Financial Deregulation

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Abstract: In the present conditions, financial accounting is completely territories, following recent high profile accounting failures at Enron and other firms. The debate is deregulated. This study was done to explore whether such regulation is the costs and efforts. The results of analyses contributed to the following results: Even though more laws have been passed, this has not stopped great accounting frauds from resulting in instability in capital market and they have hampered the increase of wealth of our society.
[Hassan Hemmati, Vahid Rafiei. **Financial Deregulation.** *Life Sci J* 2012;9(4):2838-2841] (ISSN:1097-8135). http://www.lifesciencesite.com. 416

Keywords: accounting failures -Enron-deregulation-capital market

Introduction

The debate over whether financial accounting should be deregulated began in the United States in the late 1990s and spread to Europe over the past ten years. The height of the debate spawned a vast literature dealing with the pros and cons of financial deregulation all over. Financial accounting is quite forcefully administered in several territories, with the enforcements typically becoming more stringent following recent high profile accounting failures at Enron and other firms, it should be examined whether such regulation is worth the costs and efforts required to administer it. Specifically, what need to be examined are the factors that are responsible for imposing the regulations in the first place. Are they imposed to control accounting fraud? Or does fraud occur because of the "standard and regulation overload" which creates an incentive to evade the standards?

The Necessity of Sec Reporting Requirements

At the present time, the SEC's requirements state that public corporations need to file form 10-K, in which they are required to disclose the subsequent information (Browne 2004):

- Description of the business
- issues that have been voted by stockholders,
- Legal courses of action,
- Share repurchases
- Management's discussion and analysis of results of operations
- Quantitative and qualitative admission on market risk
- Financial statements and additional information
- Modifications and disagreements with auditors regarding the disclosure of accounting and financial information,
- Company directors and executives
- Compensation of executives
- Share ownerships
- Breakdown of tax, accounting and consulting fees for financial statements and other information.

The question is now whether capital markets can survive without the required annual submission of financial reports which are required by the SEC? Some individuals believe that managers cannot be relied on to reveal the information that investors needed to make investment decisions. For instance, Salomons (1983) asserts that investors would be critically hurt: "Managers may have more to gain by withholding information than from disclosing it. We cannot depend on the market to discipline promptly companies that are free to choose what and how to report to investors. Even if good accounting can be relied on to drive out bad in the long run, investors may suffer too much damage in the short run to permit freedom from regulation"

This puts forward the theory that minimum revelation levels and particular measurement tools, such as U.S. GAAP and SEC requirements will still be required to decrease the information imbalance existing between a firm's accountants and shareholders. Another standpoint states that there are motives for the filing of financial reports by public corporation. In contrast, if corporations want to acquire finance through the sale of shares, they will encourage the development of trust that shareholders put in the company's present and upcoming financial performance by filing complete financial reports. In contrast, if control (management) and ownership (shareholders) are two different things then present shareholders will need information about the financial credibility and working results of the firm if they are expected to go contributing their funds. If a corporation does not file well-timed and credible information, stakeholders will lose faith and stop giving funds to that firm. In this respect, Warren Buffett talks about the significance of informing stockholders (1996): “We will be candid in our reporting to you, emphasizing the pluses and minuses important in appraising business value. Our guideline is to tell you the business facts that we would want to know if our positions were reversed. We owe you no less. Moreover, as a company with a major communications business, it would be inexcusable for us to apply lesser standards of accuracy, balance and incisiveness when reporting on ourselves than we would expect our news people to apply when reporting on others. We also believe candor benefits us as managers: The CEO who misleads others in public may eventually mislead himself in private”.

If firm executives wish to create faith and long-term value, they will not attempt to over state the share price by incorrectly reporting accounting figures. Buffett clarifies the share price approach of his company Berkshire Hathaway in the below manner (1996): “To the extent possible, we would like each Berkshire shareholder to record a gain or loss in market value during his period of ownership that is proportional to the gain or loss in per-share intrinsic value recorded by the company during that holding period. For this to come about, the relationship between the intrinsic value and the market price of a Berkshire share would need to remain constant and by our preferences at 1-to-1. As that implies, we would rather see Berkshire´s stock price at a fair level than a high level”.

Corporate managers who possess long-term vision and value-based compensation packages will offer pertinent financial statements to stakeholders in order to acquire finance for the growth of their firms. The reason behind an independent audit is to obtain estimation on a firm’s financial statements. Financial statements, in combination with an independent auditor’s report, are submitted to clients, creditors, current and prospective investors, and other involved parties. The external auditor’s report offers endorsement to the firm’s financial figures. Independent audits are required because of the innate clash between a firm’s management and the individuals who make use of financial reports. An external audit may create trust in a company’s financial statements, making it feasible to estimate conformity with management responsibility, carry out financial calculations and make decisions on resource allocation.

The Argument for Deregulation

The basic argument in defense of accounting deregulation is that accounting information should be regarded like other products and services and therefore regulators should step away and allow the forces of demand and supply to determine the quantity that is supplied. Several arguments have been put forth to support this point of view. Of these, one main argument is that, even if there is no regulation, there are private economics-based (Adam Smith’s Invisible Hand Theory) motivations for the firm to provide authentic information about its business and financial position to interested stakeholders outside the firm, and if it does not do so, the expenses of the firm’s activities will increase.

The foundation of this perspective is that if there is no information about the firm’s activities, other stakeholders, such as the title-holder of the firm (or the shareholders) who do not participate in the operation of the firm, will believe that the managers might be running the firm for their own profit. This means that the managers will run the firm for their own personal profit, and will not do so with the aim of increasing the profitability of the firm (there is believed to be a lack of correlation of targets between the owners and the managers). In addition to this, it will be believed that possible ‘external’ shareholders will want the managers to take advantage of every opportunity available, and if there are no protections, they will decrease the amount they are willing to fork out for the shares of that company. In the same manner, following this economics-based point of view of ‘rationality’ (self-interest), prospective creditors (such as banks and bondholders) are expected to want managers to embark on opportunistic operations with the finance the lenders are willing to lend, and for this reason, if there are no protections, these creditors will ask the firm for a higher rate at which they loan their money, i.e, a higher interest rate. The assumptions listed above assume that the managers and the shareholders will work to maximize their own self-interest.

Why Is This A Bad Idea?

Despite proofs in support of deregulation, several individuals state very firmly that less regulation is healthier for any profession, regardless of how serious the problem at hand may be. Governmental regulation is always believed to be detrimental for any profession, unproductive, and always more costly in general as compared to allowing the market place to run things out on its own. This perspective has been supported by such individuals as Ronald Reagan as well Grover Norquist (who went so far as to state that the government should not have any say in anything).

The disasters of Enron were a direct consequence of there being too little or too ineffective regulation. There were unquestionably quite a few other elements at play, but had accountants and auditors, even financial institutions been appropriately monitored, the issues would be not be acute as it was and it would be much less difficult to handle.

Enron's fraudulent financial statements did not clearly describe its financial position to shareholders and analysts (Bratton 2002, Mack 2002). Other than this, the managers and auditors made clever use of accounting and auditing loopholes to show a distorted picture of earnings to show a favorable portrayal of its financial performance (Healy 2003). Starting from 1997 until its collapse, the main objective of Enron's accounting and financial operations were to show an inflated picture of reported income, cash flow and asset values and a deflated picture of liabilities (Bodurtha 2003). All this constituted the practice of feeding investors what they wanted to hear: They wanted to see that the company they had invested in was realizing high rates of returns, and Enron provided them with that.

It is generally felt that accountants are operating in the best interests of their own firms and agencies and the firms that they work for, rather than operating to update the public ethically and correctly. If financial accounting is regulated, this prevents any organization and accounting and auditing firm to conceal the facts about the firm and its financial standing from the general public. By regulating financial accounting, firms and their accountants are being forced to be more frank and forthright regarding their financial dealings and depicting their accurate financial position.

The most critical justification to regulate accounting standards is to shield the investors. Be it a publicly listed firm, or a firm that offers the majority of its shares to its employees, both have to be safe guarded form deceitful practices. This is very critical and the main reason why the government and regulatory authority have moved to regulate accounting standards and practices. It has been demonstrated by incidences in the past that not having robust accounting procedures in place and implemented, can only lead to fraudulent practices on the part of firms and corporations.

There are divided opinions pertaining to the theories to regulate accounting standards. In spite of this, despite the divided opinions, the opinion to regulate accounting firms presents a robust case. It is not only the conscientious action to take, but it will also protect investors from firms and potential fraud. By failing to regulate accounting standards, rules and practices there will only be room for mistrust in the accounting system.

Will Deregulation Result in the Dissemination of Accurate Information?

For shareholders to make the decisions necessary for investment, they should possess sound financial information. This is why regulations are necessary to control the information that is provided to shareholders (Blundell 2004). It is for this reason that auditors have been appointed to make sure that the information present in financial statements should be dependable and have been ready in accordance with generally accepted accounting principles (GAAP).

The foregoing discussion shows that while some individuals believe that enforcing regulations only averts the development of improved accounting standards, decreases the accountability of professional organizations and raises investors' financial risk, arbitrarily imposing regulations is also a problem. With randomly enforced rules, attention is no longer given to whether the accounting standards result in sensible numbers, but on conformity with regulations (Boardman and Laurin 2000). It would be very safe to assert that the soul of the standard is taken out and in its place mere formalities are placed. Besides this, the independent auditors' standards are put to one side, and their only duty is to comply with accounting standards.

It can be very safe to say that random accounting standards do not stop fraudulent accounting practices, but they do stop the creation of improved practices. In spite of the complicated regulatory system, investors cannot be deceived for long. At one time or another, frauds are found out and the share prices of firms that have utilized window dressing to portray a better financial position are caught out and penalized appropriately. In spite o this, when regulations are removed, corporation expenses are brought down, better tools for measuring financial performance can result, and there is a reason to present additional financial information to investors and in this way help to make rating quality better.

Conclusions and Recommendations

Many answers have been hunted for the disasters caused by financial statement frauds. Some believe the solution is to create more regulations to stop financial wrongdoing by punishing the parties concerned. The issue, however, is that repeatedly these regulations result in consequences that counteract to their original motives and stop the development of fresh accounting standards that would offer a better portrayal of a firm's financial performance. Others believe that competition between the various accounting standards should be allowed so that firms can opt or the set of accounting standards they are going to utilize to create their financial statements and operating results. Nevertheless, financial and accounting frauds have occurred even when varying sets of accounting standards have been utilized (Basset and Storrie 2003). Other proposals include creating codes of ethics aimed at increasing the ethical responsibilities and accountabilities of directors, auditors and other parties concerned (Bayless 2009).

Nevertheless, even though more laws have been passed, for instance the Sarbanes Oxley Act of 2002, and the significance of improving ethical values and corporate responsibility has been harped on, this has not stopped great accounting frauds from resulting in instability in capital markets, and, for this reason they have hampered the increase of wealth in our society. This issue could be alleviated if scrutiny tools, such as boards of directors and independent auditors, are intensified. Boards of directors need to carry out an independent, active and key role in the administration of management activities, and to behave as the security guards of efficient corporate governance. Boards of directors should also devise a compensation system for company directors that will promote long-term value development for the firm itself, in the sense of a continuous return on invested funds, over and above capital expenditure.

Concerning independent auditors, their stakes must be allied with those of financial report users so that they distribute correct auditing judgments. One method in which these interests could be aligned is by forming a competitive financial report market. In this market, only trustworthy financial statements would be considered legitimate, since the user of financial statements would be responsible for paying auditing firm's fees. In this manner, independent auditors would try to act in accordance with the public concern and state whether financial statements have material errors or irregularities that could impact users' financial decisions. Changing motivations would result in the creating of accurate, well-timed and credible financial statements. This would result in solidity to the capital market, and the trust created in forms would lead to more financial development.

In the end, we must evaluate whether there is a requirement for the information needs asked for by regulatory organizations (Gaermynck et al 2008). Public corporations utilize capital markets to acquire finance for their projects. To acquire this finance they need to create trust in investors. So, even when there are no explicit financial reporting needs, these firms will still be persuaded to file financial statements with the motive of obtaining the resources they need to expand.

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10/2/2012