Running Head: NEW YORK STOCK EXCHANGE

The New York Stock Exchange: Generally Accepted Accounting Principles Versus International Financial Reporting Standards

Heather Bolling

A Senior Thesis submitted in partial fulfillment
of the requirements for graduation
in the Honors Program
Liberty University
Spring Semester 2006

Acceptance of Senior Honors Thesis

This Senior Honors Thesis is accepted in partial
Fulfillment of the requirements for graduation from the
Honors Program of Liberty University.

Gene R. Sullivan, Ph.D.
Chairman of Thesis

Bruce K. Bell, Ph.D.
Committee Member

Don H. Alban, Jr., M.A.
Committee Member

James H. Nutter, D.A.
Honors Program Director

26 April 2006
Date

Abstract

Due to the growth of international business transactions and cross-border expansions, acceptable accounting principles and guidelines are among the most controversial issues being debated in the business arena. Current regulations require that any business listing with the New York Stock Exchange (NYSE) report financial statements in compliance with the United States' Financial Accounting Standards Board's (FASB) set of standards, also known as the Generally Accepted Accounting Principles (GAAP). However, many countries follow the International Financial Reporting Standards (IFRS) upheld by the International Accounting Standards Board (IASB). The NYSE's requirement causes both trouble and confusion for foreign companies. Should the NYSE require international companies to follow the US GAAP standards, the IFRS, or should businesses be allowed to choose which set they will use? The purpose of this thesis is to explore the various systems of acceptable accounting standards currently being used and determine what options, if any, the NYSE should offer to cross-border, international companies.

Generally Accepted Accounting Principles versus International Financial Reporting Standards

Due to the large growth of international business transactions and the number of international companies, acceptable accounting principles and guidelines are among the most controversial issues being debated in the business arena (Tarca, 2004). As Dye and Sunder (2001) discuss in *Why Not Allow FASB and IASB Standards to Compete in the U.S?*, the world's economy has greatly changed over the last twenty-five years. The United States' economy, including capital markets and U.S.-based multinational corporations, is still the largest in the world. While it continues to rapidly grow, foreign economies are becoming more influential and powerful: "Faster growth in other parts of the world elevates the relative importance of other economies, their capital markets, and corporations outside the U.S." (Dye, 2001, p. 258). In order for the United States to cooperate and compete with these foreign economies, its home practices and regulations must be examined in relation to those being enforced in other countries. Foreign policies and regulations are often times greatly different than those enforced in the United States.

The New York Stock Exchange

The New York Stock Exchange (NYSE) is one of the largest stock markets in the world. Being so influential, it greatly contributes to the growth of the American economy. As of 2003, Americans held $12 trillion of both domestic and non-U.S. equities. This amounts to approximately 38% of all the market capital of the world's major exchanges (Thain, 2004b). With listings of 474 non-US companies from 51 different countries (Stuckey, 2003), numerous concerns for the NYSE's future success exist when dealing with the controversy of appropriate accounting standards requirements.

The combined global market capitalization of the NYSE is approximately $4.3 trillion (Stuckey, 2003). John A. Thain (2004b), CEO of the New York Stock Exchange, brings forth an important point that many Americans seem to loose sight of and forget. The United States' capital markets are the most liquid in the world. Although the United States is the engine of global capitalism, "no birthright dictates that we (the U.S.) will remain so" (Thain, ¶ 3).

Due to its worldwide popularity and international use, strict standards have been put into place to make listing and investing opportunities easier and more informative. Current Securities and Exchange Commission (SEC) regulations require any company listing their shares on the NYSE to abide by the United States' financial laws. In its Listed Company Manual (2002), the NYSE clearly explains the requirements necessary in annual reports in Section 203.01. The manual states, "The Exchange requires that companies publish at least once a year and distribute to shareholders an annual report containing financial statements of the company and its consolidated subsidiaries prepared in conformity with generally accepted accounting principles" (¶ 1). The number of days the annual report must be reported after the close of each fiscal year varies for both domestic and non-US companies (New York Stock Exchange, 2002).

Companies have two options to fulfill this requirement. An annual report can be distributed to their shareholders or the Form 10-K (Form 20-F for non-US issuers) that is filed with the Securities and Exchange Commission can be distributed to shareholders. Whichever option is chosen, two copies of that document, along with the date the documents were sent to shareholders, must be sent to the NYSE (New York Stock Exchange, 2002).

With the various sets of accounting standards that exist, it is no wonder that most foreign countries do not abide by a set of standards equivalent to those of the United States. For any foreign companies choosing to perform business operations and transactions within the United States economy, having to comply with possibly two different sets of standards is oftentimes very time consuming and costly. Not only must foreign companies wanting to do business in the United States pay people to format and report their financial information in compliance with their home country's regulations, they must also report that same information in compliance with American laws.

It is also not a surprise that the number of new listings of foreign companies on the United States' financial markets have decreased rather than increased in the past few years. The New York Stock Exchange has suffered immensely from this sharp decline. Between 1996 and 2000, an average of 50 non-U.S. companies listed on the NYSE per year. However, from 2002 to 2004, that number has decreased to half, dropping to only 25 a year. The European equities, with 19 companies listed on the NYSE in 2002, contributed to this decline the most. After withdrawing their companies' listings from the NYSE, the number of European countries remaining was only six. Along with these statistics, in 2004, only one new European country listed with the NYSE (Thain, 2004b).

The number of both domestic and foreign listings with the U.S. markets tells quite a lot about the concern of both local and foreign investors. As Thain (2004b) states, "Listings are an important barometer of foreign interest in the U.S. economy" (¶ 8). Along with the growth that comes with every listing, more prospective jobs open and individuals have more chances for U.S.-directed investment (Thain, 2004b).

Not only is the New York Stock Exchange suffering from a decrease in the number of foreign investors, but many small U.S. companies are choosing to list with foreign stock markets. American businesses are attracted to outside securities markets for a number of reasons: "Often, potential issuers are lured by what they see as more flexible regulatory regimes. But foreign markets also appeal to some companies because their customer bases might be abroad or foreign investors have a greater interest in its particular industry" (Shaw, 2005, ¶ 2).

Foreign markets see their opportunity to gain from this attraction. For instance, within the last year, the Toronto Stock Exchange greeted five new U.S. companies. Also, at least two new markets catering to small companies have opened. The Irish Stock Exchange introduced the Irish Enterprise Exchange (IEX) in April 2005. In only four months, the IEX experienced growth, listing eight Irish companies. Alternext, created by Euronext, is now open for international issuers, including U.S. companies. The Alternative Investment Market (AIM) opened on the London Stock Exchange in 1995, and has listed approximately 1300 companies. Of these businesses, eighteen are American based, and eleven of these have joined in the last two years (Shaw, 2005).

XL TechGroup, based out of Melbourne, Florida, chose to list on the AIM in October 2004. According to Harold Gubnitsky, the Senior Vice President and Chief Relationship Officer, XL TechGroup decided to go public to raise money in order to continue operations. The company considered various methods of doing this, including listing on a U.S. market, and in under a year, the company had a market cap of $300 million. However, listing on an American market was not the best decision for the company: "The company chose not to list in the United States because its business model would cause it to incorrectly be viewed as a regulated investment corporation. Under the Investment Company Act of 1940, that would trigger different reporting requirements" (Shaw, 2005, ¶ 6).

Of course, the main reason the company chose AIM instead of a U.S. market was the strenuous rules and regulations of the Sarbanes-Oxley Act and the Securities and Exchange Act. The requirements of AIM and the United Kingdom (U.K.) federal government were not as "all-encompassing and detailed" as those of the United States. According to Shaw (2005), the U.K. did not "require for admission a minimum market cap, a trading record, minimum shares in public hands, or prior shareholder approval for transactions" (¶ 11). Rather than the burdensome quarterly and annual filings required for a U.S. listing, AIM only requires ongoing disclosures semi-annually (Shaw, 2005).

Contributing Factors to Controversy

A variation of factors contributes to the current accounting controversy. According to Hoyle, Schaefer, and Doupnik (2004), "A survey of the relevant literature identified the following five items as commonly accepted factors influencing a country's financial reporting practices: (1) legal system, (2) taxation, (3) providers of financing, (4) inflation, and (5) political and economic ties" (p. 531). Legal systems enforced by governments around the world greatly differ from one another. With the accounting profession influencing the creation of new accounting rules, one could see how such a controversy could arise when having to consider the various opinions and views of accounting professionals.

Methods of taxation are another major difference throughout business communities. Some countries allow their published financial statements to form the basis for taxation. Yet, others permit such statements to be altered, in a variety of ways, for tax purposes. This in turn, allows companies to send the government one financial statement and the stockholders another; often times, the final values on these statements vary. Investors are frequently interested in different outcomes, as well. "There also can be a difference in orientation, with stockholders more interested in profit (emphasis on the income statement) and banks more interested in solvency and liquidity (emphasis on the balance sheet," says Hoyle et al. (2004, p. 532).

Perhaps the greatest contributing factors are political and economic ties. Accounting is not a strictly domestic concept. Hoyle et al. (2004) define accounting as, "a technology that can be borrowed relatively easily from or imposed on another country" (p. 533). When the first American settlers were creating their new government and laws, some concepts and ideas were borrowed from the existing British government. Being that many of the early American settlers came from England, a country with a well-developed and highly influential government, some traditional principles were instilled in them and came out through their participation in the creation of a new regime. Just like the English borrowed ideas from the British administration, others countries borrow accounting principles from better developed, successful sets of standards: "More recently, economic ties with the United States have had an impact on accounting in Canada, Mexico, and Israel" (Hoyle et al., 2004, p. 533).

Of course, one cannot mention an accounting or financial issue these days without mentioning the Sarbanes-Oxley Act (SOX) of 2002. Due to the notorious scandals of Enron and other corporate businesses in the early 2000s, the public's confidence in the capital markets was damaged. Similar to the necessity of the creation of the Securities and Exchange Commission, this piece of legislation was passed in hopes of restoring the public's damaged assurance in the stock markets (Hoyle et al., 2004).

The passing of the Sarbanes-Oxley act is another determining factor in whether foreign companies choose to list their stock and securities on United States markets. According to Thain (2004a), since the adoption of SOX, companies must now have solid governance structures and all relevant details of companies must be disclosed and documented. These changes allow individuals to understand possible risks and make more informed decisions. However, these improvements have come at a high cost. Because of the additional expenses that companies incur and the time and effort senior-management must provide to comply with the new rules, many cross-border, international companies are faced with financial problems. All financial statements, records, and reports have to be processed and completed following the guidelines of the IASB's IFRS and the FASB's GAAP standards.

Due to the diversity of these factors, a number of questions are formed when discussing international and cross-border transactions. Many security markets, both domestic and abroad, are in the midst of this ongoing battle, specifically the New York Stock Exchange, to name one. Those markets involved in this struggle are being forced to face, and answer, some very important questions. For example, "Whose sets of standards are correct?" and "What should be done about it?" As one can see, companies are confused and unsure of what to do when faced with the decision of where and how to list their shares. Should the New York Stock Exchange require international businesses to follow the Generally Accepted Accounting Principles (GAAP) of the United States, or should they be allowed to only comply with the standards created by the International

Accounting Standards Board? Or should companies choosing to do business in the United States, through the New York Stock Exchange, have permission to choose which set of guidelines they would like to follow?

Governing Agencies

Before the available options for possible solutions to this worldwide accounting disagreement can be confronted, the world's major governing financial agencies need to be introduced. For the United States, two major organizations – the Securities and Exchange Commission and the Financial Accounting Standards Board – are active in the creation and enforcement of accounting and financial principles. The International Accounting Standards Board (IASB) also plays an important role in international accounting regulations.

The Securities and Exchange Commission (SEC)

Following the Great Crash of 1929, Congress created the Securities and Exchange Commission and gave the members the task of enforcing The Securities Act of 1933 and the Securities Exchange Act of 1934. The SEC was also given the responsibility of promoting stability in the markets and restoring the public's trust in the capital market system (Securities and Exchange Commission, 2005). The mission of the SEC is "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation" (Securities and Exchange Commission, 2005, ¶ 1). The SEC is determined to provide the necessary capital formation needed to sustain economic growth.

A simple and straightforward concept is used to carry out the laws and the rules that govern in the U.S. securities industry: "all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it" (Securities and Exchange Commission, 2005, ¶ 6). In order for the SEC to follow this concept, public companies are required to provide meaningful financial information to the public. This way, investors may use the information provided to make a more informed decision when buying, selling, or holding a security (Securities and Exchange Commission).

The SEC is the primary overseer of the securities markets within the United States and often times works closely with Congress and other federal departments, the self-regulatory organization (e.g. the stock exchanges), and private sector organizations. This organization deals with all areas of the business world, not only the financial aspects, but the political and ethical aspects, as well. The Chairman of the SEC and several other key government administrators, including the Chairman of the Federal Reserve and the Secretary of the Treasury, participate in the President's Working Group on Financial Markets.

Although the SEC has legal authority to establish accounting and reporting standards, it often relies on another source for such principles: "Throughout its (SEC) history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest" (Financial Accounting Standards Board, 2006, ¶ 2). The organization that the SEC depends on for standards is the Financial Accounting Standards Board (FASB). This private sector organization has established standards of financial accounting and reporting since 1973. The SEC recognizes FASB as being authoritative in its issuances and standard setting. The system of regulations and principles created, established, and continually improved by FASB is known as the

United States Generally Accepted Accounting Principles (U.S. GAAP) (Financial Accounting Standards Board, 2006).

International Accounting Standards Board (IASB)

In order to present possible solutions, the history and development of International Financial Reporting Standards (IFRS) needs to be presented. Having been around since 1973, the Board of the International Accounting Standards Committee (IASC) has had a great amount of influence in the financial world: "IASC was founded in June 1973 as a result of an agreement by accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States" (International Accounting Standards Board, 2006, ¶ 2). However, in 2001, a restructuring of the already present IASC took place, and out of this reorganization, the International Accounting Standards Board (IASB) was born (International Accounting Standards Board, 2006).

The statements and rules issued by the IASC, between 1973 and 2001, are referred to as International Accounting Standards (IAS). However, when the restructure took place in 2001, the IASB decided its standards and regulations were to be called the International Financial Reporting Standards (IFRS). In April 2001, the IASB announced that the international accounting standards established by the IASC were going to be adopted and included in the newly formed IFRS (International Accounting Standards Board, 2006).

Trial and Error Transition

On January 1, 2005, more than 7000 European companies adopted the IFRS system of accounting, replacing more than 25 different accounting regimes that were being used. Despite the complexity of the transition, the switch to IFRS was for the most part very smooth. Knowledge of the upcoming changes in advance helped security markets deal with the changeover of methods in a more effective manner. However, some ripples occurred when new methods caused end of the year amounts that were not as high as normal. For example, under IFRS, the 2005 pre-tax profit for Lloyds TSB, a British bank, was 8% lower than was expected: "Deutsche Telekom's profit in 2004 was two-thirds lower under the new rules than under the old rules, while Alcatel's and Telecom Italia's were more than twice as high" (So Far, So Good, 2005, ¶ 3).

Profits are not the only numbers that have been affected by this transition. Dresdner Kleinwort Wasserstein, an investment bank, conducted a study and found that net debt is on average 16% higher under IFRS. The already struggling Italian carmaker Fiat was hit much harder by the transition to IFRS. The company saw its debt double, going from 8 million euro to 16 million (So Far, So Good, 2005).

Perhaps the most shocking outcome of the transition is the insufficient consistency and comparability of the standards. With the new regulations, numbers are being estimated for things that have no fair market values, including employee stock options. Also, companies now have more leeway when choosing how to apply IFRS (So Far, So Good, 2005). Regardless of the good that has come from the transition, a great deal of work is still needed to be done before an acceptable worldwide system of accounting standards can be created.

Although young in nature, the IASB is continually becoming more popular and more widespread. The U.S. GAAP system has had tremendous success over the last few years. The Financial Accounting Standards Board (FASB) has greatly changed over the last 30 years, becoming more popularly used by international companies (Financial Accounting Standards Board, 2004). The use of these guidelines is becoming more widely recognized and implemented. With GAAP being the primary set of standards accepted in the United States accounting arena and IFRS being the most common set approved for use between foreign companies, a complex problem has arisen in the international business world. In order to perform international business and trade transactions, companies often times have to present their financial information to markets and investors in each country where one of their markets exists. This presentation of information oftentimes causes mass confusion concerning which standards and principles should be followed and what existing laws have to be obeyed.

Conflicting Systems

Two of the most popular sets of standards presently being used in capital markets are the United States' Generally Accepted Accounting Principles (GAAP), created by the Financial Accounting Standards Board (FASB), and the International Financial Reporting Standards (IFRS), set up by the International Accounting Standards Board (IASB): "Although significantly different, they are both a comprehensive body of accounting principles whose main aim is to protect investors" (McDermott, Will & Emery, 2004, ¶ 2). Chairman of the FASB, Ed Jenkins, claims that GAAP is more comprehensive than the international standards (The Impossible Dream, 2002).

Many view these two systems as being on the opposite sides of the accounting spectrum. Don Cruickshank (2002), the Chairman of the London Stock Exchange, explained this analysis very well in a speech given on the U.S. and EU capital market issues. The U.K. accounting model is viewed as being a principles-based approach, where the U.S.' model is more rules-based. Each country, that is the U.S. and the United Kingdom, has its own ruling agency, the SEC and the Financial Services Authority (FSA). The FSA's regulations are made up of four statutory objectives and six principles: "Yes it's backed up by the rule book, but it creates a flexible and adaptable approach that allows timely decisions" (Cruickshank, 2002, ¶ 61). The SEC, on the other hand, functions under a different system of regulations. Its regulations include tens of thousands pages of accounting rules, including more than 800 pages on special purpose vehicles alone.

"A company's decision to use 'international' accounting standards (defined as both US GAAP and IFRS in the article) will be affected by the institutional framework (the body of accounting law, rules and accepted practices as well as the institutions that formulate, administer, and enforce these requirements) of its home country" (Tarca, 2004, p. 62). Due to the evolution of institutional frameworks in each country, a change has occurred in response to the demands for greater comparability in reporting. Initiatives have been taken to harmonize and join the varying standards at all levels of reporting, ranging from national, regional, and international levels (Tarca, 2004). What does this mean for companies, both domestic and foreign, participating in cross-border business transactions in foreign stock exchanges?

Companies, other than those in the United States, oftentimes choose to report their financial information using either the IFRS or their own country's version of GAAP. Business associates worldwide are greatly concerned with the numerous differences that exist between the various common sets of standards (Tarca, 2004). As reported in *Forbes* magazine, "Forbes International 500 companies adhere to no fewer than 26 different accounting standards, none quite the same as the U.S. generally accepted accounting principles (GAAP)" (Maiello, 2002, p. 166). In order to attract foreign investors, many securities markets allow alternate standards to be followed: "The stock exchanges in London, Paris, Frankfurt, Tokyo and Australia accept financial statements prepared according to domestic GAAP and other selected GAAP, including U.S. GAAP" (Tarca, p. 64). Although the stock exchanges of the countries included in Tarca's study may require that further information be offered by foreign listed firms, they (the stock exchanges) do not call for reconciliation to the stock exchange's national GAAP as mandated by the SEC (Tarca, 2004). Nonetheless, a problem arises when businesses do not use GAAP.

According to Maiello (2002), Novartis, a Swiss drug making company, had greatly varied incomes in 2001. Due to its listing on the NYSE, Novartis has to calculate both a GAAP and an IFRS income. Its earnings according to the IFRS were $4.1 billion, while its GAAP earnings were $2.8 billion. These varying income earnings cause confusion for Norvatis' investors and the company's market standings. This difference can be supported by information contained in an article by Harris (1999).

A study conducted by Esther Ortiz (2005) showed that the majority of European countries listed on the NYSE favor using the United States' GAAP system. However, a number of foreign and international companies choose to follow those principles created and upheld by the International Accounting Standards Board (IASB). Dumontier (1998) researched reasons why foreign markets choose to comply with the IASB's IFRS.

For example, over the past 10 years, Germany's reporting standards have significantly changed: "Since 1993, an increasing number of listed German companies have been publishing their consolidated financial statements in accordance with either IFRS or US GAAP. In 1998, this was approved as a substitute for the consolidated German GAAP financial statements of listed companies" (Weißenberger, 2004, p. 169). With this option being made available to businesses within the country, a larger problem is posed for international business.

Harmonization Efforts

Numerous efforts to harmonize varying standards or regulations have been and are being attempted. The Norwalk Agreement, between the United States' standard setting agency and the international governing agency is an ongoing example of such efforts. One of the most current and successful unifications is the European Union (EU).

The Norwalk Agreement

In September 2001, the U.S. FASB and the IASB met to discuss the possibility of merging both the U.S. GAAP and IFRS standards. Bob Herz, the new chairman of the FASB and previous member of the IASB, is quoted as having said, "It is the right thing to do, and now is the right time to do it" (Walton, 2004, ¶ 2). The second meeting was held just a few days later at the headquarters of the FASB in Norwalk, Connecticut. An important agreement was reached at this meeting, beginning a joint effort that would greatly impact the financial world. This union provides a much needed hope for the possibility of a harmonization between the two boards' principles and standards (Tomaszewski, 2004).

The FASB and IASB agreed to "make their existing standards fully compatible as soon as is practicable and to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained" (Walton, 2004, ¶ 3). As Gornik-

Tomaszewski (2003) states, "The FASB and the IASB acknowledged their commitment to the development of high-quality accounting standards suitable for both domestic and cross-border financial reporting" (p. 39). The Norwalk Agreement, so named after the place of the meeting, was published and stated a four part purpose (Financial Accounting Standards Board, 2005).

The focus of the Norwalk Agreement was to remove as many of differences that existed for European and other companies who have or wanted to have listings in the United States. At the time of this convergence effort, EU Commissioner Frits Bokestein said that the move "towards a single set of high-quality, best of breed, principles-based financial reporting standards, which would dramatically improve the efficiency of global capital markets: costs would decrease, comparability would improve and corporate governance would be enhanced" (Walton, 2004, ¶ 5). Along with this project, any variations of standards that exist are expected to be resolved: "The FASB and IASB pledged to make their existing financial reporting standards fully compatible as soon as practicable" (Gornik-Tomaszewski, 2003, p. 39).

The majority of the financial community is in favor of a convergence of the two standards. In order to reduce the confusion and difficulties that most cross-border businesses face, a solution to these problems must be found. Having seen the difficulties that occur while trying to upkeep and maintain two separate sets of books, the NYSE CEO, John Thain (2004a) states, "For the sake of all companies running global businesses, let us (the NYSE and Economic Club of New York City) push for convergence of FASB and IASB standards" (¶ 78). Sir David Tweedie, Chairman of the IASB, acknowledges the rocky road ahead, but supports the convergence efforts undertaken by the IASB and the United States FASB. Tweedie remarks, "By drawing on the best of U.S. GAAP, IFRSs and other national standards, the world's capital markets will have a set of global accounting standards that investors can trust" (Financial Accounting Standards Board, 2002, ¶ 4).

Not only are financial leaders all around the world excited for a possible convergence, they are hopeful that such a merger will come about easily and rapidly. As Maiello (2002) states, "Jones (vice chairman of the International Accounting Standards Board) predicts that IAS will become so popular that by 2010 the world – including the United States – will use one standard, even if there are a few names for it" (p. 166). Sir David Tweedie is recorded as saying that after the completion of the implementation of the Norwalk Agreement, problems between IFRS and US GAAP will be irrelevant. The two sets of standards will have converged to the point where they no longer have any significant differences (House, 2004).

With the United States' FASB working alongside the IASB, many of the differences that cause problems between cross-border financial reporting will undeniably be resolved. The convergence of these standards will dismiss many of the concerns and costs that are involved in the current foreign trade market. By applying the same set of standards to accounting transactions, countries all over the planet will be able to more easily conduct international business. Currently, several companies use a combination of the International Accounting Standards and the standards created by their home countries (Taylor, 1999).

Although efforts are being made to converge US GAAP and other international standards, many controversies and differences are yet to be solved. As of recently, the

International Accounting Standards' reputation is that of being more lenient than those of GAAP. This looseness allows more leeway in how companies add up and report their financial figures. Therefore, companies using IAS rules are given an unfair advantage, because their bottom lines are most times higher than those using other standards, say the United States generally accepted accounting standards (Trombly, 2000).

Alfred Popken, a director in the New York-based PricewaterhouseCoopers' global capital markets group, claims that the United States has the strictest standards in all of the accounting world. According to Popken, the International Accounting Standards will likely not gain the endorsement of the SEC until they become as tough and comprehensive as the standards in the United States. However, the pressure for an international, cross-border set of standards is steadily increasing, and since the IAS is backed by the International Organization of Securities Commissions, the popularity of the convergence efforts is rapidly growing (Trombly, 2000).

Despite the lack of support and uneasy feelings toward the labors of the Norwalk Agreement, the convergence brings about numerous solutions to the questions posed earlier in this paper. The scope of the Norwalk Agreement is the differences between the US Generally Accepted Accounting Principles (GAAP) and the International Financial Reporting Standards (IFRS). These differences are planned on being resolved in a relatively short time by selecting the most effective standard between the two sets of principles (Gornik-Tomaszewski, 2003). Having a set of standards that companies world-wide can implement will cause fewer problems in international business operations (Analysts and investors, 2004). Even the chief accountant for the Securities and

Exchange Commission (SEC) describes the Norwalk Agreement's effort for convergence as being "very good" (Nicolaisen, 2004).

The European Union (EU)

The European Union (EU) serves as a great example of a successful harmonization. The creation of free movement of persons, goods and services, and capital across member countries is one of the purposes of the EU. In order to form a common capital market, this organization has tried to synchronize financial reporting standards of all the EU member nations. The EU issued directives that must be integrated into the accounting principles of member nations (Hoyle et al., 2004).

However, in 1995, the EU Commission decided that no new directives would be issued. Instead, the EU was to work with the International Accounting Standards Committee to create a "broader international harmonization of accounting standards" (Hoyle et al., 2004, p. 539). Agreeing to participate in this partnership has helped the EU members to make their principles and regulations more compatible. The EU directives helped minimize the differences among the member nations' standards and have frequently served as an accounting model for other countries in search of a basic framework of accounting (Hoyle et al., 2004).

In hopes of acceptance as members of the EU, Hungary, Poland, and the Czech and Slovak Republics rewrote their existing Soviet style accounting regulations. Using the previously issued EU directives, these countries succeeded in forming a more market-oriented system. On May 1, 2004, these countries and/or republics were granted admission into the European Union (Hoyle et al., 2004).

Currently, only a few countries in the EU use the International Accounting Standard (IAS). David Cairns, who currently advises companies on the switch to IAS, knows a lot when it comes to the various negative and positive aspects of using the IAS. By comparing the German automaker Volkswagen's (VW) 2000 financial results under IAS and those under the existing German accounting rules, Cairns realized that VW had a ten percent boost in net income under IAS. This increase was due to a rule that allows VW to capitalize development costs for new cars. Also, under a different principle, the company could treat car leases as receivables and gain an eighteen percent increase in profits (Maiello, 2002).

Attractiveness of United States Capital Markets

As Darla C. Stuckey (2003), corporate secretary for the NYSE states in her letter to Jonathan G. Katz, secretary for the Securities and Exchange Commission (SEC), "Historically, we (the NYSE) have shared with the SEC the common purpose of ensuring that the U.S. capital markets remain attractive to companies around the world" (¶ 4). As a product of this objective, domestic investors are presented opportunities to invest in foreign companies through U.S. markets (Stuckey).

Regardless of the success of the NYSE, a problem still exists in maintaining the desired attractiveness of the United States' capital markets. Foreign companies having to change their financial reporting methods to meet the requirements of the United States' GAAP in order to be listed on US markets are apt to lose interest more quickly (Stuckey, 2003). John A. Thain (2004b), in a letter to the editor of *The Wall Street Journal*, discusses conversations he has had with leaders of NYSE-listed companies, as well as executives from abroad hoping to do business in the United States. In reference to these conversations, Thain (2004b) states, "I continue to hear a refrain. They are saying, 'The pendulum has swung too far. The costs of compliance are too high. The risks of litigation are too great.' And thus, 'We'll avoid the risks. We'll defer our decisions. We'll delay our investments'" (¶ 7).

The recent lack of foreign listings can be linked to the declining need to participate in U.S. markets. For example, one such cause is that the Sarbanes-Oxley act takes time, effort, and resources to carry out its regulations. When the cost of complying with our market guidelines increases, the profit usually earned by non-U.S. companies from listing in the U.S. markets decreases. For some European firms, the cost of incorporating the new, complex regulations from the Sarbanes-Oxley Act could increase current accounting costs by 100%. In turn, the growth opportunities being sought by these foreign companies are no longer as appealing as they once were (Thain, 2004b).

Of course the NYSE and the SEC have realized a need for accommodating home country practices for foreign investors and issuers. Stuckey (2003) mentions in her letter the fact that the SEC will accept U.S. GAAP-reconciled financial statements rather than require a full restatement of all accounts from home country standards to U.S. GAAP. Also, in place of Form 8-K required by the Exchange Act of 1934 of domestic companies, the SEC will allow home country interim reporting practices.

The NYSE and SEC do see a need to make the requirements for cross-border companies to list on domestic markets more lenient. The Sarbanes-Oxley Act of 2002 caused many non-U.S. companies to complain about the requirements being a noteworthy departure from existing reliance on home country regulations. In response to the apprehensions voiced by non-U.S. companies, the SEC has been willing and open to listen to the concerns. The SEC has also attempted to present possible adjustments for non-U.S. companies in the rulemaking of the Sarbanes-Oxley Act (Stuckey, 2003).

Efforts made by the SEC in meeting with foreign regulators, advisors, and companies to discuss those home country requirements that may conflict with the well-known and highly influential Sarbanes-Oxley Act have been noted and acknowledged by the New York Stock Exchange. One such meeting was the Roundtable on Auditor Independence held on December 17, 2002, in Washington, D.C. In support of the SEC, the NYSE sent representatives to attend on its behalf and keep the exchange leaders updated on current concerns. Other participants, including European, South American, and Asian representatives, discussed in great detail both the negative and positive aspects of how their home country regulations effected the requirements for auditor independence proposed in the Sarbanes-Oxley Act. Panelists from the United Kingdom, Japan and France presented requirements in foreign jurisdictions equivalent to those of the SEC in hopes of eliminating duplicate and/or confusing regulations (Stuckey, 2003).

Conclusion

Should companies doing business on the NYSE be required to follow one specific set of standards? In the event of the convergence of US GAAP and IFRS, this question will automatically be answered. If the two sets become alike in most of their standards, then by following the US GAAP standards, a company will ultimately be following the IFRS. The similarity of the two sets of guidelines will allow less of an opportunity for problems and differences to arise.

The American government is not the only organization that is now requiring that participants in any of their markets conform to their domestic regulations and law. The

European Parliament has ruled that as of January 1, 2006, any company with public shares in European markets must consolidate all of its financial statements and reports with the International Accounting Standards. This ruling impacts more than 7000 foreign companies who were previously using their own home country sets of standards. The Australian authorities have carried out a similar action in fulfilling their commitment to create some type of sanity in the dealings of accounting principles (Cruickshank, 2002).

What should be done about the option of a choice until the Norwalk Agreement has been implemented in all cross-border countries? Until a global solution for this problem can be found and fully implemented, the United States should maintain the Securities and Exchange Commission's current requirement. Although costly and time consuming, foreign businesses desiring to do business on American capital markets, specifically the New York Stock Exchange, should be required to follow the generally accepted accounting principles of the United States. By doing business in an American exchange market, a company is agreeing to follow the rules that currently exist in this country. Since the accounting principles in the United States are part of the financial laws of the country, companies choosing to do business and offer investment opportunities through the NYSE should be required, by law, to follow the current rules.

References

Analysts and investors must be prepared for implementation of IFRS. (2004, August 26). *The Accountant*. Retrieved February 22, 2005, from the LexisNexis database.

Cruickshank, Don. (2002, November 12). *The same – but different: Hard rules or soft principles: Perspectives from London on US and EU capital market issues*. Speech presented to London Stock Exchange investors, London, England. Retrieved January 2, 2006, from http://www.londonstockexchange.com/en-gb/about/Newsroom/Media+Resources/Speeches/speech18.htm

Dumontier, P., & Raffournier, B. (1998). Why firms comply voluntarily with IAS: An empirical analysis with Swiss data. *Journal of International Financial Management & Accounting, 9*(3), 216-245. Retrieved February 23, 2005, from the EBSCO Host research database.

Dye, R.A., & Sunder, S. (2001, September). Why not allow FASB and IASB standards to compete in the U.S.? *Accounting Horizons, 15*(3), 257-271. Retrieved February 24, 2005, from the EBSCO Host research database.

Financial Accounting Standards Board. (2002, October 29). *FASB and IASB agree to work together toward convergence of global accounting standards*. Retrieved February 24, 2005, from http://www.fasb.org/news/nr102902.shtml

Financial Accounting Standards Board. (2004). *Overview of FASB's international activities*. Retrieved February 24, 2005, from http://www.fasb.org/intl/

Financial Accounting Standards Board. (2005). *The Norwalk Agreement*. Retrieved February 25, 2005, from http://www.fasb.org/news/memorandum.pdf

Financial Accounting Standards Board. (2006). *Facts about FASB*. Retrieved February 7, 2006, from http://www.fasb.org/facts/

Gornik-Tomaszewski, Sylwia. (2003, August). Short-term convergence between US GAAP and International Financial Reporting Standards. *Bank Accounting & Finance, 16*(5), 39-42. Retrieved February 24, 2005, from the EBSCO Host research database.

Harris, M.S., & Muller III, K.A. (1999, January). The market valuation of IAS versus US-GAAP accounting measures using Form 20-F reconciliations. *Journal of Accounting & Economics, 26*(1-3), 285-312. Abstract retrieved February 24, 2005, from the EBSCO Host research database.

House, John. (2004, November 1). Financial reporting: IASB – US dangles listing carrot. *Accountancy, 134*(1335), 76-77. Retrieved February 24, 2005, from the LexisNexis database.

Hoyle, J.B., Schaefer, T.F., & Doupnik, T.S. (2004). *Advanced accounting* (7th ed.). New York: McGraw-Hill.

International Accounting Standards Board. (2006). *History*. Retrieved February 7, 2006, from http://www.iasb.org/about/history.asp

The Impossible Dream. (2002, March 3). *Economist, 362*(8262), 69-71. Retrieved February 27, 2005, from the Academic Search Premier database.

McDermott, Will & Emery. (2004, September 24). International Accounting Standards help investors make economic decisions. *Mondaq Business Briefing*. Retrieved February 23, 2005, from the LexisNexis database.

Maiello, Michael. (2002, July 22). Tower of Babel. *Forbes, 170*(2), 166. Retrieved February 27, 2005, from the EBSCO Host research database.

New York Stock Exchange. (2002, April 26). *Listed Company Manual.* Retrieved November 21, 2005, from http://www.nyse.com/lcm/

Nicolaisen: Prospects 'very good' for mutual recognition. (2004, October 13). *International Accounting*. Retrieved February 23, 2005, from the LexisNexis database.

Ortiz, Esther. (2005). GAAP choice by European companies. *European Business Review, 17*(1), 36-51. Retrieved February 22, 2005, from the Emerald Fulltext database.

Securities and Exchange Commission. (2005, December 3). *The investor's advocate: How the SEC protects investors, maintain integrity, and facilitates capital formation*. Retrieved December 30, 2005, from http://www.sec.gov/about/whatwedo.shtml

Shaw, Helen. (2005, August 9). Small-caps eye listing abroad. CFO.com. Retrieved February 7, 2006, from http://www.cfo.com/article.cfm/4265817?f=search

So far, so good. (2005, June 18). *The Economist, 375*(8431), 73-75. Retrieved January 10, 2006, from the EBSCO Host research database.

Stuckey, Darla C. (2003, January 13). Letter to Mr. Jonathan G. Katz of the SEC. Retrieved January 9, 2006 from http://www.nyse.com/pdfs/33-8154letter.pdf

Tarca, Ann. (2004). International convergence of accounting practices: Choosing between IAS and US GAAP. *Journal of International Financial Management & Accounting, 15*(1), 60-91. Retrieved February 23, 2005, from the EBSCO Host research database.

Taylor, M. E., & Jones, R. A. (1999). The use of international accounting standards terminology, a survey of IAS compliance disclosure. *The International Journal of Accounting, 34*(4). Abstract retrieved February 24, 2005, from the Emerald Full text database.

Thain, John A. (2004a, May 27). *Remarks to Economic Club of New York City.* Speech presented to the Economic Club of New York City. Retrieved February 24, 2005, from http://www.nyse.com/Frameset.html?displayPage=/events/1101074808023.html

Thain, John A. (2004b, May 28). Sarbanes-Oxley: Is the Price too High?. *The Wall Street Journal.* Retrieved January 2, 2006, from http://www.nyse.com/press/1085741646123.html

Tomaszewski, S. G., & Shoaf, V. (2004, December). Accounting for noncurrent assets held for sale and discontinued operations converges. *Bank Accounting & Finance, 18*(1), 43. Retrieved February 22, 2005, from the LexisNexis database.

Trombly, Maria. (2000, June 5). SEC may loosen reins on foreign biz; Mulls relaxing rules for stock listings in U.S. *Computerworld,* 119. Retrieved November 11, 2005, from the InfoTrac database.

Walton, Peter. (2004, October 26). Convergence with US GAAP. Retrieved on January 10, 2006 from http://www.accaglobal.com/ifrs/directarticles/2264915

Weißenberger, B. E., Stahl, A.B., & Vorstius, S. (2004). Changing from German GAAP to IFRS or US GAAP: A survey of German companies. *Accounting in Europe, 1,* 169-189. Retrieved February 23, 2005, from the EBSCO Host research database.