

Essay Question:

Professor Zeff [*Accounting and Business*, February 1999; p. 16] views the US Securities and Exchange Commission [SEC] as a 'control agency'. Examine this statement and some of the major issues currently facing the SEC.

Professor G. Muller classified the USA accounting system in 1967 as pragmatic¹. It provides an efficient and effective service to business. Pragmatic is an independent discipline that develops on an ad hoc basis, normally when problems occur within industry. It tends to take place on a piecemeal basis feeding from judgement and trial-and-error.² The UK also has a pragmatic system. Being a pragmatic system it develops without the influence of governments and economic theories.³

The USA has 50 federated states which agreed to adopt the overriding national laws regarding administration, economic, political and/or social advantage.⁴ No national company legislation like that of the Companies Act within the UK exist within the USA. There is also no exclusive accounting profession and no formulation and application of stock exchange reporting requirements. This is due each state having responsibility to create its own legislation concerning corporate regulations, almost total autonomy is vested in each states legislative authority. The only constraint to complete autonomy is the US Congress, the ultimate legislation assembly, who have the powers to override any aspects of corporate regulation enforcement.

In 1983, Watts and Zimmerman stated that in the nineteenth-century, companies voluntarily published accounting information and carried out audits in the USA.⁵ This means that within Puxty's (1987) model on the regulation of financial reporting the USA system was left entirely to the market forces. Each company chooses its own rules, influenced by pressures from, in particular, the US capital market. The US stock exchange is about five and half times that of the UK,⁶ therefore it has strong equity (Nobes, 1988).

It took the greatest financial disaster that the USA has ever experienced to establish a national independent regulatory body. The Securities and Exchange Commission (SEC) was created by the US Congress when investors and the public lost confidence in the US securities market. This was due to substantial investments becoming worthless within hours and days in October 1929.⁷ The SEC possesses quasi-judicial powers, it imposes how financial reports are prepared. It's regulations apply to listed companies, companies with assets exceeding five million dollars and who have 500 or more shareholders and those who have over 300 holders of a class of securities registered under the Securities Act 1933.⁸

Even though the SEC has the powers to prescribe accounting and reporting standards for the registered companies, its policy since the 1930's was to rely on the private sector to set them. In the 1973 Accounting Series Release (ASR) No. 150 stated that the Financial Accounting

¹ Nobes & Parker (2002), pg 56

² Choi *et al.*, (2002), pg 49

³ Nobes & Parker (2002), pg 56

⁴ Gayfer, D (2002), pg 36

⁵ Nobes & Parker (2002), pg 58

⁶ Nobes & Parker (2002), pg 12

⁷ Sutton M H (1997), pg 96

⁸ Gayfer, D (2002), pg 37

standards board (FASB) had “substantial authoritative support” from the commission and those contrary to the FASB would have no support.⁹ The standards and principles developed are the major components of *generally accepted accounting principles* (GAAP), which have been evolved from years of practice within the market. GAAP is a main feature of the USA pragmatic system.

While the SEC collaborates with FASB in establishing accounting standards, it has not surrendered complete authority. The threat of government intervention hangs over the SEC. For this reason the SEC has not hesitated to intervene when FASB are moving too slowly or in the wrong direction. In the past the SEC has imposed its own requirements, delayed or even overruled a private sector pronouncement.¹⁰ Even though the SEC has in the past overruled the FASB, it is said that “too few public companies had their annual reports reviewed by the SEC, with more than half...not being reviewed over a three year period...”¹¹ This brings into question how dedicated is the SEC? Recent investigations by the SEC include, Spear, Leeds Kellogg, and a unit of Goldman Sachs; Bear Wagner.¹² If the outcome goes against these companies it could result in the SEC rejecting their filing of accounts and therefore them becoming unregistered from the Stock Exchange.

The investigations can be considered to be a very minor issue. More important current issues surrounding the SEC include their involvement in international standard setting. SEC is a member of the International Organization of Securities Commissions (IOSCO) who have been working with the International Accounting Standards Committee (IASC) to attempt to, “improve the IASC’s standards so that they might become an acceptable framework for financial reporting in cross-border securities offerings”.¹³ The outcomes from the discussions brought about three key elements that were agreed. These three elements are, a core set of standards, comparability and transparency and rigorous interpretation and application.¹⁴

The comparability, transparency and full and fair disclosure of financial reporting has created a problem for the SEC. The SEC requires all domestic and foreign companies to use, or reconcile to, the US GAAP. The SEC has not tried to change the policy, to make domestic listed companies produce financial reports using US GAAP and foreign listed companies using either US GAAP, British or IASC standards. The implementation of this type of policy similar to that of the London Stock Exchange would result in foreign listed companies benefiting from a unfair advantage. As the USA has more of a conservative approach¹⁵ to creating standards than the UK, foreign listed companies would be able to, “adopt measurement and disclosure standards that are less prescriptive and more permissive”.¹⁶ The change would immediately come under pressure from US listed companies, in perhaps the form of lawsuits. Suggestions have been that US listed companies might go “offshore”.¹⁷ Relocating to areas such as Canada would allow them to take advantage of the less demanding reporting standards in the US capital markets. This would **look bad** on the SEC as it would encourage the relocation of the head offices and therefore having a negative impact

⁹ Walton *et al*, (2003), pg 67

¹⁰ Walton *et al*, (2003), pg 67

¹¹ Anon, (2002), pg 4

¹² Michaels A & Postelnicu A, (2004)

¹³ Sutton M H (1997), pg 98

¹⁴ Sutton M H (1997), pg 98

¹⁵ Weetman & Gray, (1991)

¹⁶ Zeff S (1999), pg 16

¹⁷ Zeff S (1999), pg 16

on the economy. The US Congress would mostly likely be disappointed with this outcome and may intervene this will result in SEC reducing its overriding status.

Since the scandals at Enron, WorldCom etc there has been an increased profile for auditor independence. The Sarbanes-Oxley Act requires the registration, inspection and enforcement of auditors. The SEC is under pressure to make sure that they investigate breaches of rules in order to eliminate new possible scandals.

In conclusion, the SEC have received assistance from the FASB in creating standards. It is therefore the SEC's job not to create, but to regulate the standards. The SEC has to control the FASB in terms of making sure they are not moving too slow or in the wrong direction. SEC have the powers to override any standards created by the FASB and to take action against companies who do not comply with the standards. It is for this reason that the SEC can be classed as being a "control agency", they have not been developing standards rather controlling the work of the FASB and making sure companies comply. Even though the SEC can be classed as a control agency it has not been that effective as shown by the scandals highlighted in Enron and WorldCom. Could it be said that SEC therefore should have been investigated themselves?

Many issues surrounding the SEC comes from the implementation of International Accounting Standards. The IOSCO has been colluding with the IASC to come to an agreement on future standards. Even after this, problems have occurred, such as receiving pressure from companies to make standards less prescriptive, trying to not implement the IASC in order to stop companies from relocating to less demanding areas, and improving the reviewing of annual companies reports. The issues regarding International Accounting Standards may result in the US Congress intervening and therefore reducing its overriding status.

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