



## U.S. Securities and Exchange Commission

### **Speech by SEC Staff: Current SEC International Accounting and Selective Disclosure Developments**

**by Commissioner Isaac C. Hunt Jr.**

*U.S. Securities & Exchange Commission*

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Good afternoon, it is a pleasure and an honor to be here to address the legal, accounting, business and academic professionals in this room today. As a former law school dean, I have a pretty clear idea about the challenges faced by this law school in preparing graduates to meet the needs of the fast-changing business community. At the same time however, it seems to me that the business and legal professionals here today have a responsibility to communicate their human resource needs to this institution to enable it to continually upgrade its offerings to its students, and also to work to maintain a strong, vibrant economic community for graduates to enter.

But, before I begin speaking about what the U.S. Securities and Exchange Commission ("SEC") views as critical global accounting and disclosure issues, I am obligated to state that the views that I express here today are my own and do not necessarily reflect the views of the Commission, other Commissioners, or the Commission's staff.

Let me start by talking briefly about the philosophy that shapes the SEC's approach to both domestic and international regulatory issues. As most of you know, the SEC was established in the wake of the 1929 market crash and ensuing Depression.

Similar to your Australian Securities and Investment Commission ("ASIC"), the SEC is a market regulator, not a prudential regulator. That is, both the ASIC and the SEC seek to maintain fair and orderly markets, and to protect investors, by requiring securities issuers to make full and fair disclosure of all material information, so that investors have a basis for making informed decisions. Therefore, the credibility of disclosure documents filed with the SEC by public companies, national and international, is at the heart of this approach. And, the basis for interpreting these filings, especially the

accounting for certain transactions, must be universally understood and accepted.

As we enter this new century, the worlds' capital markets are probably more liquid and efficient than at any other time in history. Nonetheless, I remain concerned that some industry practices may threaten this hard fought preeminence. Specifically, I am concerned with the selective disclosure, by issuers and others, of material information to certain sectors of the market. Markets are not fair as long as selective disclosure continues.

Thus, the two issues that I wish to focus attention on today are first, the widely disparate accounting practices engaged in by multinational corporations and, second, the problem of selective disclosure.

Before I begin, however, there are two matters of local interest that I wish to touch upon. First, congratulations to the Australian Securities and Investments Commission for their obtaining passage of statutes, on the federal level, recognizing electronic signatures. While I understand that the appropriate state level legislation must be enacted before this process can go into effect, this is an important first step. You are way ahead of the U.S. in this regard.

Unfortunately, however, you are catching up with us in the area of Internet fraud. The SEC recently filed a federal court action against two Australian residents who used the Internet to falsely tout the stock of Rentech, Inc., a U.S.-based company. These two individuals posted between six and seven million false e-mail messages on various Internet bulletin boards predicting a 900% increase in Rentech stock price.

The SEC believes that these activities were directly responsible for a doubling in the price of Rentech stock and a 1600% increase in the trading volume of that stock as of 10 May 1999, when NASDAQ halted trading in the stock. According to the Commission's complaint, the two individuals sold their Rentech stock after disseminating the false information, realizing approximately \$14,000 in profits.

This example may be small in terms of the money these individuals received, but the breadth of their activity across the Internet was astounding.

This case is also an example of the necessary cooperation between regulators and law enforcement officials in various jurisdictions in today's global market: cooperation between the SEC & the ASIC led to civil actions in U.S. and criminal prosecutions here in Australia.

I would now like to take the opportunity to provide a brief comment about the Commission's recent [Concept Release on International Accounting Standards](#).

## **SEC Concept Release on International Accounting Standards**

The SEC is committed to promoting high quality financial reporting and supporting efforts to develop a high quality global financial reporting structure. On February 16, 2000, the SEC approved a Concept Release on international accounting standards. A Concept Release, in SEC practice, is a step in a rulemaking procedure that solicits input into the shaping of a specific rule proposal. This release initiates dialogue on the set of core accounting standards that could be used in the process of global capital allocation. There are a few specific items covered by this Concept Release that I would like to reinforce.

First, with respect to developing international accounting standards generally, the difficult first step in the process already has been taken. The International Accounting Standards Committee ("IASC") has worked since 1972 to develop a core set of standards for international use. The IASC substantially completed its task in 1999 and it is now up to the SEC, and its regulatory counterparts throughout the world, to assess the acceptability of those standards.

When the Commission voiced its support for the development of international accounting standards in 1996, it indicated that before it would accept those standards in the U.S., it would have to ascertain whether the IASC's standards would result in the transparency, reliability and comparability that investors currently enjoy under U.S. GAAP. For the past several years, the Commissioners and the Commission staff have tried to draw attention, particularly in the U.S., to issues raised by increasingly integrated global capital markets, including development of international accounting standards. For example, we have called upon the U.S. academic community to contribute to the Commission's assessment by researching the quality of the proposed standards. The Concept Release the Commission approved in February opens a forum for discussion that would extend beyond the quality of the standards themselves.

The SEC staff has done substantial work with respect to the standards issued by the International Accounting Standards Committee, both directly and through IOSCO, the International Organization of Securities Commissions. Those who have read our comment letters on IASC standards know that there are areas – such as accounting for intangibles – where the staff has significant concerns about the quality of the information produced by applying the IASC standards. But those people also know that there are other instances, for example in the area of business combinations, where many argue the IASC standards elicit better accounting than U.S. GAAP. Some of the questions posed in the Concept Release relate specifically to the IASC standards, and give people a chance to provide input to the Commission with respect to its technical concerns about IASC standards. Other questions are ones that we have identified while working on international reporting issues, and relate to any financial statements of foreign issuers, whether or not those financials were prepared using IASC standards.

The Concept Release raises a number of complex and difficult issues. Some have suggested that the SEC is asking these questions to look for excuses to

criticize the IASC standards. That is not the case. The issues raised in the release are real ones that we have to deal with in formulating any rule proposal that affects the current filing requirements for foreign issuers wishing to offer their securities in the United States. As a result, we are seeking input based on the collective experience of those, both in the American marketplace and capital markets around the world, who work daily preparing financial statements, auditing financial statements, or using financial statements to make investment decisions. The purpose of the Release is to tap into that experience, and the Commission would welcome responses to the Concept Release from those outside the United States, including people like those in this room. I encourage each of you to get the release from the SEC's website and respond to some or all of the questions it poses. Your responses on these critical issues would be carefully considered.

The [comment period on the Concept Release](#) ends May 23. The SEC staff hopes to analyze the comments received promptly so that they can advise the Commission regarding rulemaking, which would be necessary to reduce or remove the current US GAAP reconciliation requirements for foreign issuers.

On the international level, securities regulators from around the world are meeting in Sydney this week, and international accounting standards are one of our agenda items. Securities regulators have been assessing the IASC standards, in part looking back at issues raised during the standard setting process. A report summarizing this work and the remaining outstanding substantive issues will be published this week. Additionally, I expect that IOSCO this week will approve a resolution addressing use of IASC standards in cross-border securities transactions.

## Selective Disclosure

The SEC also recently issued its long-awaited [proposal on selective disclosure](#). Selective disclosure refers to the time honored practice, in America at least, of releasing material, non-public information about an issuer of public securities, made by the issuer or its agents, to selected persons, usually financial analysts, before disclosing the information to the public at large. The new SEC measure, Regulation FD -- for "fair disclosure" -- would prohibit companies from divulging such information except through public disclosure. Regulation FD has generated considerable public comment and debate and, if enacted, would change the way most public companies release information to the market.

In my judgment, the proposal, if adopted, would be extremely costly to corporations and provide little benefit to investors. That's not to say that I do not believe selective disclosure to be a problem. I do, and I reiterate that as long as selective disclosure continues, our markets are not fair. However, I recognize that this is not an easy problem to solve and that, in adopting a solution, we should heed the advice of the medical profession: "first, do no harm!"

The proposed rule calls on issuers to disclose material information publicly and not selectively. It also directs issuers to promptly disclose publicly any information ***inadvertently*** disclosed selectively. Regulation FD does not require issuers to disclose material developments when they occur. Nor does Regulation FD provide a definition of what is "material." However, the release provides that when an issuer "chooses to disclose material, non-public information, it must do so broadly to the investing public, not selectively to a favored few." But how exactly is this to be done? Two ways mentioned in the release are that the issuer may file the information with the SEC on the appropriate form or it may disseminate it ***via*** a website.

Many companies are reluctant to engage in the wholesale sharing of information. The reasons are myriad, and range from competitive concerns to concerns about the effects of "loose cannon" investors who may misunderstand the stream of information, react negatively and substantially harm the financial prospects of the company.

In the current process, which is undeniably flawed, financial analysts serve a useful function in ferreting out and evaluating information. This generally provides the market with a superior assessment of the issuer's performance and prospects. In turn, this promotes efficient markets and moderates market volatility that can result from uninformed investor reaction to news about issuers.

The goal of reducing selective disclosure is certainly important not only to the Commission, but also to the global markets. I merely urge that we, as regulators and as market participants, proceed carefully and not seek to fix that which is not broken.

The [comment period for this release](#) has recently ended. Again, the SEC staff will begin the arduous process of assembling and weighing the commentary on this very important issue. Hopefully, with input and guidance from institutional and individual shareholders, the SEC will adopt rules that will limit selective disclosure while not unduly burdening companies or stopping the free flow of information.

## **Conclusion**

In conclusion, I would like to thank the Monash Law School Foundation Lecture Series for inviting me to speak this afternoon. Also, I would urge all of you in this room to remember that the increasingly global marketplace is reaching into almost every corner of the world. Through the Internet, information and products are being marketed, sold and traded at a dizzying rate. It is very important, therefore, that we all work together to lay a strong but balanced framework of regulation to support this marketplace. Please give us your comments on our pending Concept Release on International Accounting standards. We value your time and attention to these and other critical market development issues.

**Thank you.**

*<http://www.sec.gov/news/speech/spch381.htm>*

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