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Remarks of

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**THE U.S. ROLE IN ACHIEVING INTERNATIONAL HARMONIZATION
OF ACCOUNTING STANDARDS**

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***/ The views expressed herein are those of Commissioner Lochner and do not necessarily represent the views of the other Commissioners or the Commission staff.**

I. INTRODUCTION

Thank you and good afternoon.

My topic today is the international harmonization of accounting standards, particularly the role that U.S. regulators and standard setters should play in achieving that harmonization.

The concept of accounting harmonization has been around for a long time. At least by the early 1960's, observers noted the need for international harmonization of accounting standards, as well as the powerful economic forces leading to the creation of a single global economy that would inevitably provide the impetus for accounting harmonization. One influential U.S. commentator noted in 1963 that, in view of the development of the world economy, the lack of uniformity in accounting principles and auditing procedures as between nations was a cause of concern to thoughtful accountants everywhere. 1/

At the Ninth International Congress of Accountants in 1967, the president of the Congress stated that "[a]lmost all the international and national [experts] are in favor of the harmonization of accounting and auditing principles, and some even consider[ed] that this harmonization is essential and . . . urgent." 2/ One result of that Congress was the

1/ L. Rappaport, SEC Accounting Practice and Procedure, ch. 26 at 3 (2d ed. 1963).

2/ N. Rueschhoff, International Accounting and Financial Reporting 144 (1976)(quoting F. M. Richard, president of the Ninth International Congress of Accountants, Paris, 1967).

initiation of a process that ultimately led to the creation in 1973 of the International Accounting Standards Committee ("IASC"). 3/

In the decades that have gone by since the need for international accounting harmonization was first recognized, the forces of internationalization, which had only begun to be felt in the 1960's, have struck with a vengeance. For example, compare what has happened between 1975 and 1989 just in the international financial markets. In 1975, transactions in U.S. securities by foreign investors and transactions in foreign securities by U.S. investors were estimated to aggregate about \$66 billion. By 1989, this figure had increased by more than 80 times to a staggering \$5.4 trillion. 4/

Unfortunately, the movement towards harmonization of accounting standards has not kept up with the rate of increase in international economic activity, despite the recognition in the 1960's of the essential and urgent need for harmonization. For example, the U.S. has not recognized any international accounting standards, or any other country's national accounting standards for that matter. Furthermore, for a foreign company to offer securities in the U.S. or to list its securities on a U.S. exchange or on NASDAQ, it must reconcile its

3/ See id. at 144-45.

4/ SEC Office of Economic Analysis.

financial statements to U.S. generally accepted accounting principles, 5/ regardless of the quality of the foreign standards that the company may have previously complied with in preparing its historical financial statements.

One explanation for the lack of concrete results in actually achieving harmonization may be the absence of any belief that international accounting harmonization is within our grasp. References can be found throughout the '60's, '70's, and '80's to the need for and the inevitability of harmonization, yet commentators from those decades consistently saw harmonization as a vague long-term goal, rather than a realistic short-term objective. 6/ Everyone believes harmonization will happen, but apparently no one believes it will happen in their lifetime.

Fortunately, however, there is room for some optimism. As I will discuss later, the IASC is entering a crucial phase in its attempt to develop a nucleus of internationally accepted accounting principles. The IASC has indicated that it expects to complete its process by the

5/ See, e.g., Securities Exchange Act Form 20-F, Items 17 and 18.

6/ See, e.g., M. Lafferty and D. Cairns, *Financial Times World Survey of Annual Reports 1980* 76 (statement of John A. Hepworth, Chairman, IASC); N. Rueschhoff, *International Accounting and Financial Reporting* 148 (1976); AICPA Committee on International Relations, *Professional Accounting in 25 Countries* vii-ix (1964).

beginning of 1993. 7/ These principles may provide a basis on which all national regulators can recognize foreign company financial statements prepared in accordance with those international standards.

This process, though important and providing an opportunity for a real break-through, does not by any means guarantee that harmonization will be achieved at all, not to mention in a particularly timely manner. Thus, it is imperative that efforts be undertaken to capitalize on this period of opportunity. The United States must do its share in making international accounting harmonization a reality.

I would like to spend the next few minutes discussing the need for harmonization of accounting standards and, in particular, what the relevant U.S. entities, including principally regulators and standard setters, should do to help achieve the important goal of harmonization in as expeditious a time frame as possible.

II. HARMONIZATION AND ITS BENEFITS

The benefits of harmonization have been frequently noted, but are sufficiently important to merit a brief review.

From the point of view of the Securities and Exchange Commission, as an agency one of whose primary functions is to protect investors, an extremely valuable benefit of harmonization would be the

7/ IASC, Statement of Intent: Comparability of Financial Statements 8 (July 1990).

increase in the usefulness of financial statements that harmonization could provide to U.S. investors in foreign securities.

The U.S. rules prohibiting foreign companies from offering securities in the U.S. or listing on U.S. exchanges without compliance with U.S. accounting requirements have not deterred U.S. investors from purchasing the securities of foreign issuers. ^{8/} U.S. investors must make these purchases on the basis of financial statements that are prepared in accordance with a variety of accounting standards of a variety of countries. Thus, these financial statements are unlikely to be comparable. However, financial statements prepared in accordance with harmonized accounting standards would be far more comparable than those currently relied on by U.S. investors. They would enable, for example, an investor to compare General Motors with Daimler Benz, Toyota and Volkswagen.

Another benefit of harmonization is that it could increase dramatically the willingness of foreign issuers to participate in the U.S. securities markets. As was noted in a report on international equity offerings of the International Organisation of Securities Commissions

^{8/} The securities of over 1000 foreign issuers currently trade in the non-NASDAQ over-the-counter market pursuant to the exemption from registration with the Commission provided by Exchange Act Rule 12g3-2(b). 55 SEC Annual Report 132 (1990). The exemption is conditioned on such companies furnishing their home country disclosure documents to the Commission.

("IOSCO"), the U.S. is one of the few countries that requires reconciliation of foreign country financial statements to local U.S. accounting and auditing standards. 9/ As has often been noted, this requirement has dissuaded many high quality foreign companies from entering the U.S. equity markets. 10/ Harmonized accounting standards could help eliminate this barrier, thereby providing U.S. investors with greater and more efficient access to foreign securities, enhancing the international competitiveness of the U.S. financial markets, and enabling securities services businesses in the United States to compete more successfully with their foreign counterparts.

A further benefit of increased harmonization of accounting standards is that it should tend to simplify accounting in U.S. multinational corporations, which are now required to deal with a variety of differing accounting standards in the countries in which their

9/ IOSCO, International Equity Offers: Summary of Report 12 (1989).

10/ See, e.g., Securities Act Release No. 6866, 55 FR 23751, 23751-52 (June 12, 1990) ("One of the most significant barriers to inclusion of U.S. security holders in an offshore exchange offer has been the need for adherence to, or reconciliation with, U.S. generally accepted accounting principles ("GAAP") and auditing standards, as well as concern over continuing reporting requirements under the Exchange Act."); Securities Act Release No. 6841, 54 FR 32226, 32226 (August 4, 1989) ("Foreign issuers that consider direct access to the U.S. capital markets through registered public offerings frequently are dissuaded by the substantial differences in disclosure standards, particularly with respect to accounting standards.")

subsidiaries operate throughout the world. Maintaining separate sets of books to meet separate U.S. and local requirements --- and then converting foreign bookkeeping to U.S. requirements --- involves substantial expenditures of time and effort. To the extent international companies are permitted to prepare the financial statements of the parent and all its subsidiaries in accordance with harmonized international standards, these expenditures could be reduced.

An additional benefit of increased international harmonization of accounting standards would be that it could help reduce adverse effects on U.S. competitiveness that may be caused by disparities in accounting standards. The standard most commonly mentioned in this regard is accounting for goodwill. 11/ Business men and women tend to agree that the U.S. requirement that goodwill must be written off against income makes it easier for foreign companies to make acquisitions than for U.S. companies to make the same acquisitions. The U.S. goodwill accounting requirement can cause major differences in the post-acquisition reported income of U.S. companies compared to that of foreign companies, since many foreign companies are permitted to

11/ See generally Groves, "Where Has All the Goodwill Gone?", Internationalization of the Securities Markets: Business Trends and Regulatory Policy 591-99 (ALI-ABA 1989).

write-off goodwill immediately against shareholders' equity rather than against net income. 12/

The IASC has indicated that it intends to require goodwill to be recognized as an asset and written-off against income over a period of generally not more than five years. 13/ Thus, the proposed IASC standard would be tougher than the existing U.S. standard with respect to the amortization period, but it also would prohibit the practice of writing off goodwill directly against shareholders' equity. Regardless of what one thinks of the arguments for either type of accounting treatment, there are substantial benefits simply to settling on one standard that applies to all companies and thereby leveling out at least one bump on the business playing field.

III. OBSTACLES TO ACHIEVING HARMONIZATION

If the benefits of international accounting harmonization are clear, why has it been more talked about than realized? Why has deed lagged so far behind hope?

One factor often cited in the past as an obstacle to achieving harmonization is the differing purposes for which accounting principles have been developed in different countries. Since those purposes differ,

12/ See id. at 594.

13/ IASC, supra note 7, at 17.

so the argument goes, so will the accounting principles arising from those purposes. In some countries, such as Germany for example, financial statements have been used as a basis for accounting for tax liability. 14/ In other countries, such as the United States, financial statements have been intended to be general purpose statements that are designed for non-governmental users such as investors and creditors, but are not used principally as a part of the tax compliance system. In yet other countries, financial statements are prepared primarily for use of creditors, and not for equity investors. 15/

The dramatic increase in international capital flows in recent years, however, particularly with respect to world class companies, is pushing us towards development of multi-purpose financial statements. It is more and more important that a world class company produce financial statements that are of use not only to its banks, but also to the many outside institutions and investors, both public and private, from which such a company may want to attract funds.

For its part, the IASC has decided that international accounting principles should be designed to produce multi-purpose financial

14/ See Organisation for Economic Co-operation and Development, The Relationship between Taxation and Financial Reporting, Report by the Working Group on Accounting Standards (Paris 1985).

15/ See Groves, supra note 11, at 595.

statements that are valuable to a wide variety of users. 16/ The authority of IASC standards, which represent an international consensus on the best accounting practices, will provide additional momentum, I hope, to overcome the inertia resulting from differences in financial statement purposes among different countries.

Another claimed obstacle to international accounting harmonization is the alleged competitive disadvantage to U.S. companies which is said to be likely to result if harmonization is attained. Some have argued that recognition of international standards for foreign companies will place U.S. companies at a competitive disadvantage if U.S. companies are still, in addition, required to comply with more stringent U.S. accounting standards. 17/ It would be nice if this concern for the competitive position of U.S. companies was as much in evidence in setting U.S. standards as it is in recognizing international accounting standards. It is perhaps more than a little ironic, however, that some of those who forcefully argue that competitiveness is an obstacle to international accounting harmonization are also just as forceful in arguing that competitiveness factors should not even be considered when

16/ See IASC, supra note 7, at 8.

17/ See, e.g., Beresford, "What's the FASB doing about international accounting standards?", 6 Financial Executive 18-19 (May/June 1990).

formulating U.S. accounting standards. 18/ To do the latter would allegedly violate the doctrine of neutrality and thereby destroy the purported foundation of the U.S. accounting structure.

It is at least inconsistent (if not something more) to ignore competitive costs when formulating U.S. accounting standards, thereby increasing the disparities between U.S. and foreign issuers, while at the same time arguing that harmonization is difficult because of these very disparities. A more productive approach would be to begin by considering international competitiveness issues, as well as all other international ramifications of accounting standards, in setting U.S. accounting standards in the first place.

Even without harmonization, U.S. companies must compete for capital, both in the private U.S. markets and overseas, with foreign companies subject to different accounting standards. In my view, harmonization is not a cause of competitiveness problems for U.S. companies, but rather provides one real answer to this problem.

IV. APPROACHES TO ACHIEVING HARMONIZATION

There are at least three possible approaches to achieving harmonization of accounting standards. For simplicity's sake, let me

18/ See, e.g., Beresford, "Financial Reporting: Comparability and Competition", FASB Viewpoints 2-5 (November 8, 1990).

refer to them as the bilateral approach, the multilateral approach, and the international approach.

Let me start with the bilateral approach, under which regulators in one country enter into bilateral arrangements as to accounting harmonization with regulators in another country. An example of this approach is the proposed bilateral disclosure system between Canada and the United States pending at the SEC. 19/ The advantage of the bilateral approach is that it may be faster and easier to implement than a multilateral agreement involving many countries' regulators. The disadvantage is that, as more and more separate bilateral agreements are entered into, requirements under one bilateral agreement may differ from those under another bilateral agreement, thereby perpetuating rather than reducing accounting disparities.

The second approach is cooperation on a regional basis --- multilateralism. The best example of this approach is in the European Economic Community, which has taken a number of significant steps, including some involving accounting, to facilitate capital flows among its member states. For example, the EEC has issued a directive on mutual recognition of member states' prospectuses and related financial

19/ See Securities Act Release No. 6879, 55 FR 45896 (October 31, 1990).

statements. 20/ It is noteworthy that the EEC has also participated in international efforts at harmonization through its membership on the IASC Consultative Group.

The third approach is international. The ultimate goal of this approach is to work through international organizations to develop a body of accounting standards that would be uniformly acceptable to and uniformly used by all national regulators. Under this approach, all countries would adopt the same standards. International uniformity certainly is an attractive goal, but may be difficult to achieve in the near term.

An intermediate approach to internationalism in accounting is to develop a set of international standards that would be acceptable to each local regulator for purposes of recognizing the financial statements of foreign companies, but would not prevent a regulator from requiring its own domestic issuers to comply with further or different local accounting principles. Foreign companies wishing, for example, to issue securities in a local securities market would reconcile their home country financial statements to the international standards, but would not be required to reconcile with local accounting principles. This approach is

20/ 90/211/EEC Council Directive of 23 April 1990 Amending Directive 80/390/EEC in Respect of the Mutual Recognition of Public-Offer Prospectuses as Stock-Exchange Listing Particulars.

the one being pursued by the IASC and has been endorsed by IOSCO in its Report on International Equity Offers. 21/

In my view, the IASC approach represents a very promising approach for achieving harmonization in the near term.

The IASC was created in 1973 by the professional accounting organizations of a number of countries. It was charged with formulating international accounting standards and with improving and harmonizing worldwide financial reporting. 22/ The IASC began its work by attempting to codify the best practices of its member countries on individual accounting issues, and its standards currently accommodate a wide variety of accounting practices. Consequently, they are subject to the criticism that they do not provide sufficient comparability among preparers. 23/ To address this concern, the IASC started a comparability project in 1989 and updated it in 1990. 24/ The comparability project is substantially narrowing the range of choices in accounting practices and represents an important phase in the efforts

21/ IASC, supra note 7, at 9; IOSCO, supra note 9, at 8.

22/ See IOSCO, Towards the International Harmonisation of Financial Statements: An Invitation to Comment on an Exposure Draft on the Comparability of Financial Statements 2 (1989).

23/ IASC, Exposure Draft No. 32: Comparability of Financial Statements 7 (January 1, 1989).

24/ See id.; IASC, supra note 7.

toward harmonization. The IASC has indicated that it intends to complete the project with respect to existing international standards by the beginning of 1993. 25/ Thus, the next year and one-half represents a critical point in the effort towards harmonization.

As noted, recognition of IASC standards would not mean that local country regulators could no longer impose their own standards on their domestic companies. 26/ Rather, many of the benefits of harmonization could be obtained if, at least for purposes of foreign issuers, local regulators would accept financial statements prepared in accordance with or reconciled to IASC standards. 27/

V. U.S. ROLE IN ACHIEVING HARMONIZATION

The United States, with one of the largest financial markets in the world and a fully-developed regulatory structure, will obviously play an essential role in determining the success or failure of the efforts to achieve international accounting harmonization. I believe there are two

25/ IASC, supra note 7, at 8.

26/ Imposing local standards might, however, disadvantage their domestic companies.

27/ While this might create a comparability problem for U.S. issuers who were required to comply with U.S. GAAP, such U.S. issuers could also reconcile their financial statements to international standards if they felt that U.S. standards caused a competitive disparity. U.S. companies with significant international operations might well produce such a reconciliation as a matter of course.

primary steps which the U.S. needs to take to help achieve harmonization: first, support the IASC comparability project; and, second, reorient the U.S. standard setting process to reflect the importance of international considerations.

The most important step the U.S. needs to take to play its proper role in achieving international accounting harmonization is to definitively reject the mind-set that harmonization is a theoretically attractive, but practically unobtainable, goal. The IASC's efforts in fact present a realistic and concrete opportunity to achieve many of the benefits of harmonization in a reasonable time frame. The U.S. should act promptly to support the IASC efforts.

IASC standards have no legal authority except to the extent they are adopted by the authorities of individual countries. The SEC, through IOSCO, has actively participated in the IASC's comparability project. U.S. regulators and standard setters have not yet indicated, however, at least publicly, that they would be willing to support the standards that are ultimately developed by the IASC.

The U.S. should provide public support for the IASC's efforts to develop acceptable international standards; it should participate constructively in these efforts; and it should be prepared after the IASC efforts are completed to recognize financial statements of foreign companies that are prepared in accordance with or reconciled to the

IASC standards. It would be most unfortunate if the IASC were to complete its work and publish its standards within the next year and one-half, and yet have its work fail to provide any benefits to the United States because those standards were not recognized in the United States.

For the SEC, a primary objective is to ensure that full and fair disclosure concerning issuers is available to U.S. investors. Obviously, the Commission could not recognize international standards if U.S. investors would be harmed as a result. Many in the U.S., however, seem to view the issue of harmonization with great trepidation because in their minds it will inevitably involve a process of diluting U.S. standards. In fact, however, many international standards are at least as conservative as U.S. standards. As I noted earlier, for example, the IASC goodwill standard is more conservative from an income statement viewpoint than the U.S. standard. 28/ In addition, many accounting standards are based on difficult judgment calls, and do not involve issues for which there is only one "right" answer that, if adopted, will render financial statements perfect.

It is important to remember that accounting principles are human conventions, not laws brought down from the Mount. Just because the

28/ See supra notes 11-13 and accompanying text.

SEC or FASB has adopted a particular position on an accounting issue does not mean that every other view on that issue is defective or indefensible or would, if adopted, result in harm to investors. In the process of working towards international consensus on the IASC standards, the U.S. needs to make clear that it is genuinely willing to consider the points of view of other countries and to accept them if reasonable.

For example, one difference between U.S. and IASC standards on which reasonable persons might disagree is accounting for development costs. The relevant U.S. standard, of course, requires U.S. companies to charge all development costs to expense when incurred. 29/ In its deliberations on this issue, FASB considered allowing some development costs to be deferred, and this position was strongly supported by many knowledgeable accountants. 30/ An asset, after all, can be viewed as nothing other than a cost that will benefit a company in the future, and companies can certainly benefit from their development efforts. However, FASB ultimately decided that it was not possible to establish a development cost standard that could be applied objectively and comparably by all companies. FASB therefore simply

29/ FASB, Statement of Financial Accounting Standards No. 2: Accounting for Research and Development Costs ¶12 (1974).

30/ See id. at ¶¶53-54.

decided to require all development costs to be expensed. 31/ However, when the IASC, representing highly qualified accountants from many different countries, considered the issue it reached a different conclusion. 32/

My remarks today are not intended to indicate what the resolution of this issue should be, or whether the U.S. should adopt the IASC standard or vice versa. My intention is solely to note that very often accounting standards, particularly contentious ones, are not black or white issues but rather matters on which reasonable persons can reasonably differ. Under these circumstances, FASB, at the very least, has a duty seriously to consider IASC positions and the international consensus that they represent. One hopes that a refusal by any country, including the U.S., to consider and to accommodate where possible the views of the IASC on accounting issues will not prove to be a stumbling block to international accounting harmonization.

To the extent the U.S. appears to be simply stonewalling the process in hopes that its own standards will prevail, other countries will

31/ Id. at ¶55.

32/ IASC, supra note 7, at 19; IASC, International Accounting Standard No. 9: Accounting for Research and Development Activities ¶17 (July 1978).

rightfully be suspicious that, for the U.S., harmonization means that every other country must harmonize to the U.S. tune.

Another important step which should be taken to encourage international accounting harmonization is to give the U.S. standard setting process an international focus. Currently, of course, the primary U.S. standard setter is FASB. Its Mission Statement, which was adopted in 1973, does not even mention international considerations, much less direct FASB to work towards harmonization of accounting standards or to consider the international ramifications of its actions. Given the different concerns that existed nearly two decades ago, this is not necessarily surprising.

FASB's Mission Statement is in urgent need of updating. Since 1973, there have been dramatic changes in the economic environment, particularly in the internationalization of markets. FASB's Mission Statement needs to reflect these changes. In particular, it should direct FASB to undertake every possible effort to work towards international harmonization of accounting standards. One concrete way in which harmonization could be facilitated, or at least not made more difficult, would be if FASB would adopt new standards only in collaboration with international and major non-U.S. standard setters. If the U.S. continues to adopt standards unilaterally, the prospects for harmonization will likely recede. It would be much preferable if significant new U.S.

standards could be developed whenever possible through consensus with other standard setters.

In addition, I believe FASB should undertake a comprehensive review of its existing standards to determine how they compare with international practice. To the extent that current FASB standards depart from a respectable generally accepted international practice, FASB should consider whether it is appropriate to adopt the international consensus.

VI. CONCLUSION

Let me conclude by saying that I believe and hope that international harmonization of accounting standards is no longer just a long term goal. I believe it can be within our grasp. The substantial benefits of harmonization for the U.S. and the world economy mandate that the U.S. do all that it can to ensure that this moment of opportunity is not lost.

Thank you.