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## There's a New Sheriff In Town - Will the New SEC Chairman Allow Issuers of American Depository Receipts to Use International Accounting Standards to Satisfy Listing Requirements on U.S. Exchanges?

Joseph J.M. Orabona

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# There's A New Sheriff In Town – Will the New SEC Chairman Allow Issuers of American Depository Receipts to Use International Accounting Standards To Satisfy Listing Requirements on U.S. Exchanges?

Joseph J.M. Orabona\*

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## I. INTRODUCTION

“In the field of securities law today, there is no more important priority for securities regulators than to address the role of securities regulation in the global marketplace.”<sup>1</sup> It would be fair to infer from such a message, especially one from Harvey Pitt, the Chairman of the U.S. Securities and Exchange Commission (“SEC”), that international securities regulation and policy will be one of the SEC’s top priorities during his tenure.

Today, investors do not merely rely on their own national markets to provide for their investing needs, but look across national borders to take advantage of new opportunities for capital growth and to add an element of diversification to their portfolios by investing in international securities.<sup>2</sup> Similarly, companies around the world raise capital and enhance their global presence by offering many forms of their securities in a variety of global marketplaces.<sup>3</sup>

J.P. Morgan developed the first American Depositary Receipt (“ADR”) in 1927 to allow U.S. investors to purchase foreign security interests in Selfridges & Co., a British retailer.<sup>4</sup> Today, many foreign companies continue to access U.S. markets to raise capital and enhance global presence by offering ADRs.<sup>5</sup> U.S. investors have been very responsive to ADRs, as evidenced by the increase in the ADR dollar trading volume from \$1.8 billion in 1983<sup>6</sup> to \$752 billion in 2001.<sup>7</sup>

This comment analyzes the probability that the new SEC Chairman, Harvey Pitt, will allow issuers of ADRs to use International Accounting Standards (“IAS”) to satisfy the listing requirements on U.S. exchanges, as opposed to the current required reconciliation of their home-country

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1. SEC Historical Society to Hold Major Issues Conference on Securities Regulation in the Global Internet Economy (Oct. 25, 2001), *available at* <http://www.sec.gov/news/press/2001-119.txt> (last visited Jan. 21, 2002).

2. OVERVIEW OF AMERICAN DEPOSITORY RECEIPTS, *at* [http://www.adr.com/adr/adr\\_about\\_overview.html](http://www.adr.com/adr/adr_about_overview.html) (last visited Jan. 29, 2002) [hereinafter OVERVIEW].

3. *Id.*

4. *Id.*

5. American Depositary Receipts, Exchange Act Release No. 29226, International Series Release No. 274, [1990–1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,740, at 81,586 (May 23, 1991) [hereinafter ADR Release].

6. Bruce L. Hertz, *American Depositary Receipts*, in 600 COMMERCIAL LAW AND PRACTICE COURSE HANDBOOK 237, 239 (Practising Law Institute ed., Feb. – Mar. 1992).

7. DEPOSITORY RECEIPTS (ADRs and GDRs): 2001 YEAR-END MARKET REVIEW, *at* <http://www.adrbny.com/files/MS1637.pdf> at 5 (last modified Jan. 2, 2002) [hereinafter MARKET REVIEW]. This publication provides many useful tables, charts and other analytical data about ADRs. See *infra* Part II.C for details.

accounting standards with U.S. Generally Accepted Accounting Principles ("GAAP"). To begin the analysis, Part II will examine ADRs – definition, types and current market data. Part III will examine U.S. securities laws and U.S. exchange listing requirements applicable to issuers of ADRs. Part IV will briefly examine the Financial Accounting Standards Board ("FASB"), its role in developing GAAP, and the required reconciliation to GAAP for issuers of ADRs. Part V will describe the structure of the International Accounting Standards Board ("IASB") and International Organization ("IOSCO"), the current status of IAS, and some basic differences between IAS and GAAP. Part VI will compare and contrast the SEC's policy on adopting IAS under former SEC Chairman Levitt with the expected policy under new SEC Chairman Pitt, the arguments for and against adopting IAS in the U.S. for ADRs, and the effect of the current market events in 2001 and 2002. Part VII will conclude with an opinion, based on the analysis in Parts II-VI, on whether the new SEC Chairman Pitt will allow ADRs to use IAS to comply with listing requirements on U.S. exchanges.

## II. AMERICAN DEPOSITORY RECEIPTS

### A. *Definition and Basic Characteristics*

An ADR is a security, evidenced by a physical certificate that provides proof of ownership in one or more American Depository Shares ("ADSs"), that represents a multiple or fraction of foreign securities deposited with a depository bank ("Depository").<sup>8</sup> Although ADR and ADS are terms frequently used interchangeably, an ADS is a form of equity ownership in a non-U.S. company denominated in U.S. dollars.<sup>9</sup> ADRs, which can be listed and traded on U.S. exchanges, are a convenient way to tap into international markets by providing a limited currency risk for investors.<sup>10</sup>

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8. 17 C.F.R. § 240.12b-2 (2000) (defining the term "depository share"); *see also* DEFINITION, at [http://www.adr.com/adr/adr\\_the\\_definition.html](http://www.adr.com/adr/adr_the_definition.html) (last visited Jan. 30, 2002) [hereinafter DEFINITION]. Typically, the Depository is a U.S. bank or trust company, such as The Bank of New York, Bankers Trust Company, Citibank N.A., Morgan Guaranty Trust Company of New York, or Security Pacific National Trust Company (New York). ADR Release, *supra* note 5, ¶ 84,740, at 81,587 & n.8. However, the SEC does not require that the Depository be a bank. *Id.*

9. DEFINITION, *supra* note 8.

10. *See generally id.* ("ADRs provide U.S. investors with a convenient way to invest in

The Depository issues the ADR in the form of a receipt representing a specific amount of foreign securities.<sup>11</sup> It is deposited in an agent of the Depository or overseas branch called the Custodian.<sup>12</sup> Although the foreign securities are typically in the form of common stock, it is not unusual for them to be preferred stock or debt instruments.<sup>13</sup>

The ratio of an ADR to the underlying foreign security is not necessarily one-to-one – it may be represented as a fraction of the total number of foreign securities held by the Depository.<sup>14</sup> To attract investors, the ratio of ADRs to their underlying foreign securities is selected in order to provide the best price on the U.S. exchange by compensating for differences between the normal price on the home foreign exchange and the price listed on any U.S. exchange.<sup>15</sup> Once the ADR is purchased, the U.S. investor will receive dividends and other distributions from the Depository or Custodian.<sup>16</sup> The U.S. investor is not necessarily the actual title owner of the foreign shares underlying the ADR because ownership depends upon the securities laws of the foreign country.<sup>17</sup>

### *B. Types – Sponsored or Unsponsored*

There are two types of ADRs – sponsored and unsponsored.<sup>18</sup> A sponsored ADR is created when the issuer of the underlying security (“Issuer”) actively participates in and initiates the sale.<sup>19</sup> Assuming that the ADR will be listed on one of the U.S. exchanges, the Issuer will obtain the required securities exemption or satisfy the reporting require-

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non-U.S. securities without having to worry about the complex details of cross-border transactions,” and they “can be listed on any of the U.S. exchanges.”).

11. ADR Release, *supra* note 4, ¶ 84,740, at 81,587.

12. Hertz, *supra* note 6, at 241.

13. *Id.*

14. *Id.*; see also 17 C.F.R. § 240.12b-2 (2000)(defining “depository share.”).

15. ADR Release, *supra* note 4, ¶ 84,740, at 81,587 n.6; see also Hertz, *supra* note 6, at 241 (illustrating this example – “[I]f a stock is trading at the equivalent of \$0.50 per share, which is within the accepted price range in its home market, and it is believed that a figure of \$7.50 per ADR would be suitable in the U.S., the ratio might be set so that each ADR will represent 15 shares to produce an ADR price of \$7.50.”).

16. Hertz, *supra* note 6, at 241. Dividends and other distributions are provided to U.S. investors net of any expenses or fees incurred by the Depository or Custodian. *Id.*

17. *Id.*

18. ADR Release, *supra* note 5, ¶ 84,740, at 81,588. “In 2001, 118 new sponsored [ADR] programs were established, five unsponsored programs were converted to sponsored programs, and eighty-three sponsored programs were eliminated as a result of corporate actions.” MARKET REVIEW, *supra* note 7, at 2.

19. ADR Release, *supra* note 5, ¶ 84,740, at 81,589.

ments under the Securities Exchange Act of 1934 ("Exchange Act").<sup>20</sup> In addition, the Issuer, Depository and ADR owners will enter into a Deposit Agreement setting forth the rights and obligations of the parties.<sup>21</sup>

In contrast, third parties initiate the sale of an unsponsored ADR without any significant involvement from the Issuer.<sup>22</sup> At a minimum, the Issuer has to obtain an Exchange Act exemption.<sup>23</sup> Unlike the sponsored ADR, the rights and obligations exist only between the Depository and the ADR owner as set forth in the ADR certificate – the Issuer has no obligations to the Depository or the ADR owner.<sup>24</sup>

U.S. investors that purchase unsponsored ADRs, instead of sponsored ADRs, pay higher fees for the deposit, withdrawal, conversion of dividends into U.S. dollars, disposition of non-cash distributions, and performance of other services.<sup>25</sup> Moreover, the sponsored ADR owner will receive the same information that the Issuer provides to its shareholders, including the method the ADR owner can use to vote the underlying foreign securities.<sup>26</sup> Owners of unsponsored ADRs will not receive this information.<sup>27</sup> Finally, unsponsored ADRs are limited in their negotiability with the Issuer and in their ability to list on U.S. exchanges.<sup>28</sup>

### C. Current Market Data

The Bank of New York's Depository Receipt Division, a leader in ADR trading, provides the investing public with an up-to-date report on ADR current market data called "Depository Receipts: 2001 Year-End

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20. *Id.* ¶ 84,740, at 81,594–95. The Issuer can either obtain an exemption under Rule 12g of the Exchange Act or sign, with the Depository, a Securities Act of 1933 registration statement on Form F-6. *Id.*; see also *infra* Part III for a further discussion on the applicable U.S. securities laws.

21. ADR Release, *supra* note 5, ¶ 84,740, at 81,595.

22. *Id.* ¶ 84,740, at 81,588 ("Most often, a depository is the principal initiator of a facility because it perceives U.S. investor interest in a particular foreign security and recognizes the potential income which may be derived from a facility. In other cases, one or more brokers familiar with U.S. investor interest and U.S. trading activity in a foreign issuer's securities may request that a depository create a facility in order to facilitate trading."); see also An Introduction to American Depository Receipts, at <http://www.wallstreeter.com/introadr.htm> (last visited Nov. 27, 2001).

23. ADR Release, *supra* note 5, ¶ 84,740, at 81,588.

24. *Id.*

25. *Id.*

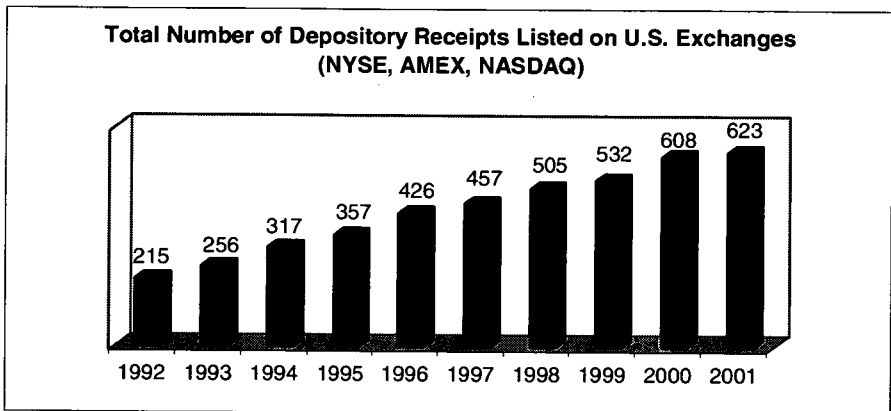
26. *Id.* ¶ 84,740, at 81,589.

27. *Id.* ¶ 84,740, at 81,588–89.

28. *Id.* ¶ 84,740, at 81,590. Only sponsored ADRs can list on the NYSE or AMEX. *Id.*

Market Review” (“Year-End Review”).<sup>29</sup> The following series of charts have been taken from the Year-End Review in order to provide the reader with an understanding of the increased popularity of these investment tools. The current market data compares the most recent decade – from 1992 to 2001. In particular, the charts selected will show the increased growth in ADR listings, annual share volume, and annual dollar volume, as well as the share trading volume by country and the dollar trading volume by country.<sup>30</sup>

The first chart depicts the 189% increase in the number of depository receipts listed on U.S. exchanges over the last ten years.<sup>31</sup> Furthermore, out of the 1,558 total listed programs in 2001, 623 were listed on U.S. exchanges – more than 39%.<sup>32</sup>



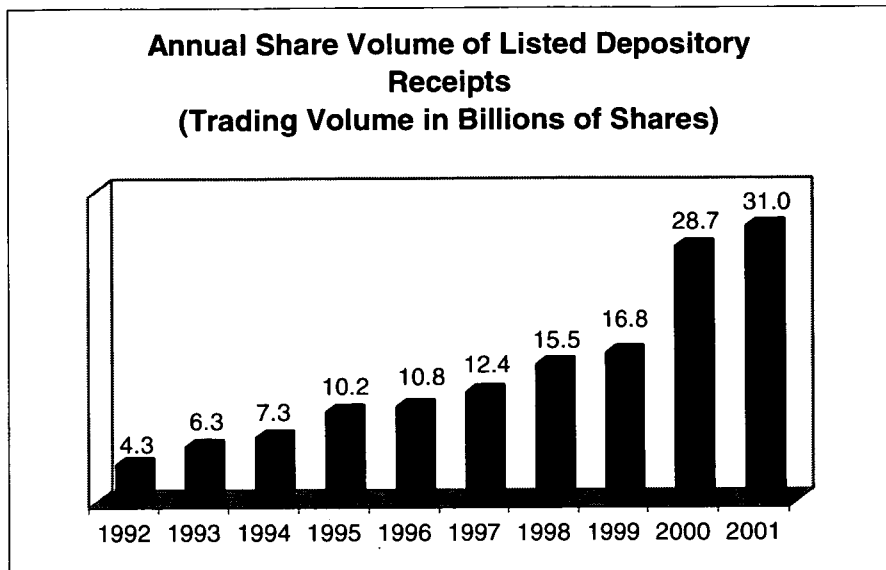
29. MARKET REVIEW, *supra* note 7, at 1 (noting that the charts used in the report include ADRs and Global Depository Receipts (“GDRs”); however, the GDR portions are minimal). The Bank of New York’s website on Depository Receipts provides current information on calendar events, basics and benefits of ADRs, how to buy ADRs, a complete directory of ADRs, and other current news and market links. The Bank of New York Depository Receipts, at <http://www.adrbny.com> (last visited Feb. 2, 2002).

30. See generally MARKET REVIEW, *supra* note 7.

31. *Id.* at 5.

32. *Id.*

The second chart shows an increase of over 388% from 1992 to 2001 in the annual share volume of all the listed depository receipts on U.S. exchanges.<sup>33</sup>



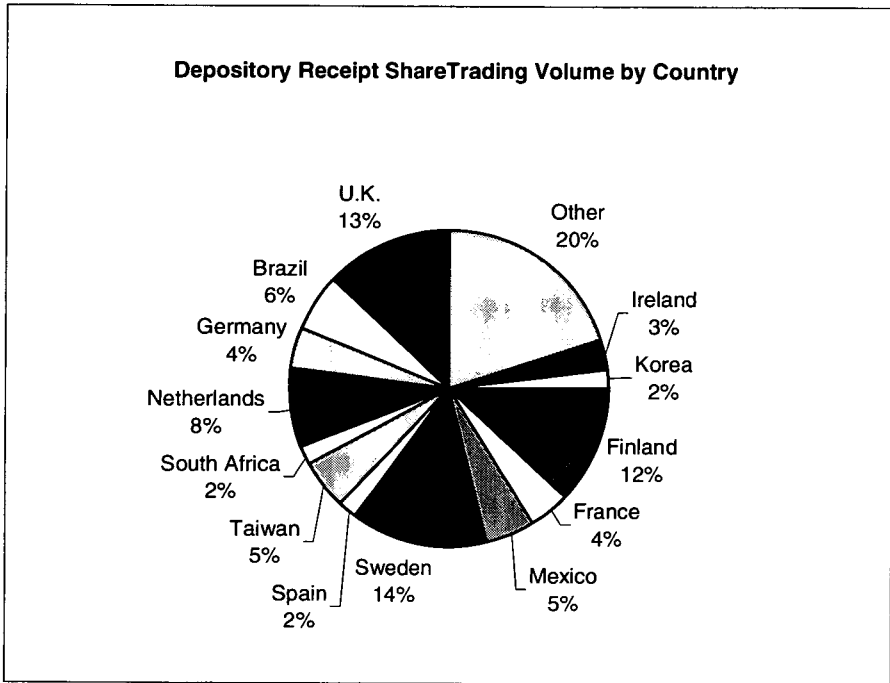
There are many countries that contribute to the U.S. market for depository receipts. The third chart depicts the depository receipt share trading volume on U.S. exchanges by country.<sup>34</sup>

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33. *Id.*

34. *Id.* There are many global companies that contribute to the depository share trading volume, such as, Nokia Corporation, Ericsson Telephone Company, Sony Corporation, Gucci Group, Novartis, and many more. *Id.* at 8.



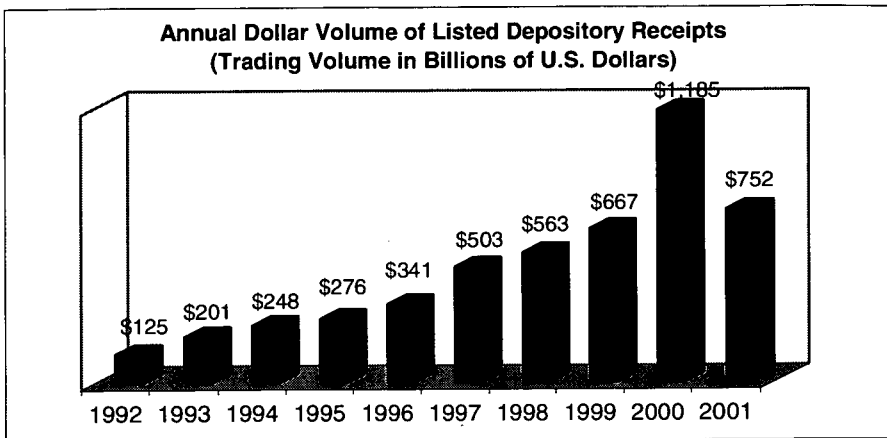


In 2000, the annual dollar volume of listed depository receipts increased by eight times the amount it was in 1992.<sup>35</sup> The last three years depicted the greatest swing in the annual dollar volume. From 1999 to 2000, the annual dollar volume increased more than 43%. However, the annual dollar volume decreased almost 37% from 2000 to 2001,<sup>36</sup> likely because of the recent economic recession.<sup>37</sup>

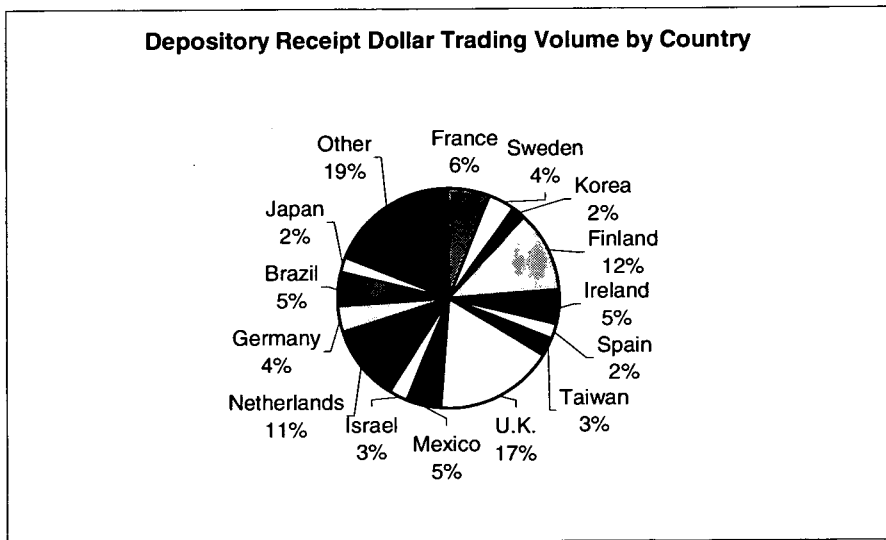
35. *Id.*

36. *Id.*

37. *Id.*



There are many countries that contribute to the dollar trading volume, as depicted in the chart above. This final chart details the percentage that each country represents.<sup>38</sup>



38. *Id.*

### III. REQUIREMENTS FOR LISTING ADRS ON U.S. STOCK EXCHANGES

ADRs are traded in the U.S. in much the same way as other domestic debt and equity securities. Issuers of ADRs access U.S. markets in one of three ways: “(1) trading ADRs with minimal regulation in the over-the-counter market; (2) listing existing ADRs on an exchange by complying with a moderate amount of regulation; or (3) simultaneously listing and offering new ADRs for sale, which requires full registration under the Securities and Exchange Acts.”<sup>39</sup> Since the level of regulatory complexity increases with each option, Issuers of ADRs usually enter U.S. markets through the “less regulated method, such as the over-the-counter market, and utilize more complex methods over time.”<sup>40</sup>

The Issuers that list their ADRs on U.S. equity markets usually access one of the three major U.S. exchanges: The New York Stock Exchange (“NYSE”); NASDAQ; or The American Stock Exchange (“AMEX”).<sup>41</sup> These exchanges individually monitor and police their members with SEC oversight as a self-regulatory organization (“SRO”).<sup>42</sup> Issuers seeking to use an SRO must not only comply with the SEC requirements, but must also meet the specific listing criteria established by each SRO.<sup>43</sup>

#### A. Securities Law Requirements

##### 1. Registration and Disclosure Requirements

ADRs listed on U.S. exchanges or on the U.S. over-the-counter markets, are subject to the Securities Act of 1933<sup>44</sup> (“Securities Act”) and

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39. Jay D. Hansen, *London Calling?: A Comparison of London and U.S. Stock Exchange Listing Requirements for Foreign Equity Securities*, 6 DUKE J. COMP & INT’L L. 197, 209 (Fall 1995).

40. *Id.*

41. ADR Release, *supra* note 5, ¶ 84,740, at 81,590. Other foreign issuers of ADRs can choose to conduct trading in the U.S. over-the-counter (“OTC”) market. *Id.* (OTC trading is conducted using a market maker who publishes quotes in “Pink Sheets,” a daily listing of market maker quotations operated by one of the electronic services offered by the National Association of Securities Dealers, Inc. (“NASD”).

42. Roberta S. Karmel, *Will Convergence of Financial Disclosure Standards Change SEC Regulation of Foreign Issuers?*, 26 BROOK. J. INT’L L. 485, 501 (2000).

43. *Id.*; see also Edward F. Greene, U.S. REGULATION OF INTERNATIONAL SECURITIES AND DERIVATIVE MARKETS § 2.03(2) (4th ed., 1998).

44. 15 U.S.C. § 77a et seq. (2001).

the Securities Exchange Act of 1934<sup>45</sup> ("Exchange Act").<sup>46</sup> The ADRs and the deposited foreign securities are considered separate for purposes of the Securities Act, and each is subject to the registration requirements unless an exemption is available.<sup>47</sup> Under Section 5 of the Securities Act, it is unlawful for issuers to sell ADRs on U.S. exchanges unless the issuer has an effective registration statement filed with the SEC for the underlying foreign securities and the ADRs.<sup>48</sup>

In 1983, the SEC adopted Form F-6 for issuers of ADRs to comply with the registration requirement under Section 5 of the Securities Act.<sup>49</sup> There are several requirements for an Issuer to be eligible to use Form F-6. First, the deposited foreign securities must be either registered with the SEC or exempt under the Securities Act.<sup>50</sup> Second, the ADR holder must be able to withdraw the deposited foreign securities at any time, subject to certain limitations.<sup>51</sup> Finally, as of the date of filing Form F-6, the Issuer of the deposited securities must be either a registrant under the Exchange Act or exempt from registration under Rule 12g3-2(b).<sup>52</sup>

An Issuer of ADRs filing Form F-6 is required to disclose specific information to the SEC. The Issuer must provide the name of the Depository and the address of its principal executive office,<sup>53</sup> as well as a description of all related expenses incurred, directly or indirectly by the Depository and imposed upon the holder of the ADRs.<sup>54</sup> Furthermore, the Issuer of the ADRs should provide the SEC with terms of the deposit, including the amount of deposited securities represented by one unit of ADR.<sup>55</sup> The Issuer must also provide any terms associated with the collection or distribution of dividends and the transmission of any

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45. 15 U.S.C. § 78a et seq. (2001).

46. ADR Release, *supra* note 5, at ¶ 84,740, at 81,587.

47. *Id.* ¶ 84,740, at 81,594. If the Issuer sells his securities using the ADR form in order to facilitate a public offering in the U.S., it does not affect the registration requirements with respect to the foreign issuer's securities. *Id.* The Issuer must register both the ADRs and the foreign securities with the SEC. *Id.* ¶ 84,740, at 81,594 & n.47 (The ADRs are registered using Form F-6, and the deposited foreign securities are registered using either Form F-1, F-2, F-3 or F-4).

48. *See* 15 U.S.C. § 77e (2000).

49. ADR Release, *supra* note 5, ¶ 84,740, at 81,594 & n.50.

50. *Id.* ¶ 84,740, at 81,595 & n.52; *see also* Form F-6, General Instruction I.A.(2).

51. *Id.* ¶ 84,740, at 81,595 & n.53; *see also* Form F-6, General Instructions I.A.(1).

52. *Id.* ¶ 84,740, at 81,595. For a further discussion of the applicable securities exemptions, *see infra* notes 65-67.

53. 17 C.F.R. § 229.202(f)(1) (2000).

54. *Id.* § 229.202(f)(2) (2000) (The description of the expenses must include the type of service, the amount of the expense, and to whom it is to be paid.).

55. *Id.*

notices, reports, and proxy soliciting material.<sup>56</sup> The sale or exercise of rights, and sale or deposit of securities resulting from dividends, splits, or reorganization must be disclosed in the registration statement.<sup>57</sup> The Issuer must disclose any amendments, extensions, or termination of the deposit, as well as any rights the ADR holders possess with respect to inspection of the transfer books of the Depository and the list of holders of the ADRs.<sup>58</sup> Finally, restrictions upon the right to deposit or withdraw the underlying foreign securities, and any limitations upon the liability of the Depository must be provided to the SEC in the Issuer's registration statement.<sup>59</sup>

## 2. Exemptions from Registration

Registration with the SEC can be costly, time consuming and, at times, unnecessary. Section 4(2) of the Securities Act provides an exemption from registration for "transactions by an issuer not involving any public offering."<sup>60</sup> Thus, issuers of ADRs in a private placement do not have to register the underlying foreign securities pursuant to Section 5 of the Securities Act.<sup>61</sup> Moreover, issuers of ADRs in a public offering can still be exempt from Section 5 if the issuer can find an applicable exemption under the Securities Act.<sup>62</sup>

One exemption available for the deposited securities arises when a third-party purchases the Issuer's securities on a secondary market and then deposits them within an ADR program.<sup>63</sup> However, the issuance of the ADR after the deposit constitutes a public offering which must be registered under the Securities Act.<sup>64</sup>

Another exemption from registration exists under the Rule 12g3-2(b).<sup>65</sup> The Rule allows an exemption from the periodic reporting requirements under the Exchange Act for foreign private issuers.<sup>66</sup> How-

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56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. 15 U.S.C. § 77d(2) (2000).

61. Karmel, *supra* note 42, at 509.

62. ADR Release, *supra* note 5, ¶ 84,740, at 81,594.

63. *Id.* ¶ 84,740, at 81,594 & n.49. *See, e.g.*, 15 U.S.C. § 77d(1) (exempting transactions by persons other than the issuer, underwriter or dealer from registration); 15 U.S.C. § 77d(3) (exempting from registration certain transactions by dealers following a distribution).

64. ADR Release, *supra* note 5, ¶ 84,740, at 81,594.

65. 17 C.F.R. § 240.12g3-2(b) (2000).

66. *Id.*

ever, the foreign private issuers must periodically provide the SEC with "material information that they publicly file or publish abroad pursuant to law or stock exchange requirements or that they distribute to their security holders."<sup>67</sup>

A safe harbor exemption was created specifically for foreign issuers under Rule 144A.<sup>68</sup> It provides an exemption from Securities Act registration requirements for specified sales of restricted securities to qualified institutional buyers.<sup>69</sup> This exemption applies "only to securities that, when issued, are not of the same class as securities listed on a national securities exchange or on NASDAQ."<sup>70</sup> For ADRs listed on a U.S. exchange or quoted in NASDAQ, both the ADRs and the deposited foreign securities underlying the ADRs are treated by the SEC as "publicly traded."<sup>71</sup> Thus, Issuers cannot sell ADRs in reliance on the safe harbor exemption in Rule 144A because the ADRs are the same class of securities as the deposited foreign securities.<sup>72</sup>

### 3. Periodic Disclosure Requirements

Under the Exchange Act, issuers of ADRs that list the securities on a U.S. exchange or have them quoted on NASDAQ must comply with the periodic reporting requirements.<sup>73</sup> When the ADRs are listed on a U.S. exchange, both the ADRs and the deposited foreign securities underlying the ADRs must be registered with the SEC pursuant to Section 12(b) of the Exchange Act,<sup>74</sup> or sold pursuant to an exemption from the Exchange Act.<sup>75</sup> In contrast, when the ADRs are quoted on NASDAQ and an issuer files Form F-6, only the deposited foreign securities underlying the ADRs are required to be registered pursuant to Section 12(g) of the Exchange Act.<sup>76</sup>

This Comment is only concerned with the periodic reporting requirement related to the preparation of the issuer's financial statements. Un-

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67. 17 C.F.R. § 240.12g3-2(b) (2000); *see also* ADR Release, *supra* note 5, ¶ 84,740, at 81,595.

68. 17 C.F.R. § 144A (2000).

69. Karmel, *supra* note 42, at 509 (interpreting 17 C.F.R. § 230.144A (2000)).

70. *Id.*

71. *Id.*

72. *Id.*

73. ADR Release, *supra* note 5, ¶ 84,740, at 81,596; *see also* 15 U.S.C. § 77m(a) (2002).

74. *See* 15 U.S.C. § 77l(b) (2002); *see also* ADR Release, *supra* note 5, ¶ 81,596 & n.66.

75. *See supra* notes 60-72.

76. *See* 15 U.S.C. § 77l(g) (2002); *see also* ADR Release, *supra* note 5, ¶ 84,740, at 81,596 & n.66.

der the Exchange Act, the issuers of ADRs must file annual reports with the SEC in accordance with Form 20-F.<sup>77</sup> The annual reports must contain the Issuer's financial statements either prepared in accordance with GAAP or reconciled to GAAP.<sup>78</sup> Issuers must also file other materials that are required to be prepared pursuant to home market regulations.<sup>79</sup>

### B. Specific U.S. Exchange Listing Requirements

Each U.S. exchange<sup>80</sup> is an SRO, and therefore, each U.S. exchange has different quantitative (such as, market share and financial performance) and qualitative (such as, corporate structure and organization) standards set forth in the Issuer's listing agreement.<sup>81</sup> However, each Issuer that lists its ADRs on one of the U.S. exchanges, becomes subject to the periodic reporting requirements under the Exchange Act, unless otherwise exempt.<sup>82</sup> To ensure compliance with securities laws, "listing standards are submitted to the SEC for review and approval."<sup>83</sup>

The NYSE<sup>84</sup> requires foreign companies listing ADRs to comply with either the foreign or domestic issuer listing standard.<sup>85</sup> The domestic standard requires at least 2,000 U.S. "round-lot" shareholders, while the foreign standard requires at least 5,000 U.S. "round-lot" shareholders.<sup>86</sup>

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77. ADR Release, *supra* note 5, ¶ 84,740, at 81,596.

78. *Id.* See also *infra* Part IV (discussing GAAP).

79. *Id.*

80. The discussion, *infra* Part III.B, is limited to the primary U.S. markets where ADRs are traded: NYSE, NASDAQ and AMEX.

81. Karmel, *supra* note 42, at 501.

82. ADR Release, *supra* note 5, ¶ 84,740, at 81,596 & n.66 (citing Section 13(a) of the Exchange Act, 17 U.S.C. § 77m(a)) (summarizing the registration requirements for ADRs listed on NYSE, NASDAQ and AMEX). In addition to the periodic reporting requirements, "any foreign or U.S. person who acquires, either directly or through ADRs, more than five percent of the equity securities of a foreign issuer that is subject to the periodic reporting requirements must report such acquisition to the issuer and the Commission and must otherwise comply with the Commission's regulations under Sections 13(d) and 13(g) of the Exchange Act." ADR Release, *supra* note 5, ¶ 84,740, at 81,595 & n.70 (citing Sections 13(d) and 13(g), respectively, as 15 U.S.C. § 77m(d) and 77m(g)) (2002).

83. Karmel, *supra* note 42, at 501; see also 17 C.F.R. § 240-19b-4 (2000).

84. For more information on NYSE, see NYSE Homepage, at <http://www.nyse.com> (last visited Feb. 5, 2002).

85. *Id.*; see also NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL, § 103.00 (2001) [hereinafter NYSE LISTING MANUAL].

86. Karmel, *supra* note 42, at 501 (stating that "round-lot" shareholders are holders with 100 shares); see also NYSE, Listing Requirements, Non-U.S. Standards, at <http://www.nyse.com/listed/intnlstandards.html> (last visited Feb. 5, 2002) (providing the listing requirements for international foreign issuers seeking to access the NYSE); NYSE, Listing Requirements, U.S. Standards, at <http://www.nyse.com/listed/domesticstandards.html>

The NYSE charges a one-time original fee and continuous fees for shares listed.<sup>87</sup> Furthermore, the NYSE requires initial listing and periodic listing requirements for its members.<sup>88</sup> Most importantly, the NYSE requires its issuers to provide shareholders with annual audited financial statements and unaudited quarterly financial statements prepared in accordance with the Exchange Act.<sup>89</sup>

NASDAQ<sup>90</sup> requires companies interested in listing on its exchange to meet either the NASDAQ National Market or the NASDAQ Small-Cap Market standards.<sup>91</sup> Foreign companies seeking to list their ADRs on NASDAQ must have at least 100,000 ADRs issued.<sup>92</sup> Similar to the NYSE, issuers on NASDAQ must pay “an initial fee up to a maximum total fee for any 24-month period.”<sup>93</sup> There are initial and periodic listing requirements to have the ADRs remain on NASDAQ.<sup>94</sup> Issuers of ADRs on NASDAQ must also file annual and quarterly report filings with the SEC as set forth under the Exchange Act.<sup>95</sup> Currently, the SEC is considering NASDAQ’s application to become a registered exchange.<sup>96</sup>

For the most part, the same rules that apply to foreign issuers listing

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(last visited Feb. 5, 2002) (providing the listing requirements for domestic issuers).

87. Karmel, *supra* note 42, at 501.

88. *Id.* A foreign issuer can be delisted from the NYSE for failing to comply with the periodic listing requirements. *Id.* There are several specific quantitative listing requirements for foreign and domestic issuers. *See id.*

89. *Id.* at 503 (stating that the audited financial statements must be provided within three months of the close of the fiscal year, and at least fifteen days before its annual shareholder meeting); *see also* NYSE LISTING MANUAL, *supra* note 85, § 203.01-02 (providing NYSE rules for annual and quarterly reports).

90. For more information on NASDAQ, *see* NASDAQ Homepage, at <http://www.nasdaq.com> (last visited Feb. 5, 2002); *see also* NASDAQ, Summary of Listing Fees and Financial Requirements, at [http://www.nasdaq.com/about/nasdaq\\_listing\\_req\\_fees.pdf](http://www.nasdaq.com/about/nasdaq_listing_req_fees.pdf) (last visited Feb. 5, 2002) (providing a summary of the NASDAQ Stock Market listing requirements and fees).

91. NASD MANUAL (CCH), NASD MARKETPLACE RULES 4300 & 4400 (2001).

92. Karmel, *supra* note 42, at 504-05.

93. *Id.* at 505.

94. *Id.* at 505. A foreign issuer can be delisted from NASDAQ for failing to comply with the periodic listing requirements. *Id.* There are several specific quantitative listing requirements for foreign and domestic issuers. *See id.*

95. NASD MANUAL (CCH), NASD MARKETPLACE RULES 4320 & 4420 (2001).

96. SEC Grants Extension of Time on NASDAQ’s Exchange Registration Application, News Release No. 2001-135, at <http://www.sec.gov/news/press/2001-135.txt> (last visited Feb. 5, 2002) (stating that the SEC granted an extension to the NASDAQ for an indefinite period of time “in order to address the issues raised by the [SEC] staff and in the 46 comment letters received” as of November 14, 2001).



on NASDAQ also apply to AMEX<sup>97</sup> listings.<sup>98</sup> There are seven steps to list an ADR on AMEX: (1) the foreign issuer must file an original listing application and supporting documentation with AMEX, including the non-refundable fee of \$1,000; (2) the foreign issuer's application and supporting documentation are reviewed by the AMEX Listing Qualifications Staff to ensure compliance with the exchange's guidelines; (3) the foreign issuer must file a registration statement with the SEC, or utilize an exemption, pursuant to the Exchange Act; (4) AMEX reserves a ticker symbol and approves the listing; (5) the SEC approves the Exchange Act registration, or uses of an exemption; (6) the foreign issuer selects a "Specialist;" and (7) the ADR is actively traded.<sup>99</sup> AMEX also proscribes certain listing guidelines for international companies,<sup>100</sup> as well as sample listing applications for ADRs.<sup>101</sup>

### C. Advantages to Issuers for Listing ADRs on U.S. Exchanges

The competition among international stock exchanges for foreign company listings is not confined solely to companies from developing countries in areas such as Asia, Eastern Europe and Latin America.<sup>102</sup> However, some of the advantages of listing ADRs on U.S. exchanges include: (1) increasing share value by broadening the investor base; (2) protecting against unwanted mergers and acquisitions; and (3) increasing name recognition in U.S. marketplaces.<sup>103</sup>

## IV. ANALYSIS OF U.S. ACCOUNTING STANDARDS

### A. Administrative Policy on Setting U.S. GAAP

The SEC has the authority to establish the accounting standards that

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97. For more information on AMEX, see AMEX Homepage, at <http://www.amex.com> (last visited Feb. 5, 2002).

98. Karmel, *supra* note 42, at 507; see generally AMEX STOCK EXCHANGE COMPANY GUIDE § 100 (2001).

99. *Id.*

100. AMEX, LISTING GUIDELINES FOR INTERNATIONAL COMPANIES, at [http://www.amex.com/about/amex\\_listnonu.stm](http://www.amex.com/about/amex_listnonu.stm) (last visited Feb 5, 2002).

101. AMEX, SAMPLE LISTING APPLICATION FOR AMERICAN DEPOSITORY RECEIPTS, at <http://www.amex.com/about/adr.pdf> (last visited Feb.5, 2002).

102. Hansen, *supra* note 39, at 197-98.

103. *Id.* at 199.

govern the production of financial statements included in registration statements and periodic reports prescribed by the Securities and Exchange Acts.<sup>104</sup> Under the Exchange Act, the newly created SEC was authorized to “prescribe the form and content of financial statements” issued by companies required to register under the Securities and Exchange Acts.<sup>105</sup> However, the SEC has, historically, delegated this authority to the private sector due to its leadership in establishing and improving accounting standards to be used by reporting companies.<sup>106</sup>

In 1938, the SEC voted to rely on the private sector to create the standards, reserving an oversight function for itself.<sup>107</sup> This private sector reliance began with the creation of the Committee on Accounting Procedure, which was reorganized twenty years later as the Accounting Principles Board (“APB”).<sup>108</sup> Between 1938 and 1973, the performance of the APB did not meet the expectations of the federal government and the corporate world.<sup>109</sup> This dissatisfaction led to the creation of the FASB in 1973.<sup>110</sup> Today, the SEC recognizes the FASB as the private sector body whose accounting standards it considers to have “substantial authoritative support.”<sup>111</sup> These accounting standards have come to be known as Generally Accepted Accounting Procedures, “GAAP.”<sup>112</sup>

The FASB is a creation of the private sector whose origins date back to Securities and Exchange Acts.<sup>113</sup> It is composed of seven members

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104. SEC Concept Release: International Accounting Standards, Securities Act Release No. 33-7801, Exchange Act Release No. 34-42430, [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,237, at 82,969 (Feb. 16, 2000) [hereinafter IAS Release]. See, e.g., 15 U.S.C. §§ 77g and 77s(a) (2000); 15 U.S.C. §§ 78c(b), 78l(b), 78m(b) (2000).

105. See 15 U.S.C. § 78(d) (2000).

106. IAS Release, *supra* note 104, ¶ 86,237, at 82,980 & n.37 (citing Accounting Series Release No. 4 (April 25, 1938) and Accounting Series Release No. 150 (December 20, 1973)).

107. ROBERT VAN RIPER, *SETTING STANDARDS FOR FINANCIAL REPORTING: FASB AND THE STRUGGLE FOR CONTROL OF A CRITICAL PROCESS* 7 (1994).

108. VINCENT J. LOVE, *UNDERSTANDING AND USING FINANCIAL DATA: AN ERNST & YOUNG GUIDE FOR ATTORNEYS* 4 (1994).

109. See GARY JOHN PREVITS, *THE DEVELOPMENT OF SEC ACCOUNTING 1-226* (Addison-Wesley Publishing Co. 1981).

110. LOVE, *supra* note 108, at 4.

111. PAUL B. MILLER, *THE FASB: THE PEOPLE, THE PROCESS, AND THE POLITICS* 21 (Richard D. Irwin, Inc. 1994); see also *FACTS ABOUT FASB*, at <http://www.fasb.org/facts/index.html> (last visited Feb. 5, 2002) (providing the mission of the FASB, its structural organization, the decision-making process, topic selection for the FASB agenda, members of the current FASB, and other additional information).

112. See discussion *infra* III.C for further explanation of GAAP.

113. VAN RIPER, *supra* note 107, at 6-7; see also *Facts About FASB*, at <http://www.fasb.org/facts/index.html> (last visited Mar. 27, 2002).

servicing five-year terms.<sup>114</sup> Its goal is to “establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.”<sup>115</sup> The partnership that exists between the SEC and the FASB has facilitated input into the “accounting standard-setting process from all stakeholders in U.S. capital markets, including financial statement preparers, auditors and users, as well as regulators.”<sup>116</sup> Although the SEC relies on the private sector, FASB, to establish GAAP, the SEC will, when necessary, supplement, override or otherwise amend GAAP.<sup>117</sup> The FASB must consistently balance the issuer’s desire for broad, flexible standards with the auditor’s quest for specific, bright-line rules.<sup>118</sup>

The SEC is involved daily with the application of GAAP through its review and comment process involving registration statements and periodic reporting pursuant to the Securities and Exchange Acts.<sup>119</sup> The Division of Corporate Finance performs the review which allows the SEC to examine and comment on a company’s application of GAAP and other reporting requirements.<sup>120</sup>

### B. A Basic Understanding of GAAP

The expression “generally accepted accounting principles” is a technical accounting term that simply combines “conventions, rules, and procedures necessary to define accepted accounting practice at a particular time.”<sup>121</sup> GAAP is important because management and investors

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114. VAN RIPER, *supra* note 107, at 9.

115. Facts About FASB, at <http://www.fasb.org/facts/index.html> (last visited Feb. 5, 2002).

116. IAS Release, *supra* note 104, ¶ 86,237, at 82,980.

117. *Id.* ¶ 86,237, at 82,981.

118. VAN RIPER, *supra* note 107, at 11. In 1988, the FASB Chairman noted that: “In general, the issuers (of financial reports) want few standards, or only very broad standards, with plenty of room for the exercise of judgment in their application; auditors are inclined to want more standards, and more specific ones.” *Id.* (quoting Dennis R. Beresford, *The Economic and Social Consequences of Financial Accounting Standards*, Address at the Financial Executives Institute Conference (Nov. 1, 1988)).

119. IAS Release, *supra* note 104, ¶ 86,237, at 82,980; *see also* U.S. Securities and Exchange Commission Homepage, at <http://www.sec.gov/rules/concept/34-42430.htm> (last visited Mar. 27, 2002).

120. IAS Release, *supra* note 104, ¶ 86,237, at 82,982; *see generally* U.S. Securities and Exchange Commission, Division of Corporate Finance, at <http://www.sec.gov/divisions/corpin.shtml> (last visited Feb. 6, 2002).

121. Henry R. Jaenicke, *GAAP and the Basic Financial Statements*, in 1133 CORPORATE LAW AND PRACTICE COURSE HANDBOOK 9, 11 (Practising Law Institute ed., Aug. 1999) (quotations in the original).

have potentially conflicting financial reporting interests – thus, there is a need to reduce bias in financial reporting and create a “level playing field.”<sup>122</sup> GAAP is not only created by standard-setters, such as FASB, APB, and SEC, but also from widely accepted and prevalent industry practice, as well as other non-authoritative literature.<sup>123</sup> Some other sources of GAAP include Emerging Issues Task Force Consensuses, AcSEC Statements of Position, SEC Financial Reporting Releases, SEC Staff Accounting Bulletins, and ABP Opinions.<sup>124</sup> Thus, the application of GAAP to an issuer’s business transactions and other events generates the set of basic financial statements – balance sheet, income statement, statement of stockholder’s equity, and cash flow statement – that is required to be included in a registration or periodic filing with the SEC.<sup>125</sup>

### C. Reconciliation to GAAP for Issuers of ADRs

Currently, issuers of ADRs are required to either prepare financial statement in accordance with GAAP or prepare financial statements in accordance with another comprehensive body of accounting standards (including IAS) and reconcile differences to GAAP.<sup>126</sup> If the foreign issuer uses another comprehensive body of accounting other than GAAP, then it must provide the SEC with an audited reconciliation to GAAP.<sup>127</sup> The current reconciliation requirement to GAAP is designed to facilitate comparability between the financial statements of foreign issuers of ADRs prepared under non-GAAP to those prepared in accordance with GAAP.<sup>128</sup>

Multinational accounting firms favor the GAAP reconciliation because it serves as a quality control mechanism of their local offices during their review of foreign issuer’s financial statements and disclosures.<sup>129</sup> However, the SEC, based on its reviews of filings involving foreign issuers using non-GAAP, has noted several occurrences where the inclusion of reconciling items appeared to be the result of non-

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122. *Id.* at 12.

123. *Id.* at 13.

124. *Id.*

125. *Id.* at 14.

126. IAS Release, *supra* note 104, ¶ 86,237, at 82,981.

127. *Id.* (There are some exceptions to the reconciliation requirement. These exceptions, prescribed under IAS, involve accounting for cash flows, business combinations, and changes in foreign currency exchange rates).

128. *Id.*

129. *Id.*

compliance with home-country accounting principles rather than a difference between those principles and GAAP.<sup>130</sup> The SEC noted that these unnecessary reconciling items might be “indicative of not enough focus on the accuracy of the primary financial statements.”<sup>131</sup>

The SEC has stated that the objective of the reconciliation to GAAP is to “protect interests of U.S. investors by requiring that all companies accessing U.S. public markets provide high quality financial reporting that satisfies the informational needs of investors, without requiring the use of U.S. standards in the presentation of that information.”<sup>132</sup>

## V. DEVELOPMENT OF INTERNATIONAL ACCOUNTING STANDARDS

The SEC has been committed to the establishment of high quality, comprehensive international accounting standards since 1988, when the SEC issued this policy statement – “[A]ll securities regulators should work together diligently to create sound international regulatory frameworks that will enhance the vitality of capital markets.”<sup>133</sup> In order to promote this policy, the SEC recognizes a significant transformation in the global marketplace resulting from recent developments in competition, technology, political climates, and economic turmoil.<sup>134</sup> In 2000, the SEC, continuing its interest in developing a global reporting framework, adopted the International Disclosure Standards developed by the International Organization of Securities Commissions (“IOSCO”) for non-financial statement disclosures.<sup>135</sup>

### A. Historical Development of IAS

World markets seek a more global economy by facilitating cross-

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130. *Id.* ¶ 86,237, at 82,982.

131. *Id.* ¶ 86,237, at 82,983.

132. *Id.* ¶ 86,237, at 82,984 (citing Grace Pownall and Katherine Schipper, *Implications of Accounting Research for the SEC's Consideration of International Accounting Standards for U.S. Securities Offerings*, ACCOUNTING HORIZONS, Sept. 1999, at 21).

133. *Id.* ¶ 86,237, at 82,982 (citing Regulation of International Securities Markets, Securities Act Release 33-6807, [1988–1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,341, at 89,579 (Nov. 14, 1988)).

134. *Id.* ¶ 86,237, at 82,983.

135. *Id.* ¶ 86,237, at 82,984.

border investment transactions.<sup>136</sup> Yet, the significant legal and regulatory differences in accounting standards among countries are a major barrier to achieving this goal.<sup>137</sup> In 1973, the United States and eight other industrialized nations formed the International Accounting Standards Committee ("IASC")<sup>138</sup> in order to develop IAS and "promote their worldwide acceptance and observance."<sup>139</sup> To assist IASC with the regulatory aspect of developing IAS, the International Organization of Securities Commissions ("IOSCO") was created.<sup>140</sup>

The IASC is an independent, private sector body that was developed for the purpose of creating a uniform set of accounting standards to be used by companies involved in cross-border securities offerings.<sup>141</sup> Although IASC "isn't an official regulatory body, . . . [so it] has no real enforcement authority," the committee is regarded as an "advisory authority."<sup>142</sup> In December 1998, IASC completed its set of core accounting standards to be submitted to IOSCO for approval and adoption worldwide.<sup>143</sup>

IOSCO has a membership of 172 international organizations in 2001, including the SEC, with varying levels of membership.<sup>144</sup> The goal of IOSCO, as an organization of securities regulators (who lack any enforcement authority), is to "propose effective regulations, exchange in-

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136. Janice Grant Brunner, *All Together Now? The Quest for International Accounting Standards*, 20 U. PA. J. INT'L ECON. L. 911, 911-12 (Winter 1999).

137. *Id.* at 911.

138. *Id.* at 912 (noting that IASC is "composed of financial personnel from over eighty different countries and on e hundred accountancy organizations . . .").

139. *Id.* at 918 (quotations in original) (quoting IASC Celebrates its First 25 Years, MGMT. ACCT., Sept. 1998, at 59).

140. *Id.*

141. *Id.* (citing David Mercado, *Evolving Accounting Standards in the International Markets*, in 961 CORPORATE LAW AND PRACTICE COURSE HANDBOOK 343, 347 (Practising Law Institute ed., Oct. 1996); see also IASC, An Introduction to the IASC, at [http://www.iasc.org.uk/frame/cen1\\_1.htm](http://www.iasc.org.uk/frame/cen1_1.htm) (last visited Feb. 6, 2002).

142. Brunner, *supra* note 136, at 920.

143. *Id.* at 916-18. It was enumerated in 1993 by IOSCO that IASC would prepare the "necessary components of a reasonably complete set of accounting standards (core standards) that would comprise a comprehensive body of [accounting] principles for enterprises undertaking cross-border offerings and listings." *Id.* at 919 (quotations in original) (citing Paul Pacter, *International Accounting Standards: The World's Standards by 2002*, C.P.A. J., July 1998, at 17-18).

144. E-mail from Sofia Varner, General Secretariat, IOSCO, to Joseph Orabona, Author of this article (Feb. 8, 2002, 11:34:13 PST) (on file with author). See also Isaac C. Hunt, Jr., *It's a Small World After All: The SEC's Role in Securities Regulation Globalization*, 51 ADMIN. L. REV. 1105, 1107 (1999) (noting that there were 164 members of IOSCO in 1999) (Mr. Isaac is a current SEC Commissioner in 2002). See generally IOSCO Homepage, at <http://www.iosco.org> (last visited Feb. 6, 2002).

formation promote the development of capital markets, establish regulatory standards, provide surveillance of international securities transactions, and assist in the enforcement of standards to ensure the integrity of capital markets.”<sup>145</sup> IOSCO’s accounting and disclosure committees will review the core set of accounting standards submitted by IASC, and it will recommend endorsement to the IOSCO Technical Committee.<sup>146</sup> The Technical Committee, one of many committees established by IOSCO, includes regulators from sixteen of the world’s largest securities markets, including the SEC.<sup>147</sup> If the Technical Committee unanimously approves the core set of accounting standards, then it will “trigger” consideration by individual nations, and possible adoption (most likely contingent on SEC approval).<sup>148</sup>

### B. *The Effect of IOSCO Endorsement of IAS*

What is the effect of IOSCO’s endorsement of IAS? As previously stated, IOSCO’s acceptance of IAS could lead the SEC to allow foreign issuers (at a minimum) to avoid converting or reconciling financial statements to GAAP before listing ADRs on U.S. exchanges.<sup>149</sup> Furthermore, IAS could improve competition among U.S. exchanges, especially from newer exchanges, such as the Boston Stock Exchange, and among global securities markets.<sup>150</sup> Advocating the advantage of adopting IAS, SEC Commissioner Isaac Hunt stated: “[O]ne cannot overlook the potential expansion of investment opportunities if all issuers could use one set of accounting standards that would be accepted world-wide for securities offerings.”<sup>151</sup> From the perspective of U.S. exchanges, Richard Grasso, chairman of NYSE, favors the SEC’s adoption of IAS for foreign issuers of ADRs.<sup>152</sup> In the academic community, research has identified a “trend away from developing” national accounting standards

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145. Brunner, *supra* note 136, at 919; *see also* IOSCO, General Information on IOSCO, at <http://www.iosco.org/gen-info.html> (last visited Feb. 6, 2002).

146. Brunner, *supra* note 136, at 919.

147. *Id.*

148. *Id.* (quotations in original); *see also* Pacter, *supra* note 143, at 18.

149. Brunner, *supra* note 136, at 920; *see also* IASC Nears the Finish Line, *BUS. EUR.*, Nov. 18, 1998, at 7 (stating that an endorsement of IAS by IOSCO would guarantee global acceptance, “even in New York”).

150. *See* Hunt, *supra* note 144, at 1114.

151. *Id.*

152. *See id.* (Grasso “predicted a twenty percent increase in NYSE’s capitalization” if the SEC accepts international accounting standards.).

and "towards adopting current international accounting standards."<sup>153</sup> Thus, IOSCO's endorsement of IAS will dramatically affect the accounting and regulatory environments in our global markets.

#### VI. THE NEW SEC IS LIKELY TO PERMIT ISSUERS OF ADRS TO USE SOME "FORM" OF IAS

The new SEC Chairman, Harvey Pitt ("Pitt"), knows that the success of IAS depends on U.S. support because the U.S. plays a dominant role in the regulatory structure of capital markets.<sup>154</sup> U.S. rejection of IAS "may ultimately impair the growth of the world's capital markets and cross-border transactions."<sup>155</sup> However, former SEC Chairman Arthur Levitt ("Levitt") stated that the SEC would not accept IAS core standards without foreign issuers reconciling financial statements to GAAP, unless: (1) IAS constitute a "comprehensive body of accounting; (2) are the standards of high quality and result in comparability and transparency and provide for full disclosure; and (3) they can and will be rigorously interpreted and applied."<sup>156</sup> For Pitt to make a decision on the adoption of IAS in the near future, he must consider the opinions of foreign countries, major U.S. accounting firms, American Institute of Certified Public Accountants ("AICPA"), FASB, former Chairman Levitt, and other SEC leaders. In addition, the recent loss of investor confidence in U.S. and global markets at the end of 2001, resulting from the terrorist attacks on the World Trade Center and Pentagon, as well as some major "accounting scandals" involving some of the U.S.'s largest accounting firms and corporations will affect Mr. Pitt's ultimate deci-

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153. *Id.* (citing Robert K. Larson & Sara York Kenny, *The Harmonization of International Accounting Standards: Progress in the 1990s?*, 7 MULTINATIONAL BUS. REV. 1 (1999)).

154. *See* Brunner, *supra* note 136, at 913.

155. *Id.* (citing Glenn Cheney, *International Standards Fail to Stir U.S. Interest*, ACCT. TODAY, July 27, 1998, at 14 (quoting Patricia McConnell, senior managing direct at Bear Stearns and vice-chairperson of the IASC, as stating that the SEC's rejection of IAS would be "the kiss of death").

156. Charles Canfield, *FASB v. IASC: Are the Structure and Standard Setting Process at the IASC Adequate for the Securities and Exchange Commission to Accept International Accounting Standards for Cross-Border Offerings?*, 20 NW. J. INT'L L. & BUS. 125, 130 & n.1 (Fall 1999) (citing Securities and Exchange Commission, Report on Promoting Preeminence of American Securities Markets, at <http://www.sec.gov/news/studies/acctgsp.htm> (last modified Dec. 12, 1997)).



sion on IAS.

A. *Opinions on SEC Adoption of IAS for Foreign Issuers*

Foreign countries, especially the United Kingdom (“U.K.”), are interested in the U.S. policy position on adopting IAS for cross-border transactions.<sup>157</sup> Tony Blair, the Prime Minister of the U.K., addressing the NYSE in 1998, advocated for IAS and stated that: “[P]romoting greater accountability and openness will strengthen the incentives on governments to pursue sound policies [that] will enable markets to price risk more accurately and should help countries manage more effectively the risk of global integration.”<sup>158</sup> Other countries that are part of the European Union (“EU”) also want to see the SEC adopt IAS for foreign issuers of ADRs because the EU has a 2005 deadline for full adoption of IAS for financial reporting by all participating countries.<sup>159</sup>

Foreign political support is important, but it is critical for financial executives in foreign countries to support implementation of IAS. A recent survey published in November 2000 by AICPA, and performed by PricewaterhouseCoopers LLP (“PwC”),<sup>160</sup> indicated the existence of strong support for IAS adoption among members of the European business community.<sup>161</sup> Almost eighty percent of Chief Financial Officers (“CFOs”) surveyed by the AICPA supported the adoption of IAS in the EU by 2005, and more than sixty-seven percent favored IAS as the “sole financial reporting standard or, at least, an alternative to each country’s version of GAAP.”<sup>162</sup> Of those CFOs surveyed that did not currently use IAS, almost seventy percent admitted that implementation would be

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157. *See id.* at 127.

158. *Id.* at 127 (citing International Accounting Standards Committee, Late News from the IASC, at <http://www.iasc.org.uk.htm> (last modified Oct. 7, 1998)).

159. *Financial Reporting – IASB Meeting – Something to Run With*, ACCOUNTANCY (U.K.), Jan. 22, 2002, at 2. The European Commission’s plan to implement clear and comparable financial reports, if approved by the European Union, requires “publicly listed companies in member states to report their financial results according to the IAS by 2005.” AICPA, *CFO’s in Europe Favor International Accounting Standards*, 191 J. OF ACCT. 1 (2001) [hereinafter *CFO’s in Europe*].

160. *CFO’s in Europe*, *supra* note 159, at 1 (noting that PwC performed the independent survey of more than 700 listed companies in the fifteen European Union countries and Switzerland); *see also* Summary of CFO Survey on International Accounting Standards, at <http://www.pwcglobal.com/ias2005> (last visited Apr. 8, 2002).

161. *Id.*

162. *Id.* (noting that nineteen percent of those surveyed already implement IAS standards, while sixty-eight percent were from companies using national accounting standards only).

feasible before the 2005 deadline, and ninety percent believed that all EU members could achieve implementation by 2010.<sup>163</sup> Moreover, about fifty percent of the CFOs noted that the prime motivation for adopting IAS was not to achieve technical accounting transparency, but rather as a strategic maneuver involving key business aspects, such as “international marketability and mergers and acquisitions.”<sup>164</sup> Finally, approximately eighty percent of the CFOs that use IAS agreed that the “benefits far outweigh the drawbacks,” and fifty-two percent of those yet to fully adopt IAS “believed it would be worthwhile.”<sup>165</sup>

It is not only the foreign business communities and leaders that are interested in Chairman Pitt’s policy on IAS – domestic companies and government leaders also await a policy decision in the near future. Of primary importance to the SEC are the opinions of the largest global accounting firms. Recently in 2001, seven of the world’s largest accounting firms participated in the survey on IAS, called “GAAP 2001.”<sup>166</sup> In advocating jointly the adoption of a “single worldwide framework for financial accounting and reporting based on high-quality IAS,” the seven largest accounting firms reported that more than sixty-six percent of the sixty-two countries responding to the survey are proactively investigating the proposed changes to their national accounting standards.<sup>167</sup>

Individually, some of the U.S. “Big Five” accounting firms<sup>168</sup> have expressed their opinions on SEC adoption of IAS for foreign issuers accessing U.S. exchanges. Arthur Andersen LLP (“Andersen”) does not believe that Chairman Pitt will permit foreign issuers, including those that seek to issue ADRs, to file financial statements solely in accordance with IAS without providing investors with a reconciliation to U.S. GAAP.<sup>169</sup> A spokesman for Andersen stated that: “Until further steps have been taken to provide that an adequate global infrastructure is in place, the SEC should not eliminate its reconciliation requirement to

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163. *Id.*

164. *Id.*

165. *Id.*

166. *Accounting Firms Note Mixed Progress in Norms*, BUS. WORLD (MANILA), Dec. 13, 2001, at 20; *see also* GAAP 2001 Survey, at <http://www.ifad.net> (last visited Apr. 9, 2002).

167. *Id.*

168. The “Big Five” accounting firms in the U.S. include: PricewaterhouseCoopers LLP, KPMG Peat Marwick LLP, Deloitte & Touche LLP, Arthur Andersen LLP, and Ernst & Young LLP.

169. Don Swartz, *What Price Global Accounting Standards?*, 71 C.P.A. J., May 1, 2001 at 42.

U.S. GAAP for foreign registrants.”<sup>170</sup> Similarly, PwC agreed with Andersen’s opinion, and stated:

We do not believe that a solid case has been presented for relaxing the reconciliation requirement. In recent years, U.S. markets have shown themselves to be significantly focused on a single figure of earnings. Bringing IAS into the domestic marketplace at this point means that there would be two (quite different) measures of earnings, which is apt to lead to confusion. . .

A fundamental element of financial reporting is comparability. If non-U.S. companies were to report under IAS without reconciling their financial statements with U.S. GAAP, U.S. investors would lose this comparability.<sup>171</sup>

Moreover, Thomas Milan, a spokesman for Ernst & Young LLP (“E&Y”), believes that IAS can be successful:

In an age of significantly increasing international investments and financial reporting on the Internet, the need for a common worldwide financial language and framework for reporting is quickly making diverse national standards obsolete. . . Governments, regulators, investors, and the accounting profession all need to rededicate themselves to achieving convergence of accounting standards at the earliest feasible date.<sup>172</sup>

In support of the views held by the three public accounting firms, the AICPA, after submitting its comments on IAS to the SEC, made the following statements:

Although individual IAS may be of high quality, we do not believe the body of IAS is of sufficiently high quality to be used without reconciliation to U.S. GAAP in cross-border filings in the U.S. at this time. . . The existing core standards contain significant recognition and measurement alternatives and are, as a whole, written generally and susceptible to varied interpretation. Consequently, different companies following IAS might apply IAS differently for similar transactions. Therefore,

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170. *Id.*

171. *Id.*

172. Daniel M. Hrisak, *Mixed Progress in Move to Create International Accounting Standards*, MANAGING THE GEN. LEDGER, Feb. 1, 2002, at [http://www.ioma.com/products/prod\\_detail.php?prodid=19](http://www.ioma.com/products/prod_detail.php?prodid=19) (last visited Apr. 9, 2002) (quoting Thomas Milan of Ernst & Young LLP).

we believe that the requirement to include reconciliation to U.S. GAAP should be retained until industry specific guidance and interpretative guidance that reduces inconsistent application can be promulgated by the IASC . . . . With convergence of IAS and national regimes around high-quality standards, fewer reconciling items will exist over time, and at a future date, a reconciliation will become unnecessary.<sup>173</sup>

In response to SEC Concept Release, "International Accounting Standards,"<sup>174</sup> the FASB stated that it supports an effort to develop a "single set of high-quality accounting standards to be used worldwide within [the] overall objective of increasing international comparability while maintaining the highest quality accounting standards in the United States."<sup>175</sup> In addition, the FASB noted that "much work [is] left to be done in achieving that objective, including work on converging national and international standards and work on developing an adequate financial reporting infrastructure to support their use."<sup>176</sup> The FASB believes, like Andersen, PwC, E&Y, and AICPA, that: "[A]t this time, elimination of the current requirements for foreign issuers using IASC standards to reconcile to U.S. GAAP would not move us closer to our goals."<sup>177</sup>

"As more investors seek access to foreign markets, and more companies seek capital worldwide, the need for a common business language has become compelling . . . . These standards are not merely an ideal for better global marketplace – they are fundamental to its very existence."<sup>178</sup> In making those statements, it was clear that former SEC Chairman Levitt favored the adoption, in some form, of IAS.<sup>179</sup> Furthermore, Levitt also recognized that "financial statements prepared and audited under IASC standards would gain worldwide respect, resulting in substantial progress toward the goal shared by all constituencies" because it would achieve his goal of a "common business language."<sup>180</sup>

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173. Swartz, *supra* note 169, at 41.

174. IAS Release, *supra* note 104, ¶ 86,237, at 82,969.

175. FASB, *Joint FAF/FASB Response to SEC Concept Release, "International Accounting Standards*, June 5, 2000, at 10, available at <http://www.fasb.org/IASC/index.html> (last visited Apr. 8, 2002) [hereinafter FASB Response].

176. *Id.*

177. *Id.*

178. Swartz, *supra* note 169, at 41.

179. *See id.*

180. *Id.*

In order for Pitt to successfully adopt IAS for cross-border transactions, he will need the support of the accounting profession.<sup>181</sup> Although Levitt supported the IAS movement, “[r]elations were strained” between himself and the accounting profession.<sup>182</sup> Accountants say Pitt and his new Chief Accountant, Robert Herdman (“Herdman”),<sup>183</sup> must keep pressure on international standard-setters and promote the development of a new set of high-quality IAS.<sup>184</sup> Thus, the accounting profession believes that “Herdman’s first task may be to push for international accounting standards.”<sup>185</sup>

### *B. The Effect of Current Events on IAS Adoption by the SEC*

“The year 2001 [was] a terrible one for our economy,” with the nation falling into recession even before the September 11 terrorist attacks.<sup>186</sup> Furthermore, the recent collapse of The Enron Corporation (“Enron”) and several other “accounting scandals” discovered by the SEC have generated a need for the SEC to consider the adoption of IAS.

In June 2001, the SEC handed down its harshest penalty to Andersen in an antifraud settlement – a civil penalty of \$7 million.<sup>187</sup> A few months later, Enron announced its restatement of four years of prior financial statements due to improper application of GAAP – also involving Andersen.<sup>188</sup> In January 2002, the SEC censured KPMG Peat Marwick LLP (“KPMG”) for violating auditor independence rules.<sup>189</sup>

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181. Judith Burns, *Accountants Hope to Patch Relationship With SEC*, DOW JONES NEWS SERVICE, Oct. 5, 2001.

182. *Id.*

183. *Id.* (noting that Herdman spent thirty-eight years at Ernst & Young LLP, serving as vice chairman overseeing relationships with the SEC, FASB and AICPA).

184. *Id.* Charles Bowsher, chairman of Public Oversight Board, said, “If you’re going to have a globalized market, that’s an issue that has to be a priority.” *Id.*

185. *Id.*

186. Judith Burns, *SEC Chief Accountant Seeks Post-Enron Reforms*, DOW JONES NEWS SERVICE, Dec. 6, 2001 (quoting the SEC Chief Accountant, Robert Herdman’s speech to the AICPA).

187. SEC Release No. 2001-62, *Arthur Andersen LLP Agrees to Settlement Resulting in First Antifraud Injunction in More Than 20 Years and Largest-Ever Civil Penalty -- \$7 Million – in SEC Enforcement Action Against a Big Five Accounting Firm*, June 19, 2001, at <http://www.sec.gov/news/press/2001-62.txt> (last visited Aug. 2, 2002) (In connection with audits of Waste Management, Inc. from 1992 to 1996, Arthur Andersen was found to have “knowingly or recklessly issued materially false and misleading audit reports.”).

188. See Nanette Byrnes, Mike McNamee, Diane Brady, Louis Lavelle, Christopher Palmeri, *Accounting in Crisis*, BUS. WK., Jan. 28, 2002 at 44 [hereinafter *Accounting in Crisis*].

189. SEC Release No. 2002-4, *SEC Censures KPMG For Auditor Independence Viola-*

Unfortunately the Enron scandal was not the only one to shake investor confidences. In early 2002, Xerox Corporation settled with the SEC over allegations of a four-year scheme to defraud investors.<sup>190</sup> Shortly thereafter, the SEC brought criminal charges against three Northern California software corporations for accounting frauds committed by top executives.<sup>191</sup> In late June 2002, investors received news of an accounting scandal larger than Enron when WorldCom announced that it was involved in prior "accounting improprieties of unprecedented magnitude."<sup>192</sup>

These accounting frauds and improprieties have destroyed investor confidence in audit reports prepared by management, and opined by the accounting profession.<sup>193</sup> Pitt responded quickly requiring 947 listed companies to have top corporate officers sign sworn certifications attesting to the accuracy of the companies' recent 2001 annual reports and 2002 quarterly filings.<sup>194</sup> Congress, in another attempt to restore investor confidence, passed the Sarbanes-Oxley Act of 2002.<sup>195</sup> This Act contains a five-member Public Company Accounting Oversight Board to ensure public company compliance with GAAP.<sup>196</sup>

"As the debate on international accounting standards heats up over

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tion, Jan. 14, 2002, at <http://www.sec.gov/news/press/2002-4.txt> (last visited Aug. 2, 2002) (KPMG, a big five accounting firm, engaged in improper professional conduct by serving as auditor of a client it had made substantial investments in at the same time—an obvious breach of independence).

190. Press Release, U.S. Securities and Exchange Commission, Xerox Settles SEC Enforcement Action Charging Company with Fraud (Apr. 11, 2002), at <http://www.sec.gov/news/press/2002-52.txt> (last visited Aug. 2, 2002).

191. Press Release, U.S. Securities and Exchange Commission, SEC Brings Financial Fraud Charges Against Executives at Three Northern California Software Companies (May 20, 2002), at <http://www.sec.gov/news/press/2002-71.htm> (last visited Aug. 2, 2002).

192. Press Release, U.S. Securities and Exchange Commission, SEC Statement Concerning WorldCom (June 26, 2002), at <http://www.sec.gov/news/press/2002-94.htm> (last visited Aug. 2, 2002).

193. SEC Chairman Harvey L Pitt, Speech at the U.S. Securities and Exchange Commission Headquarters (Jan. 17, 2002), *Public Statement by SEC Chairman: Regulation of the Accounting Profession*, at <http://www.sec.gov/news/speech/spch535.htm> (last modified Jan. 17, 2002) [hereinafter *Regulation of Accounting Profession*].

194. Press Release, U.S. Securities and Exchange Commission, SEC Web Site Provides Link to CEO, CFO Certifications of Financial Statements of 947 Companies (July 29, 2002), at <http://www.sec.gov/news/press/2002-115.htm> (last visited Aug. 2, 2002).

195. Press Release, U.S. Securities and Exchange Commission, Statement of the Commission Regarding the Public Company Accounting Oversight Board (Aug. 1, 2002), at <http://www.sec.gov/news/press/2002-118.htm> (last visited Aug. 2, 2002) (President George W. Bush signed this landmark bill into law). This Act is a comprehensive reform legislation designed to remedy the 2001 and 2002 corporate and accounting scandals and corruption.

196. *Id.*

the next few years, front-and-center should be a drive toward making them clear, pertinent, and timely.”<sup>197</sup> Investor confidence has to be a key factor in the debate. The recent financial disasters of 2001 and 2002 should help to fuel that debate – some will even argue that Pitt has already started discussing the issue.<sup>198</sup>

### C. Implication of Chairman Pitt’s Policy on IAS for ADRs

On August 1, 2001, the Senate confirmed the “new sheriff” to lead the SEC into a brave new world – one that will view significant changes to the current disclosure system.<sup>199</sup> Pitt told the Senate, “Our securities laws are, in the main, nearly 70 years old, and reflect a time, and a state of technology, light-years away from what we now confront daily.”<sup>200</sup> This call for a change to the current securities laws has many spectators anticipating the SEC’s adoption of some form of IAS.<sup>201</sup>

Pitt made his first formal attempt to address IAS during his speech at the SEC Historical Society Major Issues Conference on November 14, 2001.<sup>202</sup> He said “we need to recognize that we in the U.S. have to make appropriate accommodations to differing regulatory and accounting standards worldwide.”<sup>203</sup> Furthermore, Pitt recognized that:

U.S. investors already invest around the globe, and therefore their interests will be best served if foreign companies can be brought into our markets, which offer the protections of fair trading, and full and fair disclosure, by the companies whose securities trade in those markets. We must make it inviting for global businesses to offer and trade their securities in our markets, but without sacrificing necessary investor protections. This is a consistent Commission message, but sometimes it has been obscured, so I want to make it unequivocally clear – we are determined to find a way to make our

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197. *Accounting in Crisis*, *supra* note 188, at 48.

198. *See infra* notes 204-214.

199. *See New SEC Chairman Will Try to Simplify the Rules*, INT’L ACCT. BULL., Aug. 30, 2001 [hereinafter *Simplify the Rules*].

200. *Id.*

201. *See id.*

202. SEC Chairman Harvey L. Pitt, Remarks at the SEC Historical Society Major Issues Conference (Nov. 14, 2001), in *Speech by SEC Chairman: Remarks at the SEC Historical Society Major Issues Conference*, at <http://www.sec.gov/news/speech/spch523.htm> (last modified Jan. 10, 2002). [hereinafter *SEC Historical Society Speech*].

203. *Id.*

*markets as hospitable as possible to issuers around the world, while adhering to our mandate of investor protection.*<sup>204</sup>

In December 2001, Sir David Tweedie, the new head of the International Accounting Standards Board ("IASB"), said that he was "impressed by Pitt's positive attitude toward IAS."<sup>205</sup> A few days later, Pitt made a "u-turn" and extended "the hand of friendship to the U.S. accountancy profession," indicating that he was prepared to "take a more flexible approach to differences between U.S. GAAP and International Accounting Standards."<sup>206</sup> In addressing the AICPA, Pitt said that:

[T]he SEC and the profession needed to agree on accounting principles that would enable foreign issuers to list in the U.S. and allow investors to purchase their securities with confidence that they understood what they were buying. In certain significant areas, a pragmatic approach tending towards short-term convergence on important issues may be helpful. . . .<sup>207</sup>

After the collapse of Enron, Pitt addressed the public on the regulation of the accounting profession.<sup>208</sup> Pitt reiterated his statement made earlier to the Senate by noting that the present disclosure system, "which was been in effect for 67 years, doesn't provide for 'current disclosure.' Financial disclosures are dense and impenetrable."<sup>209</sup> Pitt noted the need for improvement not only in SEC oversight of the disclosure and financial reporting system, but in prompt response by the FASB.<sup>210</sup> Pitt may, through his statements to the accounting profession, be "hinting" that the IASC must create IAS that are "tough, no-nonsense, fully transparent. . . [and] subject to independent leadership and governance" if it wants U.S. support.<sup>211</sup>

Pitt has indicated that IAS and market globalization are going to be priorities during his tenure as SEC Chairman.<sup>212</sup> Moreover, it appears

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204. *Id.* (emphasis added).

205. *Independence and International Standards: The Talk of 2001*, THE ACCOUNTANT, Dec. 20, 2001 (noting that the relationship between Tweedie and Pitt would be key to the successful creation of a "modern set of stringent" IAS).

206. *SEC In Friendly Makeover*, ACCOUNTANCY, Dec. 27, 2001.

207. *Id.*

208. *Regulation of Accounting Profession Speech*, *supra* note 193.

209. *Id.*

210. *Id.*

211. *See id.*

212. *See supra* notes 199-211.



that Pitt will use SEC resources to ensure that IAS are high-quality standards “in which investors can have confidence.”<sup>213</sup> Pitt also wants to “break down all non-essential access barriers to our markets.”<sup>214</sup> Issuers of ADRs hope Pitt will “break down” the required reconciliation to GAAP “barrier.”

## VII. CONCLUSION

“One size fits all has never been a popular concept for the standardization of financial reporting internationally.”<sup>215</sup> Foreign issuers of ADRs realize that the United States has the deepest and broadest equity markets, but it is a headache for them to report under national accounting principles and reconcile to GAAP.<sup>216</sup> At the end of 2001, SEC Commissioner Hunt tried to provide relief for that headache by stating, “I can think of *no greater gift to the investing public* than establishing a set of worldwide accounting standards.”<sup>217</sup> Foreign issuers of ADRs only hope that Congress and SEC Chairman Pitt were listening when that statement was made.

“International accounting standards will be a ‘major focus’ for SEC accountants” in the near future.<sup>218</sup> Due to the financial accounting frauds and corruption in 2001 and 2002, now may be the best time for Congress, SEC Chairman Pitt, the new Public Company Accounting Oversight Board, major accounting firms, the private corporate sector, and IOSCO to seriously consider improving and implementing International Accounting Standards. One thing is certain, issuers of ADRs may not have to wait much longer for “headache relief.”

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213. *SEC Historical Society Speech*, *supra* note 202.

214. *Id.*

215. Donald Sutherland, *International Green Accounting*, Green Pages, at <http://www.eco-web.com/cgi-local/sfc?a=editorial/index.html> (last visited Mar. 28, 2002).

216. *Id.*

217. Hrisak, *supra* note 172 (emphasis added).

218. Judith Burns, *SEC Chief Accountant Seeks Post-Enron Reforms*, DOW JONES NEWS SERVICE, Dec. 6, 2001.