Remarks Of

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Washington, D.C.

"Litigation Reform, Simplification, And Internationalization"

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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners, or the staff of the Commission.

U.S. Securities and Exchange Commission
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I. Introduction

I appreciate the opportunity to participate in the Office of Chief Accountant's ("OCA") Alumni Technical Meeting for 1993. It has been my privilege to work with many fine accountants in both OCA and the various Divisions during my tenure at the Commission. I have learned a great deal about accounting from these individuals, although I acknowledge that I have a great deal yet to learn. I look forward to the continuation of this education process.

It is my intention today to discuss briefly three issues which may be of interest to the accounting industry --- securities litigation reform, the need to simplify accounting standards, and the need to accelerate the international harmonization of accounting standards. To some extent, all of these issues dovetail together.

II. Securities Litigation Reform

Accountants have been voicing concerns for many years about the threat to the accounting industry and to our capital formation process that is posed by meritless securities litigation. I believe these concerns are valid. Securities litigation is a costly endeavor, and the parties involved are faced with inherent uncertainty about outcomes. No doubt defendants often settle claims for which they have valid defenses.

However, as was stated recently by Bill McLucas, the Commission's Enforcement Division Director, in congressional testimony on this subject:

> The strength and stability of our nation's securities markets depend in large part on investor confidence in the continued fairness and efficiency of those markets. In order to maintain this confidence, it is important that investors have effective remedies against persons who violate the antifraud provisions of the federal securities laws. Although the Commission devotes substantial resources to the detection and prosecution of securities law violations, private actions under Section 10(b) of the Securities Exchange Act of 1934 serve as the

primary vehicle for compensating defrauded investors. Private actions also provide additional deterrence against securities law violations.

. . .

Given the fundamental importance of private actions, litigation reform legislation should be approached with caution. It would be unfortunate if legislation intended to "reform" the system led to an erosion of investor safeguards.[1]

I am concerned that the securities litigation reform legislation now under consideration in Congress, if enacted, would achieve reform at the expense of existing protections against deliberate fraud and would make it impossible for many defrauded investors who prevail at trial to recover full compensation for their losses. Thus, I have not supported the legislative securities litigation reform efforts underway to date.

I argue that it is difficult to make the fine, qualitative judgments necessary to sift out the meritless securities litigation from all securities litigation either by rule or by statute. I believe that such a process can be better handled by the judicial system itself. In fact, I submit that litigation reform is presently being conducted by the federal judiciary. I further submit that proponents of litigation reform may be better served by encouraging the continuation of the judicial reform that has occurred to date rather than to engage in the pursuit of well intentioned but ill-fated legislative reform.

For an example of such judicial reform, I would point out that the Supreme Court's recent decision in Reves v. Ernst & Young narrows substantially the exposure of accountants and other professional advisers to RICO liability.[2] The Reves decision should diminish the exposure of professional advisers to liability under RICO. Reves follows a number of recent decisions in favor of accountants that indicate that the pendulum of liability had swung too far against accountants and is now beginning to

return more toward the center.[3] This judicial trend should be a positive development for securities litigation reform.

Further, earlier this month, the Supreme Court held that a right of contribution is available in private actions under Section 10(b) and Rule 10b-5, a result urged by the Commission in an amicus curiae brief filed with the Court.[4]

Moreover, Rule 11 sanctions are now being imposed more frequently against both plaintiffs and defendants for taking meritless positions in litigation.[5]

Interestingly enough, according to a survey of federal district court judges conducted by the Federal Judicial Center ("FJC"), most judges believe that groundless litigation presents only a small problem on their dockets.[6] More than 80% of federal judges apparently also believe that meritless litigation is controlled most effectively by prompt rulings on motions to dismiss or motions for summary judgment.[7] I am inclined to agree with these judges.

III. Simplification

I wish to point out that the accounting industry can help itself in the litigation area by attempting to improve auditing and accounting standards. One way to improve these standards in my view is to support the adoption of simpler, more objective accounting standards that would make it possible for accountants to obtain more objective and relevant evidence regarding their clients' compliance with those accounting standards, resulting in more reliable audit reports. In this manner, both accountants and issuers should encounter less litigation regarding overstatements of assets, equity, and income.[8]

A compelling case for simpler accounting standards was made by the Commission's Chief Accountant, Walter Schuetze, in a 1991 article entitled "Keep It Simple."[9] If I could leave the members of this audience with any one message today, that message would be to urge each of you to work toward the simplification of

accounting standards. The current standards are too complex, which leads, among other things, to litigation problems.

As our distinguished Chief Accountant set forth in his article:

> Accounting standards have to be implemented by ordinary people. Financial reports are used by ordinary people. The standards and the results of applying the standards have to be understandable to ordinary people. . . . Keep It Simple.
>
> If we keep it simple, then the users of the information will have information that they can use. . . . The smaller CPA firms and their clients will be able to keep up with the rest of the world. Preparers of financial statements can stop fussing over things that cost a lot of money and have little usefulness, . . . and do things to improve the quality of U.S. products in the world marketplace. And the FASB will stand a better chance of promoting its ideas in Australia, Canada, France, Germany, Great Britain, Italy, Japan, Russia, Pacific Rim countries, and at the IASC.[10]

IV. Internationalization

Since I have mentioned the International Accounting Standards Committee ("IASC"), I do wish to discuss briefly the need to accelerate the international harmonization of accounting standards.

With respect to our need for harmonized international accounting standards, I wish to point out that there has been a marked increase in U.S. investor interest in non-U.S. securities. Given that increased interest, it appears to me that our securities regulatory policy should be to encourage the trading of non-U.S. securities by U.S. investors in the United States, while continuing to attempt to provide such investors with access to complete and meaningful financial information regarding these securities. While there are disagreements as to the most appropriate interim mechanism to apply

to lead toward such an objective, I believe it is fair to say that this objective can best be achieved in the long term through harmonization of international accounting standards.

Of course, it remains to be seen just how long it will take to achieve this best long term solution. My guess is that under present circumstances, it will take too long. I am of the view that such harmonization could be achieved smoother and faster if U.S. accounting standards were simplified. Walter made this same point in his "Keep It Simple" article.[11]

I am sure that everyone here is aware of the announcement earlier this year by Daimler-Benz of an intention to conform to U.S. accounting standards and to list on the New York Stock Exchange. While I was pleased with the announcement and view it as meaningful in the short term, one wonders how significant this announcement will prove to be over the long haul. My guess is not very. The same can be said for the recent announcement by Ciba-Geigy AC, a Swiss issuer, to become the most recent Swiss company to apply new accounting standards apparently as part of a strategy to catch the eye of foreign investors.[12] Ciba now intends to restate its 1992 earnings in accordance with IASC standards and the EC directives.

I do not view a battle of announcements over which accounting system is attracting the most international interest as offering any solution to the international accounting standards controversy. In my view, to repeat, a successful international harmonization project represents the best such solution. I hope that the Commission will encourage, and participate in, such a project with a little more gusto and flexibility than has been demonstrated in this area in the past.

Bilateral agreements can also accelerate the process of accounting harmonization in my opinion. Thus, I was pleased to see the recent announcement by the Financial Accounting Standards Board ("FASB") that it has developed and issued a comment

document on disaggregated disclosures jointly with another standard setting body, the Accounting Standards Board ("AcSB") of the Canadian Institute of Chartered Accountants.[13]

Since the process of internationalizing accounting standards will take some time to complete, cooperative projects between two or more countries which seek to harmonize and to improve their respective standards can serve as important steps toward accelerating that process. I encourage the FASB to pursue more such joint standard setting projects.

In addition to simplification and to FASB sponsored joint standard setting projects, there is another project that I encourage the accounting industry to engage in as a means of accelerating the international harmonization of accounting standards. That project is to identify U.S. accounting standards that arguably are flawed relative to the comparable international accounting practice and to improve the U.S. standards so that they conform to the international trend. One such example that I have discussed in the past is the pooling of interest business combination method.[14]

A review of the business combination accounting practices internationally indicates that the international trend is to be more stringent on pooling than is now required under APB Opinion No.16. (I should add that APB Opinion No. 16 is also very detailed and complex and is in need of simplification.) I understand that pooling accounting is utilized infrequently outside the U.S. Apparently the U.K is in the process of implementing pooling criteria that is more restrictive than is permitted in the U.S., and proposed IASC standards would effectively limit poolings to those rare circumstances where the parties to the business combination join together in a substantially equal arrangement, to the extent that there is no apparent survivor, which is also more restrictive relative to U.S. accounting.

If, as intended, the IASC standards result in a more comparable accounting treatment for business combinations and are generally accepted internationally, it will be necessary in the near future in my opinion for the FASB to reconsider APB Opinion No. 16. I am inclined to believe that the U.S. should follow the IASC's example and should consider limiting pooling treatment to those situations where the parties to the combination are relatively the same size.

I suspect that there are other similar examples. It appears to me that where the international accounting trend, and, in particular, an IASC standard, tends to be superior to the U.S. accounting standard, then the U.S. standard should be amended to conform with the other standard. Such a standard improving process should hasten harmonization and should be undertaken promptly in the U.S. by the appropriate accounting authorities in my view.

I see that my time is about to expire so in keeping with the schedule I will conclude. I am extremely proud of the Commission's accounting staff. Their highly regarded reputation is well deserved in my judgment. I look forward to working with each of you in the future on the many accounting policy issues on the plate.

ENDNOTES

1. Testimony of William R. McLucas, Director, Division of Enforcement, United States Securities and Exchange Commission, concerning private litigation under the federal securities laws before the Subcommittee on Securities of the Committee on Banking, Housing and Urban Development of the United States Senate, dated June 17, 1993, at 1 ("McLucas Testimony").

2. 61 U.S.L.W. 4207 (U.S. March 3, 1993). In Reves, the Court held that, in order to be subject to liability under the most frequently used section of RICO, a defendant must participate in the operation or management of the enterprise itself. An accounting firm that does nothing more than audit and issue a report on an issuer's financial statements generally will not meet this test.

3. See, e.g., Bily v. Arthur Young & Co., 834 P.2d 745 (Cal. 1992) (rejected "reasonably foreseeable" rule for negligence liability and adopted privity and Restatement 2d rules); Securities Pacific Business Credit v. Peat Marwick Main & Co., 597 N.E.2d 1080, 79 NY.2d 695, 586 N.Y.S.2d 87 (1992) (no relationship approaching privity existed for negligence liability); Securities and Exchange Commission v. Price Waterhouse, 797 F.Supp. 1217 (S.D.N.Y. 1992) (dismissed SEC complaint for injunctive relief). See also Seamons, "Auditors Do Not Operate or Manage Their Client's Affairs: Reves v. Ernst & Young," Insights (June 1993), at 25.

4. Musick, Peeler & Garrett v. Employers Insurance of Wausau, 61 U.S.L.W. 4520 (U.S. June 1, 1993).

5. Rule 11 of the Federal Rules of Civil Procedure currently provides a mechanism for limited fee shifting in abusive and meritless cases. The Rule requires an attorney to certify that each pleading, motion or other paper filed in federal court is "well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law." Filings may not be made for any "improper purpose, such as to cause unnecessary delay or needless increase in the cost of litigation." Should a court determine that a filing was made in contravention of Rule 11, it "shall impose" upon the attorney, the represented party, or both, "an appropriate sanction, which may include an order to pay to the other party or parties the amount of reasonable expenses incurred because of the [filing], including a reasonable attorney's fee." See McLucas Testimony, supra note 1, at 16.

6. FJC Directions, No. 2, Nov. 1991, at 4.

7. Id., at 31.

8. See McLucas Testimony, supra note 1, at 10, n. 15.

9. Schuetze, "Keep It Simple," Accounting Horizons (June 1991), a quarterly publication of the American Accounting Association, at 113 ("Schuetze Article").

10. Schuetze Article, supra note 9, at 117.

11. "International standard setters also will not follow the FASB's lead in issuing complex, detailed standards. If the IASC were to issue a standard as detailed as FASB Statement 96 on income taxes, IASC would lose its following, which is beginning to grow. That approach would be not only foolhardy but also suicidal for IASC." Id., at 116.

12. "Earnings for '92 Are Restated To International Standards," The Wall Street Journal (June 16, 1993), at A8.

13. See Invitation to Comment, Reporting Diseggregated Information by Business Enterprises, Financial Accounting Series No. 126-A (May 3, 1993).

14. See Roberts, "Time for Review of Pooling Criteria," Remarks delivered to the Second Annual Conference on Financial Reporting, University of California at Berkley, San Francisco, California (Nov. 1, 1991).