

QUESTION: Compare and contrast the approach of the US and UK financial regulatory bodies and comment upon the major issues and events which have shaped the regulatory environments of both countries over the last twenty years.

Introduction

This paper aims at comparing and contrasting the UK/US financial regulatory bodies in the financial accounting standard issue and application aspect. Recently we found the obvious tendency of global accounting standard convergence and this has the significant influence on both of UK and US financial regulatory environments. This convergence is also called accounting harmonisation which aims at developing a single set of high quality, global acceptance accounting standards that require transparent and comparable information in general purpose financial statements. (Nobes & Parker, 2002, pp93) In order to achieve that goal, both of UK and US move toward the International Accounting Standards at present. This paper will outline the major structure of financial regulatory systems in both two countries and then will compare the major steps that UK and US financial regulators took toward this tendency over last decades.

Briefing of UK/US financial accounting systems:

Both of UK/US system are more pragmatic system and have traditionally been regarded as a service function to business. This orientation towards business practices has resulted in lots of the similarities existed between UK and US system. Nobes and Parker (2002) outline some major similarities between UK/US's financial system as follow:

(1) *Reliance on generally accepted accounting principles*

Accounting under both systems are essentially based on practice and generally accepted principles. These principles have developed through long time of practice, and their development has been influenced primarily by the business and financial

communities and the accounting profession.

(2) Full disclosure and fair presentation

In this kind of pragmatic system of accounting, they rely on criteria such as "a true and fair view" in the UK, and "fair presentation" in the USA. A policy of full disclosure of information about the company's performance is necessary in order to make all the financial information be comparable!

(3) Professional autonomy

The profession in both of UK and US are autonomous (i.e. self-regulating) and credible. The profession take a leading role in the establishment and maintenance of standards; Therefore accounting standard setter in both countries is the private and independent.

Financial regulatory system in UK:

In case of UK, the ultimate legislative or say regulatory body is EU Council of Ministers. EU Commission has got the considerable and supervisory power. Due to UK is one of the EU member states, it have to implement the EU Directives. For example, EU's Fourth and Seventh Accounting Directives have the major influence on UK's company law and financial regulatory system.

Apart from EU level, UK also has its own financial regulators, such as Financial Services Authority (FSA). FSA is an independent body that is responsible for regulating financial services in UK. FSA has got the supervisory power on UK securities markets and the listed companies. One of its divisions called the UKLA (UK Listing Authority) carries out this responsibility. UKLA seeks to ensure that listed companies comply with their ongoing obligations under the listing rules. The UKLA has the power to impose a financial penalty on a listed company or director where the listing rules have been broken. (Source: FSA website 2002)

Another important regulator in UK is Financial Reporting Council (FRC). FRC was found in 1990, is responsible for promoting good financial reporting and also setting the accounting standards with its subsidiaries: Accounting Standards Board (ASB)

and Financial Reporting Review Panel (FRRP). It is an independent private sector body funded by the accountancy profession and Department of Trade and Industry (DTI). FRC provides general policy guidance to its operational bodies: ASB and FRRP. ASB makes, amends and withdraws accounting standards. FRRP examines apparent departures from the accounting requirements of the Companies Act 1985, including applicable accounting standards. (Source: FRC 2000)

Financial regulatory system in US:

US Congress, the ultimate legislative assembly, which can override and/or inquire into the adequacy of corporate regulation enforcement.

In the main, however, Congress has left accounting matters and corporate regulation to Securities and Exchange Commission (SEC), an independent regulatory body with both quasi-legislative power (in that it can promulgate rules and regulations and prescribe registration and report forms) and quasi-judicial power (in that it can hold investigations, issue orders, opinions and injunctions against firms' continuing quotations on the stock exchange). (Source: SEC website)

In the main, SEC just maintain a supervisory role and left the standards setting responsibility to Financial Accounting Standards Board (FASB): which built in 1973, is appointed and funded by Financial Accounting Foundation, and is now the primary accounting standard-setting body. FASB issues Statements of Financial Accounting Standards - SFAS which are mandatory for companies registered with SEC. FASB also issues "Interpretations" (guidelines, explanations and/or clarifications of SFAS) and Statements of Financial Accounting Concepts (SFAC). The latter, of which six have been issued, are statements of general concepts designed to establish a conceptual framework which will guide the criteria to be used when SFAS are set and/or revised. (Source: FASB website)

Now this paper will explore the IASs and the relevant issues made by UK and US financial regulators. And also will state the IASs' influence on both countries' regulatory environment.

Adoption of IASs and its influence in UK

In UK, during last twenty years, the quality of its financial reporting has got a stable improvement. Following this period of relative stability and progress, UK regulatory framework has got a significant change. One key change is from European Commission (EC)'s Directive which requires all of EU member states' listed companies to adopt the International Accounting Standards (IASs) for their group accounts by 2005. This event has a significant influence on UK financial reporting system and it also reflects the tendency of EU accounting harmonisation.

1) Reasons for accounting harmonisation in EU

The accounting harmonisation is particularly necessary and urgent within the UK and other EU member states. The reasons are as following: Firstly, the EU's objective is to establish the free movement of labour, resource and the capital within EU member state. Then free movement of the capital require a integrated financial services, and capital market within the EU member states." (Nobes & Parker, 2002, pp93). As the one of EU member state, UK also wants to achieve above objective. Therefore adoption of one set accounting rules in all member states is necessary because it can improve the accounting comparability and transparency between the UK companies and other EU member states' companies.

Secondly, some UK listed large public companies want to get a listing in other member state's capital market or in the international capital market. Therefore they need to adopt a kind of international recognised accounting standards attract the foreign investors. In general, investors prefer one set of accounting standards in order to make the accounts from different countries be more comparable. Therefore by using one set accounting rules, it is much more easy for these investors to understand

and compare the company's accounts of UK and other countries. This comparability would assist shareholders, analysts and other users of accounts, and help to maintain the attractiveness of UK companies to international investors. (Nobes & Parker, 2002, pp94)

Next, for some UK multinational corporations, which listed in the other member states' capital market, also seek to a common set rules. If all the member states adopt same set of accounting rules, then these companies and their subsidiaries round member states will reduce the cost of designing, running and adjusting the accounts which are from member states. (Black, Amat & Growthorpe, 1999)

2) Possible solutions

In this way, in order to improve the EU accounting harmonisation, EU Commission has considered several possible solutions:

Firstly, EC drafted some Accounting Directives to provide legal frameworks for the financial statements of companies in UK and other EU member states since 1970s. Some important Directives are as following: Fourth Directive which was issued in 1978 provides the format and rules of annual accounts of the limited liability companies in EU. Seventy Directive is more relevant with the consolidation accounts. However due to these Directives are just a framework and not detailed enough, they are not very helpful to improve EU accounting harmonization.

Another solution is adoption of US GAAP within EU member states. However this solution has been rejected by EU commission. The reason is because firstly US GAAP is too complex. It lacks the flexibility when dealing with the different situations in each member state. Secondly, US rules is aim at US market. It is not widely accepted by other countries. Accounting harmonisation cannot be limited in a specific country. It should put focus on broader international market. (Combarros, 2000)

Final choice is International Accounting Standards (IASs) which developed by International Accounting Standard Board (IASB) as the basis for harmonising European accounting system. IASB which was found in 1973, is an independent, privately funded accounting standard setter based in London, UK. IASB aims at developing a single set, global acceptance accounting standards that require transparent and comparable information in general purpose financial statements. (Source: IASB website) IASs is an important and successful accounting standard recently. It is accepted by International Organisation of Securities Commission (IOSCO), the companies which apply IASs can easily access the international capital markets. IASs also has a clear prospect of recognition for some international organisation such as WTO. (European Commission, 1995, p4) IASB was found within EU. Most of its member is from the UK accounting profession. So it is very close to and is highly influenced by UK system.

3) Process and influence of IASs application

In 1995, EU commission decided to move towards IAS in order to achieve the broader international accounting harmonization and deal with their accounting problems. In 1996, EU commission announced that there aren't any significant differences between EU Accounting Directives and IASs. After that, IASB has worked in conjunction with EC in order to reduce the differences between EU Accounting Directives and IASs. In 2000, EC proposed compulsory use of IASs for the consolidated statements of listed companies by 2005. On July 2002, the European Parliament and Council released the Regulation (EC) No 1606/2002 of the application of international accounting standard (IAS Regulation) in order to harmonises the financial information presented by public listed companies in order to ensure a high degree of transparency and comparability of financial statements.

In UK, EU's IASs regulation introduces important changes, which will directly influence the way in which UK's companies prepare their financial statements. For those UK companies affected, this EU's regulation means they will have to comply

with accounting standards issued by IASB, instead of much of the Companies Act 1985 and the domestic accounting standards issued by the Accounting Standards Board (ASB). In this way, this regulation make IASB standards have direct legal force in UK. Recently ASB has a programme of converging domestic and IASB standards. In the future, UK standards are likely to be very similar to IASB standards in many respects, and in particular, ASB standards will only be used by non-publicly traded companies. (Source: DTI website. 2002)

Unlike Accounting Directives, EU IAS Regulations have the force of law without requiring transposition into national legislation. Member States have the option of extending the application of this Regulation to unlisted companies. As the result, apart from the listed companies, in 2003, UK DTI and FSA also announced that from January 2005, the implication of IASs in 2005 will be extended to following aspect: Firstly, the publicly traded companies in UK will also be permitted to use IAS in their individual accounts from the same date; and secondly, other companies and limited liability partnerships in the UK will be permitted to use IASs in both their individual and consolidated accounts from the same date. (Source: DTI 2003) The regulation with adoption of one set accounting standard represents the biggest change in UK financial reporting for these 20 years. Financial reporting of UK companies will be more transparent and more easily comparable, which will benefit users, and lead to more efficient capital markets.

IASs and its influence in US

During the recent decades, under the pressure of economic globalisation and free capital flow around the world, more and more companies seeking to get listing on international capital market, and investors also were attracted by investment global opportunities. As result, the call for common financial reporting and disclosure become more intense.

1) US GAAP vs IASs

However in US, all foreign companies must use US accounting rules (US GAAP) if they want to get listing in US capital market. And this policy is different from the one that London Stock Exchange adopted, which is allowed the UK domestic listed companies adopt UK accounting standards, while the foreign listed companies may use UK, US, or IAS standards under the principle of mutual recognition. As the result, in 1990s, the number of foreign listings increased at a faster rate, but by the end of 1997 only 343, or 11%, of the 3,046 listed companies were from foreign countries in NYSE. By contrast, at the end of 1997 the LSE main market had 526 foreign listings, which represented 20% of the 2,683 total listed companies. A comparison of the total market value of domestic and foreign companies listed on the NYSE and LSE at the end of 1997 on following table, (exchange rate \$1.6/1) we found the relative dominance of foreign listings in London compared to New York. (Zeff, 1998).

	New York	London
Domestic	\$8.9 trillion	£1.3 trillion (\$2.1 trillion)
Foreign	\$2.8 trillion	£2.4 trillion (\$3.8 trillion)

Then in 1996, US Congress put the pressure on SEC to support the IASs. The Congress passed the National Securities Improvement Act, which state that SEC should enhance its support the development of high-quality IASs and IASs would be acceptable to SEC for offerings and listings by foreign corporations in US markets.

2) Process of movement toward IASs

In 1996, SEC released a statement that support IASB to develop an accounting standards that could be used for preparing financial statements used in cross-border

offerings. And it also indicated that, if the IASB successfully completes an agreed-upon work plan, SEC will consider allowing foreign companies to use IASB accounting standards in securities offerings in the US market. (Source: SEC website 1996) However SEC's statement didn't fully support IASs and it requires lots of amendment on IASs to reduce the gap between IASs and US GAAP in order to gain that acceptance from SEC. As SEC Chairman Arthur Levitt (1996) said that "There's no doubt in my mind that [the IASC *standards*'] acceptability to U.S. investors will depend on how well those *standards* measure up to our own". (Source: SEC website 1997) The reason is mainly due to the significant difference existed between US GAAP and IASs. IASs are a principle-based standard with limited application guidance and GAAP are rule-based standards with more specific application guidance. (Pacter. 2002. p97) If the SEC allow foreign companies to adopt the IASs which are different from those U.S. companies adopted, SEC would immediately come under pressure, to allow U.S. companies have the same right. Otherwise, as ZEFF (1998) claims that US companies may go "offshore," i.e., relocate headquarters in elsewhere outside the United States in order to take advantage of less demanding reporting standards in US capital market. That is one of the major reason that SEC can't accept IASs and all foreign companies which listed in US capital market, have to prepare their financial statements under US GAAP.

However the Enron debacles has damaged the reputation of US GAAP. Recently, FASB are trying to converge IASs and US GAAP through coordinating with IASB. FASB and SEC have started to refocus on IASB and its IAS. (Livingston. 2002. p6) FASB is now showing more flexibility in adopting more principle-based standards. In 2002, FASB published a proposal for public comment on a principle -based approach to accounting standard setting. (Investor Relations Business, 2002. p11). The IASB and FASB also said they are committed to developing high-quality compatible accounting standards that could be used for both domestic and major international capital markets. They recently announced the desire to undertake a joint project aimed at reduction of some key differences between US GAAP and IAS by 2005. This

comes on top of the IASB's existing agenda. (Livingston. 2002. p6). At the same time, SEC chairman Harvey Pitt also appeared SEC want to work together with IASB and FASB on the scope of this project. (Pitt. 2002. p86)

In this way, we'll find an obvious trend of convergence i.e. US is moving towards IASs. All of those mentioned above reflect a significant change of US regulators, SEC and FASB. Just for short moment ago, these US regulators still claims that any convergence of the global accounting standards would have to be based on the US GAAP, a rules-based system and reject the IASs which is more principles based system. Now US regulators start to know that US GAAP is not a superior system. This move towards IASs will make the foreign companies which are listed on US capital market might not follow US accounting standards in the future. And this will save multinational companies' time and money to prepare two separate statements for US GAAP and IASs. On another hand, it may make US market become more attractive to these companies.

COUCLUSION

During the recent decades, there were lots of significant change that has influence the world's capital markets. The breakup of Soviet Union and the reunification of Germany, for example, have created major new demands for capital and, therefore, new investment opportunities. Under the economic globalisation pressure, lots of companies have been reaching capital markets outside their home country to meet their financing needs. At the same time, the development of technology have reduced the constraints of time and distance, with telecommunications and computers linking people and markets all over the world. These forces have created a climate in which capital flows across borders more easily and in which investors have expanded their choice beyond national borders. Under this background, both of UK and US financial regulators have noticed the importance of establish a single set of high-quality global recognised financial reporting standards because this will greatly reduce uncertainty

about comparability of published accounts, and enhance the transparency of information to the marketplace. UK as the member state of the EU, it has got significant influence from EU and other member states, so compared with US, it reflects more flexibility and be more active to responding the accounting harmonization. UK has agreed to adopt the IASs within the EU region by 2005 and this will strengthen the free capital movement inside all member states. However for US regulator, due to its super-power status, it is not easy for them to accept other countries' rules in short time. But now they have noticed the tendency of international accounting standards convergence and start adjust itself to incorporate into the global market. And that will benefit not only US market, but also the whole worldwide!

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