliciting input from scholars and practitioners regarding the possible adoption of the IAS.[94] If adopted by the SEC for use in filings by foreign issuers, the IAS will eliminate the need for reconciliation of a foreign company's financial statements to U.S. GAAP.[95] However, unless the SEC also adopts the IAS for use by domestic issuers, there will be no change in the current uneven playing field.

## IV. THE EFFECTS OF DIFFERENCES IN DISCLOSURE STANDARDS

The disparate times and circumstances under which most nations' securities regimes were developed often results in significant problems when a firm, accustomed to its home country disclosure requirements, desires to list its securities in a foreign country.[96] The following are representative examples of the effects of the current state of diversity in disclosure

91. *See* Paul Pacter, *The World's Standards by 2002,* CPA JOURNAL, July 1998, *at* http:// www.nysscpa.org/cpajournal/1998/0798/Features/f140798.htm.

92. *See* Paul Volcker, *Raising the Standard*, BANKER, Aug. 1, 2001, at 14.

93. Martin Scicluna, *Foundations and Flaws*, FIN. TIMES (London), July 6, 2000, at 2.

94. *See* Release No. 7801, *supra* note 9, at 8896. Comments on the concept release were due on May 23, 2000, and the SEC may use the comments to determine whether and in what form to adopt the IAS. *See id*.

95. In a speech at the Conference of International Accounting Standards in Oslo, Norway, in May 2001, Travis Gilmer, Professional Accounting Fellow at the SEC, indicated that the SEC was still examining the responses received from the concept release and deciding what action is most appropriate. Travis Gilmer, International Accounting Standards and U.S. Capital Markets (May 28, 2001), *at* http://www. sec.gov/news/speeches/spch494.htm.

96. *See* Jorge Gonzalez, Jr, & Christopher D. Olive, *Foreign Issuer Disclosure and Accounting Compliance in U.S. Public Offerings and Securities Listing*, 1-Sum Naftalbra 39, 41 (1995) (explaining that foreign disclosure requirements are often not in line with requirements of home country and that getting in line with foreign disclosure requirements can be expensive).

requirements.

### A. Differences in Non-financial Disclosure Standards

In 1994, Sony Corporation, a foreign private issuer, wrote down $2.7 billion in goodwill related to its Sony Pictures subsidiary.[97] The SEC found that prior to the write down, Sony made inadequate disclosures about the nature and extent of Sony Picture's losses and their impact on its consolidated results.[98] By consolidating Sony Picture's results with those of Sony's highly profitable music business as a single "entertainment" segment, Sony hid the poor operating results of its subsidiary in its annual and quarterly reports.[99] As a result, the SEC issued an order to Sony to cease and desist from such periodic reporting violations and obtained a $1 million civil penalty.[100]

### B. Differences in Accounting Standards

In 1993, Daimler-Benz announced it was listing its stock, previously traded only on German stock exchanges, on the New York Stock Exchange;[101] however, the company wished to keep its liberal German methods of disclosure without reconciling to U.S. disclosure rules.[102] After several years of discussions, Daimler-Benz agreed to reconcile its statements with U.S. GAAP as mandated by the SEC.[103] The change resulted in the reporting of significant losses and caused great embarrassment for the company.[104] Under U.S. GAAP, Daimler-Benz's financial

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97. INT'L DISCLOSURE ISSUES, *supra* note 5, Part VIII.F.3.

98. *Id.*

99. *Id.* In both annual and quarterly reports, an issuer is required to include a narrative discussion and analysis of its financial condition and the results of its operations. *See* 17 C.F.R. § 229.303 (2000).

100. INT'L DISCLOSURE ISSUES, *supra* note 5, Part VIII.F.3.

101. *See* Gonzalez, *supra* note 96, at 55-56.

102. Licht, *supra* note 2, at 81-82.

103. *Id.*

104. *Id.* at 82. The German standards allowed Daimler-Benz to conceal in "reserves" income from positive years and apply the reserves to boost earnings in down years, resulting in what is known as income smoothing. Cox, *supra* note 53, at 1203; *see also* Eric M. Sherbet, *Bridging the GAAP: Accounting Standards for Foreign Sec Registrants*, 29 INT'L LAW. 875, 885-86 (1995). The change to U.S. GAAP, which prohibits

statements revealed previously hidden segments, such as aerospace, software, and consumer appliances that had incurred significant losses.[105] As a result, the company divested itself of such under-performing lines and returned to profitability even under the more rigorous accounting standards.[106]

## V. ANALYSIS OF THE IDS AND IAS

Part IV demonstrated that the current U.S. regulatory system of disparate rules for foreign and domestic issuers may result in a lack of comparability between similar companies. This part seeks to determine what the IDS and IAS, in an integrated disclosure document, will do to level the playing field for domestic issuers.

### *A. IDS*

As discussed in Part III above, foreign private issuers are granted several accommodations from the SEC's disclosure requirements. The SEC's recent adoption of the IDS does much to bring the levels of required disclosure for foreign and domestic issuers together; however, the burden placed on foreign issuers is still much less than that imposed on domestic issuers.[107] The following are some of the more significant differences between non-financial disclosure requirements for foreign and domestic issuers. Note that, unlike the IDS as proposed by IOSCO, which were intended to apply only to offerings and listings of common equity securities, the rules adopted by the SEC apply to all types of offerings and listings and to annual reports filed on Form 20-F.[108]

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such "reserve" accounting, converted Daimler-Benz's reported profit of $354 million into a loss of $1 billion. Cox, *supra* note 53, at 1203.

105. Cox, *supra* note 53, at 1203.

106. *Id.*

107. Roberta S. Karmel, *Will Convergence of Financial Disclosure Standards Change SEC Regulations of Foreign Issuers?*, 26 BROOK. J. INT'L L. 485, 523-25 (2000).

108. Denis T. Rice, *International Legal Developments In Review: 1999: Business Transactions And Disputes: International Securities*, 34 INT'L LAW. 599 (2000).

### 1. *Industry segments*

A domestic issuer is required to provide detailed information about its industry segments, including sales, operating profit and loss, and assets attributable to each segment for the previous three years.[109] A foreign issuer, however, is only required to present such information if it is required to do so under its home country method of accounting.[110] Many domestic companies consider such detailed industry information to be competitively valuable and disclose it reluctantly.[111] When a foreign competitor listing in the United States is allowed to forego disclosing such information, the competitive disadvantage becomes even more pronounced.

### 2. *Age of Audited Financial Statements*

The permitted age of financial statements in a registration statement has been shortened for foreign private issuers.[112] The time period has been shortened to fifteen months for the new Form 20-F, and can be as short as twelve months if the offering is the company's first public offering in any jurisdiction.[113] Further, if the registration statement is dated more than nine months after the issuer's fiscal year end, it must also include unaudited interim financial statements that cover the first six months of the current fiscal year and the corresponding period in the prior year.[114] While this new requirement brings the

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109. 17 C.F.R. § 229.101(b) (2000).

110. *See* Release No. 7745, *supra* note 9, at 53,904.

111. *See*, *e.g.*, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION, Statement of Financial Accounting Standards No. 131, §§ 109-111 (Financial Accounting Standards Bd. 1997) (describing concerns over the enactment of an accounting pronouncement that requires disclosure in financial statements of industry segment information).

112. Kinsey, *supra* note 86. The "age" of financial statements refers to the length of time between the period-end to which the financial statements relate and the effective date of the registration statement in which they are included. Karmel, *supra* note 107, at 493.

113. 17 C.F.R. § 249.220f (2000). *See also* Kinsey, *supra* note 86, n.9.The foreign issuer can, however, overcome the twelve-month requirement by making a showing that no other jurisdiction is imposing the requirement and that compliance is impractical or presents an undue hardship, a relatively low hurdle. *Id*.

114. Release No. 7745, *supra* note 9, at 53,902. Under the previous version of

standards for foreign private issuers closer in line with those of domestic issuers, domestic companies are still subject to a more demanding disclosure regime.[115]

### 3. *Executive Compensation*

Foreign issuers may present information on the compensation of their executives in the aggregate,[116] whereas domestic issuers must detail the amount of salary, bonus, fringe benefits, and stock compensation for the company's CEO and four other most highly compensated officers on an individual basis.[117] While this may seem to be a minor difference, investors often discount the stock of a company when they believe it overcompensates its officers.[118]

### 4. *Beneficial Ownership*

In contrast with the accommodations made for foreign issuers, the new standards also contain a change that actually increases the amount of required disclosure for foreign companies beyond that required of domestic companies.[119] Item 7 of revised Form 20-F reduces the threshold for disclosure of transactions with "beneficial owners" from ten percent to five percent owners.[120] The percentage change makes the disclosure threshold the same for foreign issuers as for domestic issuers;[121] however, the definition of beneficial owner on revised Form 20-F, taken verbatim from the standards endorsed by IOSCO, is broader than the definition applicable to domestic issuers under

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Form 20-F, interim financial statements were required after ten months. Kinsey, *supra* note 86, n.8.

115. *See* 17 C.F.R. § 210.3-12 (2000) (requiring a domestic issuer to supplement audited financial statements that are more than 134 days old with interim financial statements).

116. Kinsey, *supra* note 86.

117. *See* 17 C.F.R. § 229.402 (2000).

118. *See* Kathy Kristof, *Rethinking Executive Compensation*, HOUSTON CHRON., Aug. 24, 2001, *available at* http://houston.webpont.com/finance/pf20010824.htm.

119. J. Stephen Hatfield, *Tell Me More, Tell Me More: New SEC Disclosure Standards Will Prove Troublesome Here and Abroad*, LEGAL TIMES, May 15, 2000, at 42.

120. Release No. 7745, *supra* note 9, at 53,904.

121. *See* 17 C.F.R. § 229.403(a) (2000) (indicating the domestic threshold is five percent).

Rules 13d-3 and 16a-1(a)(1) under the Exchange Act.[122] Under the new standards, a beneficial owner includes "persons who hold their securities through one or more trustees, brokers, agents, legal representatives, or other intermediaries, or through entities in which they have a 'controlling interest,' which means the direct or indirect power to direct the management and policies of the entity."[123] Further, persons with the right to acquire any securities of the issuer within sixty days by option or other agreement are deemed beneficial owners of those securities.[124] By contrast, to be deemed a beneficial owner under Rule 13d-3, the holder of an option, warrant, or similar right must be entitled to a security that grants the owner the right to vote or to decide whether to hold or dispose of the security.[125] The broader test under the new disclosure standards, termed the "pecuniary interest test," is used in other contexts applicable to domestic issuers, but not for purposes of determining who has control over the company.[126] The new rules will add to the already onerous task of determining who has beneficial ownership of a foreign corporation's shares.[127]

In addition to the differences between the IDS and the disclosure requirements placed on domestic issuers, foreign

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122. 17 C.F.R. §§ 249.220f, Item 7, 240.13d-3, 240.16a-1(a)(1) (2000).

123. 17 C.F.R. §§ 249.220f, Item 7 (2000).

124. *Id.*

125. 17 C.F.R. § 240.13d-3 (2000). Rule 13d-3(d)(1)(i) provides:

> A person shall be deemed to be the beneficial owner of a security . . . if that person has the right to acquire beneficial ownership of such security, as defined in Rule 13d-3(a) within sixty days, including but not limited to any right to acquire: (A) Through the exercise of any option, warrant or right . . . .

*Id.*

Further, Rule 13d-3(a) provides:

> [A] beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares:
>
> (1) Voting power which includes the power to vote, or to direct the voting of, such security; and/or,
>
> (2) Investment power which includes the power to dispose, or to direct the disposition of, such security.

*Id.*

126. Hatfield, *supra* note 119.

127. *Id.*

private issuers are granted several other important accommodations. For example, foreign private issuers are not subject to the recently enacted Regulation FD,[128] which requires an issuer to make public disclosure of any information it discloses to certain enumerated persons, such as securities market professionals.[129] Additionally, the new auditor independence rules require an issuer to disclose in its proxy statements all fees paid to its auditors, including fees for non-audit related services.[130] However, because foreign private issuers are exempt from the SEC's proxy requirements,[131] this new fee disclosure rule does not apply.[132]

### *B. IAS*

In 1996, the staff of the FASB completed a study comparing the IAS and U.S. GAAP.[133] The study showed that while the two sets of standards do have similar underlying approaches to accounting in general, many differences exist that could lead to very different results in financial statements.[134] Some of the

128. 17 C.F.R. § 243.101 (2001). "FD" refers to "fair disclosure." *See* Selective Disclosure and Insider Trading, Securities Act Release No. 7881, 65 Fed. Reg. 51,716 (Aug. 24, 2000) [hereinafter Release No. 7881].

129. 17 C.F.R. § 243.100 (2000).

130. *See* Revision of the Commission's Auditor Independence Requirements, Securities Act Release No. 33-7919, 73 S.E.C. Docket 1885, 2000 WL 1726933 at 82-83 (Nov. 21, 2000) [hereinafter Release No. 7919].

131. *See supra* note 76 and accompanying text.

132. *See* Release No. 7919, *supra* note 130, at 82-83 (describing the final proxy disclosure rule).

133. IASC-U.S. PROJECT, *supra* note 68, at 3. The study's four objectives were:

1) To provide a basis for the FASB and the IASC to raise the quality of their standards while narrowing the differences between them.
2) To provide a tool for investors, financial analysts, and other users of financial statements to use in comparing U.S. firms with firms that use the IASC standards
3) To provide an information base that can be used in assessing the acceptability of the IASC standards for securities listings in the United States.
4) To provide insights into the relative strengths of the IASC and FASB structures and processes for serving the ongoing information needs of U.S. capital markets.

*Id.* at 7-8.

134. *Id.* at 15. Of the topics analyzed by the study, 53% showed the IAS and

more significant differences follow.[135]

### *1. Amortization of Goodwill*

Goodwill, a common byproduct of a business combination,[136] may be recognized differently under the IAS than under U.S. GAAP. The IAS presume that goodwill will be amortized over twenty years or less unless that presumption is overcome,[137] while U.S. GAAP no longer allows automatic amortization, but rather requires that companies periodically review goodwill for impairment.[138] The difference between expensing and not expensing an asset such as goodwill will have a significant effect on a company's financial results: a company that does not amortize will report higher earnings.[139]

### *2. Measurement of Impaired Assets*

Both the IAS and U.S. GAAP require a company to "write down" the carrying value of certain assets whenever circumstances indicate the book value may not be recoverable.[140]

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U.S. GAAP to have a similar general approach, but 22% showed a fundamental difference in the approaches taken by the two standards. *Id.* at 20. Further, in 11% of the tested topics, a preparer of financial statements would have a choice about how to account for a certain item under either the IAS or U.S. GAAP. *Id.* The remaining 14% of the cases identified a variation due to one set of standards not addressing a topic covered by the other. *Id.* Note that the IASC-U.S. Comparison Project was completed when only thirty-two IASs existed, as compared to the current forty; however, the examples provided in the following text remain as differences between the IAS and U.S. GAAP as they currently exist.

135. Each example variance is representative of one of the types of differences noted in the IASC-U.S. Comparison Project and provided in summary form in the SEC concept release on the IAS: recognition differences, measurement differences, alternatives, lack of requirements or guidance, and other differences. *See* Release No. 7801, *supra* note 9, at 8909-15.

136. Goodwill in the accounting sense is the difference between the purchase price of an acquired firm and the fair market value of the underlying net assets acquired. *See* BLACK'S LAW DICTIONARY 694-95 (6th ed. 1990).

137. INT'L DISCLOSURE ISSUES, *supra* note 5, Part VI.C.4.a.

138. *FASB Issues Long-Awaited Statements On Business Combinations*, MANAGING GEN. LEDGER, Sept. 1, 2001, *available at* 2001 WL 17720324.

139. Release No. 7801, *supra* note 9, at 8910-11.

140. *See id.* at 8912 (indicating that although there are measurement differences, both standards have requirements for impairing assets).

IAS 36[141] requires such "impairment losses" to be reversed if the financial conditions that originally indicated impairment reverse.[142] U.S. GAAP, however, prohibits reversal of an impairment loss regardless of subsequent circumstances.[143] Therefore, the book value of an asset may differ depending on which accounting standards are used.

### *3. Property, Plant, and Equipment*

Under IAS 16,[144] an entity may choose to measure its fixed assets at either cost less accumulated depreciation or at a periodically determined fair value.[145] Under the latter alternative, revaluation increases are added directly to shareholders' equity as a revaluation surplus or recognized as income, depending on the circumstances.[146] Revaluation decreases are first charged against any surpluses for the same asset, with any excess being expensed.[147] U.S. GAAP does not permit any revaluation of property, plant, and equipment; all fixed assets are carried at original cost less accumulated depreciation.[148] The differences in the two methods of accounting for fixed assets may result in significantly differing statements of financial position.[149]

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141. IMPAIRMENT OF ASSETS, International Accounting Standard No. 36 (International Accounting Standards Comm. 1999).

142. Release No. 7801, *supra* note 9, at 8912.

143. ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, Statement of Financial Accounting Standards No. 121, § 11 (Financial Accounting Standards Bd. 1995).

144. *See* ACCOUNTING FOR PROP., PLANT AND EQUIP., International Accounting Standard No. 16 (International Accounting Standards Comm. 1999).

145. Release No. 7801, *supra* note 9, at 8912.

146. *Id.* If the revaluation increase reverses a revaluation decrease previously recognized as an expense, the increase will be credited to income. *Id.*

147. *Id.*

148. RECOGNITION AND MEASUREMENT IN FIN. STATEMENTS OF BUS. ENTERS., Statement of Financial Accounting Concepts No. 5, § 67a (Financial Accounting Standards Bd. 1984).

149. The IASC-U.S. Comparison Project notes that the impact of revaluation on the financial statements may be difficult to trace and statements prepared under IAS 16 cannot be easily reconciled to be comparable to statements prepared under the U.S. GAAP principle of disallowing revaluation of fixed assets. Release No. 7801, *supra* note 9, at 8911-12.

### 4. *Specialized Industries*

U.S. GAAP provides specific accounting guidance for several specialized industries, such as insurance, not-for-profit, oil and gas, entertainment, and employee stock-compensation plans.[150] The IAS currently do not have such specialized guidance.[151] Similarly, IAS 20[152] provides a comprehensive set of standards for accounting for the receipt of government assistance by business enterprises, but U.S. GAAP contains no analogue.[153] Comparability is affected by specific guidance in one set of standards coupled with the absence of such information in the other.[154]

### 5. *Business Combinations*

U.S. GAAP and the IAS contain similar methods of accounting for the acquisition by one enterprise of another, the "purchase" method.[155] The IAS, however, also provide an alternative method, the "pooling-of-interests" method, which the FASB recently abandoned when it adopted Statement of Financial Accounting Standards No. 141.[156] Under the IAS, if the business combination is structured such that the acquiring

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150. *Id.* at 8913; *see*, *e.g.*, ACCOUNTING AND REPORTING BY INS. ENTERS., Statement of Financial Accounting Standards No. 60 (Financial Accounting Standards Bd. 1982); FIN. STATEMENTS OF NOT-FOR-PROFIT ORGS., Statement of Financial Accounting Standards No. 117 (Financial Accounting Standards Bd. 1993); FIN. ACCOUNTING AND REPORTING BY OIL AND GAS PRODUCING COS., Statement of Financial Accounting Standards No. 19 (Financial Accounting Standards Bd. 1977); FIN. REPORTING BY PRODUCERS AND DISTRIBS. OF MOTION PICTURE FILMS, Statement of Financial Accounting Standards No. 53 (Financial Accounting Standards Bd. 1981); ACCOUNTING FOR STOCK-BASED COMPENSATION, Statement of Financial Accounting Standards No. 123 (Financial Accounting Standards Bd. 1995).

151. Release No. 7801, *supra* note 9, at 8913. However, the IASC currently has plans to address issues relating to the insurance and agriculture industries. *Id.* at 8913, n.58.

152. *See* ACCOUNTING FOR GOV'T GRANTS AND DISCLOSURE OF GOV'T ASSISTANCE, International Accounting Standard No. 20 (International Accounting Standards Comm. 1983).

153. Release No. 7801, *supra* note 9, at 8913.

154. *Id.*

155. *Id.* at 8914.

156. *Id. See* BUS. COMBINATIONS, Statement of Financial Accounting Standards No. 141 (Financial Accounting Standards Bd. 2001).

enterprise is impossible to identify (such as when two companies merely exchange stock), the pooling of interests method may be applied; otherwise, the purchase method must be used.[157]

Because the pooling of interests method treats the combination of two enterprises as a "uniting" of the two companies, the assets, liabilities, and equity of the two companies are merely added together, with no resulting goodwill.[158] On the other hand, a combination accounted for as a purchase requires the acquired assets and liabilities to be recorded at fair value, with any excess of the purchase price over the fair value of the assets resulting in goodwill.[159] Goodwill must be amortized as an expense, reducing net income for several years.[160] For these reasons, it is easy to see why two combining companies would rather use the pooling of interests method. Unfortunately, the effects of using the pooling method under the IAS for a business combination, rather than the purchase method, are almost impossible to identify from an examination of financial statements.[161] Further, differences in accounting for the goodwill which results from the purchase method will cause more discrepancies in companies' reported results.[162]

While IOSCO has endorsed the IAS for use by its members, IOSCO's Technical Committee has issued a report that identifies 120 substantive issues relating to the IASC standards and outlines supplemental treatments to address each issue.[163] Further, in a speech in May 2000, SEC Commissioner Hunt expressed "significant concerns about the quality of the information produced by applying the IASC standards."[164]

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157. Release No. 7801, *supra* note 9, at 8914.

158. *See* Brunner, *supra* note 89, at 927.

159. *Id.*

160. *Id.*

161. Release No. 7801, *supra* note 9, at 8914.

162. *See supra* Part V.B.1.

163. *See* INT'L DISCLOSURE ISSUES, *supra* note 5, Part II.B; *"Rome Wasn't Built in a Day"—Tokar*, ACCOUNTANT, June 29, 2000, at 13.

164. Isaac C. Hunt, Jr., Current SEC International Accounting and Selective Disclosure Developments, Address at the Monash Law School Foundation Lecture Series, Melbourne, Australia (May 15, 2000), *at* http://www.sec.gov/news/speech/spch381.htm. In addition to the variances noted in the FASB study, the SEC's Division of

However, he denied claims that the SEC concept release on the IAS was an attempt to find excuses to criticize the IASC standards.[165]

The United States is not the only stumbling block in the push for acceptance of the IAS. In a survey of the 1998 financial statements of 125 European companies that refer to the use of the IAS, the auditors of almost half expressed no opinion on compliance with the IAS.[166] The survey also noted that forty-three IOSCO members, including Australia and the United Kingdom, have not yet implemented the IAS cash flow method, a standard endorsed by IOSCO in 1993.[167] This evidence illustrates that the IASC has a number of hurdles to overcome before it gains acceptance by the international financial community.

## VI. A PROPOSAL

As the SEC has indicated, "the only way to achieve fair, liquid and efficient capital markets worldwide is by providing investors with information that is comparable, transparent and reliable."[168] In doing so, it must begin at home. While the United States has the most demanding securities disclosure standards in the world, it has relaxed those standards for foreign companies listing on U.S. exchanges, putting domestic issuers at a relative disadvantage.[169]

Both the Securities Act and the Exchange Act require the SEC to consider whether a change to existing securities laws will promote competition, cross-border capital formation, and efficiency in multi-jurisdictional offerings and listings.[170]

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Corporate Finance has published a list of issues encountered in reconciling from the IAS to U.S. GAAP. *See* INT'L DISCLOSURE ISSUES, *supra* note 5, Part V.

165. Hunt, *supra* note 164.

166. *Financial Times Survey Reveals Patchy Compliance with International Accounting Standards*, CPA JOURNAL, Mar. 1, 2000, at 13.

167. *Id.* The SEC currently does accept cash flow statements prepared in accordance with the IAS in filings by foreign issuers. *See* 17 C.F.R. § 249.220f (2000).

168. Release No. 7801, *supra* note 9, at 8896.

169. *See* Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage What You Measure*, 96 COLUM. L. REV. 1335, 1338 (1996).

170. *See* 15 U.S.C. §§ 77b(b), 78c(f) (Supp. V 2000).

Further, the SEC is prohibited, under the Exchange Act, from promulgating any rule or regulation that imposes an unnecessary or inappropriate burden on competition.[171] The SEC noted that its adoption of the IDS was intended to "harmonize disclosure requirements for foreign issuers, without imposing any negative impact on U.S. businesses."[172] While the IDS themselves may actually bring disclosure requirements for domestic and foreign issuers closer together, the disclosure scheme as it currently exists is still far from being neutral to U.S. businesses.

A possible solution to this inconsistency is to lower the disclosure requirements for domestic issuers to the level of foreign private issuers. However, this would be inconsistent with the SEC's goal of providing investors with full corporate transparency.[173]

A better solution is to harmonize disclosure standards for both foreign and domestic issuers. The IAS, if the discrepancies between the international standards and U.S. GAAP can be worked out, are a good example of the type of harmonization necessary.[174] Further, the non-financial disclosure discrepancies between domestic and foreign issuers need to be eliminated if domestic companies are to compete on a level playing field with foreign issuers. Some accommodations, such as allowing foreign issuers more time to file annual reports and allowing older financial statements to be included in registration statements, are currently see n as necessary to allow a foreign company to reconcile its financial statements to U.S. GAAP.[175] However, such accommodations will become unnecessary with the adoption of a uniform set of international accounting standards. This Article advocates eliminating the accommodations for foreign issuers by adopting a uniform set of accounting and non-financial disclosure standards applicable to both domestic and

171. 15 U.S.C. § 78w(a)(2) (1994).

172. Release No. 7745, *supra* note 9, at 53,907.

173. *See supra* text accompanying note 56.

174. Any adoption by the SEC of the IAS for foreign issuers, though, will have no effect on the disharmony between domestic and foreign issuers unless domestic issuers are required to apply the IAS.

175. Karmel, *supra* note 107, at 487, 493.

foreign issuers.

Harmonization of domestic and foreign disclosure requirements does carry its costs, however. While the United States provides for companies the largest pool of investment capital in the world,[176] it is not the only market available. The world's securities markets operate in a competitive environment whereby each country competes for a company's listing.[177] An argument may be made that increasing the disclosure requirements for foreign issuers to conform to those of domestic issuers would result in a flood of delistings from the U.S. stock exchanges and cancellations of pending listings by foreign companies.[178] Empirical evidence, however, shows that foreign companies already experience multiple benefits by listing their shares in the United States.[179] Some evidence exists that at least a portion of the benefits enjoyed by foreign companies listing in the United States is due to the increased transparency arising from reconciling their financial statements to U.S. GAAP.[180] There is no question that managers weigh the costs and benefits when deciding whether to list in a foreign market.[181] Historically, managers have concluded that the benefits of listing in the United States outweigh the costs of additional disclosure,[182] and this is unlikely to change with the solution proposed in this Article.

One might also question whether adequate competitiveness among the securities markets exists to allow foreign firms to

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176. *See* Cox, *supra* note 53, at 1219.

177. *See supra* Part II.A.

178. *See supra* text accompanying note 19.

179. *See* Cox, *supra* note 53, at 1217-19. Among the benefits of a secondary U.S. listing are increased liquidity and enhanced market value in both the U.S. and the companies' home markets. *Id.* at 1217-18.

180. *Id.* at 1222-23 (citing Professor Darius P. Miller's study, *The Market Reaction to International Cross-listings: Evidence from Depositary Receipts*, 51 J. FIN. ECON. 102 (1999)). Professor Cox notes, however, that such studies of the benefits of U.S. GAAP reconciliation ignore the costs of such reconciliation. *Id.* at 1223.

181. *See* Choi, *supra* note 16, at 1870.

182. *See* 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. S120, S122-23 (1994) (noting that after foreign issuers appreciate the benefits provided by U.S. GAAP, they no longer view the reconciliation requirement as a disadvantage).

"shop" for regulatory regimes. Currently, only the United States, England, and, to a limited extent, Germany, with their financial infrastructures and relatively low costs of capital, are able to compete for multinational listings.[183] Therefore, the argument that foreign companies will opt for another, more lax, disclosure regime instead of listing in the United States seems to be without merit.

Another problem with harmonization is that current market participants incur transition costs as the result of changes to the regulatory regime.[184] All participants, including issuers, investors, and financial professionals, will have to learn a new set of rules, a learning process that carries significant costs.[185] These costs, however, may be seen as an investment that will result in the benefits of increased comparability between domestic and foreign companies. Additionally, such costs will be offset by eliminating the cost of learning two sets of rules or multiple exceptions to the general rule.[186]

In its adoption of Regulation FD, the SEC stated that its staff would undertake a comprehensive review of the reporting requirements of foreign private issuers.[187] The SEC needs to undertake this task with a view to the dichotomy it has created in attempting to accommodate foreign companies.

## VII. CONCLUSION

The internationalization of the world's securities markets presents opportunities for both issuers and investors. Differences in disclosure requirements among the nations' securities markets and particularly within a single nation, however, threaten to diminish the benefits of globalization. Securities regulators worldwide currently are attempting to harmonize both financial and non-financial securities disclosure rules. This Article notes that such efforts are perhaps most

183. *See* Cox, *supra* note 53, at 1232.

184. *See* Geiger, *supra* note 37, at 1832.

185. *Id*. at 1832-34 (discussing the transition costs involved in a proposal to harmonize securities disclosure regulations on an international basis).

186. *Id*. at 1833.

187. Release No. 7881, *supra* note 128, at 51,724.

important when applied within the U.S. securities regulation regime.

As the examples of Daimler-Benz[188] and Sony[189] show, differing disclosure standards for foreign and domestic companies result in a lack of comparability. This Article also identified other potential areas of disparity between a registration statement prepared under international standards and one prepared under standards applicable to domestic U.S. companies.

While comparability is one of the SEC's primary means of satisfying its mission to protect investors, investors are not receiving the same information about a foreign company listing its securities in the United States as they are about domestic companies. Until the SEC requires the same levels of disclosure for foreign issuers as are required for domestic issuers, its efforts at internationalizing securities disclosure standards will be ineffective.

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188. *See supra* Part IV.B.

189. *See supra* Part IV.A.

* This Comment received the Gus A. Schill, Jr. Writing Award and was named the Best Candidate Paper of 2000-2001 by the *Houston Journal of International Law*.