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Abstract

Most financial reporting jurisdictions across the world allow a local monopoly in financial reporting standards for publicly held corporations. In the U.S., for example, the statutory authority over these standards is vested in the Securities and Exchange Commission (SEC), who delegates the task of writing standards to the Financial Accounting Standards Board, retaining an oversight function for itself. In some countries these standards are specified through statutes in varying levels of detail. Few countries permit their corporations to choose among two or more sets of competing standards; monopoly is the reigning norm.

This paper examines regulatory competition as a model for writing and implementing corporate financial standards. Under this model, two or more approved standard setting bodies are allowed to compete for the allegiance of the reporting entities. Each corporation can choose which of the two or more sets of competing standards it wishes to use in preparing its financial reports. Corporations must choose an entire set of standards *in toto*, and clearly mark the reports with the set of standards used to prepare them. We examine the consequences of such regulatory competition for the quality and efficiency of standards, quality of information provided to shareholders and other interested parties, and the efficiency of corporate governance and managerial actions. A debate on the merits of monopoly versus competitive standards may help direct the formation of national and international regimes for setting accounting standards.

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Daimler-Benz AG reported a net income of DM168 million under German GAAP (Generally Accepted Accounting Principles), and a loss of DM949 million under U.S. GAAP, for the first six months of 1993.[1] This example has often been cited in support of international harmonization of accounting standards. It is likely that by year 2010, publicly-held corporations in a large part of the world may have to prepare their financial reports using a single set of financial standards produced by a single body of standard setters. Monopoly of a single set of accounting standards is already the norm within national economies.

I shall build on previous work[2] to make a case to the contrary: a competitive regulatory regime for accounting standards, within and across national jurisdictions, that allows individual firms to choose from a set of accounting standards, is more efficient. I shall also outline a mechanism for implementing such a regime.

There are several reasons to resist the demand for harmonization or uniformity of accounting standards. First, the metaphor of the firm as a competitor in a vast economic game with the accountant as the scorekeeper sets unrealistic expectations of financial reports. People expect an unambiguous score for corporations, just as they do in a game of soccer. Attempts to explain

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[1] Broby (1995).

[2] Dye and Sunder (2001)

the ambiguity of scores are doomed as prevarication, incompetence, chicanery or worse. Beliefs in unidimensionality and uniqueness of corporate performance are widespread. Accountants should educate the public instead of pandering to ignorance and misunderstanding.

Second, the meaning and import of accounting numbers depend on the economic environment in which a firm operates. Environments of business vary not only across countries but also within economies and industries. Forcing uniformity of financial reporting on firms in different environments focuses on form instead of substance.

Third, while accountants recognize the need for simplicity and comparability to help the non-experts, they also consider the ability of managers to manipulate financial reports to suit their own interests. If financial statements only reported the amount of cash in the till, simplicity would be easy to attain. Consequences of ignoring the difficult to "count" resources and obligations are often more serious than the consequences of additional complexity.

Fourth, no standard-setting body has information to confidently assess the consequences and relative merits of alternative accounting standards. Continual changes in the business environment make this task even more difficult. Experimentation with alternatives in a competitive regulatory environment can help identify desirable accounting standards.

Financial reporting jurisdictions across the world have created local monopolies for writing financial reporting standards for publicly held corporations. In the U.S., for example, the statutory authority over these standards is vested in the Securities and Exchange Commission (SEC) who delegates the task of writing standards to the Financial Accounting Standards Board, retaining oversight and intervention functions for itself. In some countries statues specify these standards. Few countries permit their corporations to choose among two or more sets of competing standards; monopoly is the reigning norm.[3]

This paper examines regulatory competition as a model for writing and implementing corporate financial standards. Under this model multiple standard-setting bodies may compete for the allegiance of the reporting entities. Each corporation can choose which set of competing standards it wishes to use in preparing its financial reports. The number of competing sets need not be more than a few; corporations must choose an entire set of standards *in toto*; and clearly mark the reports with the set of standards used to prepare them.

I examine the consequences of such regulatory competition for quality and efficiency of standards; quality of information provided to shareholders and other interested parties, and the efficiency of corporate governance and managerial actions. A debate on the merits of monopoly versus competitive standards may help direct the formation of national and international regimes for setting accounting standards.[4]

A great deal of pertinent analysis and evidence on the economic efficiency of competitive regulatory regimes is already available in accounting, economics,

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[3] New Market in Germany permits the listed firms a choice to report by either U.S. or international GAAP. See Luez (2001).

[4] Falk and Dunmore (1999) present a model of competitive standards of auditing by professional bodies. Instead of a race to the top or bottom, such competition among audit firms, that are members of competing professional organizations of their own, results in efficient market segmentation by quality and price of services provided.

environment, finance and legal scholarship. We draw on these resources to address the merits of competitive accounting standards.

Why Financial Reporting Standards?

Financial reporting standards serve as a template contract among agents who participate in a firm, especially between the investors and the top management.[5] Shareholders and managers can, and often do, negotiate a contract that best suits their mutual interests. Freedom of firms to choose their own reporting practices works initially to the disadvantage of a dispersed body of shareholders, and ultimately to the disadvantage of all in the form of higher cost of capital.

Thousands of investors cannot effectively negotiate a contract with a few senior managers. They can only react to the proposals made by managers with a coarse yes or no response. The directors elected to represent shareholder interests in such negotiations are, themselves, susceptible to moral hazard. Besides, shareholders being the first to commit their resources to the firm, face a holdup problem: managers may try to expropriate the capital committed by shareholders by changing the accounting rules.

Under the circumstances, it is economical to have many firms share a template contract. Laws that govern corporate charters, issue of securities, rules for exchange listing of corporate shares, and standards of financial reporting are examples of template contracts. Their broad terms leave some room for firms to

[5] See Dunmore and Falk (1999) for examination of arguments for a competitive regime in auditing. Sunder (1997, Chapters 11-12).

customize through individual choice. Generally accepted accounting principles (GAAP) allow such flexibility.

Current Structures

The current structure for setting financial standards in U.S. was set up in 1972 based upon recommendations of the Wheat Commission. The Commission itself was set up following the difficulties the Accounting Principles Board, a senior committee of the American Institute of CPAs, had in getting its rulings on accounting for investment tax credit accepted by the industry. The Financial Accounting Standards Board (FASB) was set up as an independent private body, consisting of seven members drawn from auditing, industry, investment houses and academia, and financed by contributions from business organizations.

Since its establishment, more than three decades ago, the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC) have faced criticism for their unwillingness or inability to write “tough” accounting rules, but also for being unresponsive to the business community. Examples include the FASB’s attempts to write standards to account for inflation, oil and gas exploration costs, pension liabilities and equity-based employee compensation. As the only setter of accounting standards in the US, the FASB tries to satisfy all its constituencies, but it is not always possible to do so.

Challenge of Setting Efficient Standards

Diverse legal and market conditions prevail across countries. These differences have been used to defend variations in accounting practices.[6] On the other hand the advantages of uniformity, comparability and harmonization of financial reporting across economies form the basis on which national and international standard-setting bodies are justified. It is difficult to compare the costs and benefits of differentiation and harmonization in financial reporting to arrive at efficient solutions.

Standard-setters need criteria for social choice, and identify the rules that best satisfy the chosen criteria. Both these tasks are complicated by the diversity of interests of affected parties, and the lack of information about the consequences of alternative standards. A competitive standards regime can integrate the relevant information from various sources and use it to set standards in an efficient and incentive-compatible fashion.[7]

What should be the criteria for selecting financial reporting standards? Accounting standards affect many agents in society including shareholders, employees, customers, vendors and the government. Pareto criterion for social choice seems least objectionable: If Option A is better than Option B for at least some agents without being worse for any, Option A is rated by this criterion to be superior to Option B.[8]

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[6] See Sunder (1997a, 1999). There are significant cross-jurisdictional variations in how stock prices behave and how they are associated with accounting and other information. Durnev et al. (2001), for example show that the proportion of stock return variance explained by stock market-wide variations varies from a high of 57 percent in Poland to a low of 2.3 percent in U.S. during recent years. The synchronicity of accounting and stock market returns also varies considerably across countries (Alford et al., 1993).

[7] See Hayek (1945).

[8] The ranking of options by Pareto criterion is only partial; if Option A is better for some agents and Option B is better for some others, Pareto criterion cannot rank them with respect to each other.

Standard-setters face an information barrier in identifying efficient standards. Standard setters try to discover the consequences of their proposals for various agents through their own analysis, surveys, and solicited comments. Beyond the direct costs of preparing financial reports, it is difficult to assess the economic consequences of proposed standards. Solicitation of comments often yields strategic responses from those who favor or oppose the proposals for their own reasons, making it difficult to arrive at Pareto efficient solutions.

Given the importance of the role of financial accounting in markets for capital, it is reasonable to choose financial accounting standards on the basis of their effect on lowering the cost of capital for the reporting firms. Cost of capital criterion has several advantages. More informative financial reports increase the knowledge the investors have about the firms, and therefore their confidence in their trading decisions. Lower risk to investors translates into demand for and expectation of a lower rate of return from their investments in the firm. It also means a willingness to pay higher prices for a given security defined as a sequence of cash flows. Given the scale of operations of a firm, it can raise more money from equity and bond investors for its securities. These extra resources become available to various participating agents in the firm. While the division of this extra surplus among agents is matter of their bargaining power and factor market conditions,[9] it is reasonable to expect that accounting standards that lower the cost of capital are Pareto superior to other standards; they make at least some people better off without hurting the interests of others.

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[9] See Sunder (2001).

Minimizing the cost of capital is related to, but not identical to, maximizing shareholder value. Benefits of reduced cost of capital are distributed among many classes of agents in the economy. Maximization of the shareholder value benefits only those who already hold the shares of the firm when the standards change. Since shareholder value maximization tells us nothing about where that value comes from—and it may well arise as a transfer from other agents—we cannot usually assume that shareholder value maximization will yield a Pareto superior set of standards. Minimization of cost of capital is, therefore, a more desired criterion for social choice.

A monopoly standard-setter is unable to use the cost of capital criterion to choose standards. The monopolist does not have the opportunity to observe and compare the cost of capital consequences of alternative proposals.

Alternative Regimes

In the U.S., corporate charters are governed by the laws enacted by fifty states, listing requirements by various stock exchanges, and financial reporting standards by the Financial Accounting Standards Board. Development of laws governing corporate charters in the U.S. has been helped by competition among the fifty states to attract corporations. Similarly, development of stock exchange regulations and listing requirements has been facilitated by competition among the stock exchange for the listing of growing firms. Although fifty states in U.S. have enacted their own security laws, the federal statutes can override them. Financial accounting standards are developed by a single organization through a deliberative process without the benefit of economic competition across standard- setting organizations.

By choosing a monopoly mechanism for setting financial accounting standards, we deprive ourselves of the benefits of competition. We cannot experiment with alternatives to discover their economic consequences, generate internal incentives for organizations to set efficient standards, and reduce, even eliminate, political pressures from this field of commerce.

It is conceivable that such competition might have created a "race to the bottom." This has not happened. While the entrepreneurs or managers of corporations may have personal incentives to choose incorporation in states that favor their own interests at the cost of others, the shareholders are hardly constrained to buy shares of such firms. If the legal regime of a state favors one class of agents over another, a competitive system allows the latter group to choose and value the companies incorporated in another state. This competition directs the investment capital toward the latter jurisdiction, lowering the cost of raising capital. In contrast, the capital should flee from the former jurisdiction, raising the cost of capital for companies who choose to incorporate there. Such reaction of the shareholders to incorporation choices force the entrepreneur/managers to choose, in their own interest, incorporation in lower cost of capital jurisdictions.[10]

In many countries there is only a single statute to govern corporate charters and issue of securities, a single stock exchange, and a single set of standards for financial reporting. Arguments about the value and advantages of competition given above for the U.S. apply with equal force to other countries. Even relatively small countries and economies can reap the benefits of competition. These countries may permit the companies to choose between alternative domestic charters, security laws, exchanges and accounting standards. If domestic alternatives are not available, their creation could be encouraged. If domestic alternatives are not possible, corporations could be allowed to include international alternatives in their menu of possible choices. For example, firms could be allowed the choice of being governed by the corporate laws of a given jurisdiction, not necessarily one in which their operations are located. Some firms already choose to list their securities in exchanges far away from their home base. Similar freedom to choose the applicable financial reporting regime will help improve the financial reports, as well as the reporting standards in the direction of reducing the cost of capital of firms.

Huddart et al. (1998) model standards for financial disclosure by corporations as an instrument of listing competition among exchanges run by informed traders in the presence of uninformed traders. More precise disclosure requirements narrow the bid-ask spreads, and attract more uninformed traders to the exchange. The narrower spreads also reduce the information advantage of the informed traders. This loss is more than compensated for by the improved ability of informed investors to disguise their information in a deeper market, created through their ability to attract more uninformed traders. Thus, both the informed as well as the uninformed traders prefer more precise disclosure

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[10] See Bebchuk (1992), Dodd and Leftwich (1980), and Romano (1998).

standards for exchange listing for their own reasons, generating a race to the top, not the bottom.

Internationally, countries compete for attracting industry, banking and maritime registration through a choice of regulatory framework attractive to business firms, banks, shipping firms, and individuals.[11] A single international standard for banks, environment and ships can be less efficient than competitive standards. A similar argument is applicable to financial reporting.[12]

Regulatory Competition

In many countries there is only a single statute to govern corporate charters and issue of securities, a single stock exchange, and a single set of standards for financial reporting. Arguments about the value and advantages of competition given above for the U.S. also apply to other countries. Even relatively small countries and economies can reap the benefits of competition. They may permit the companies to choose between alternative domestic charters, security laws, exchanges and accounting standards. If domestic alternatives are not available, their creation could be encouraged. If domestic alternatives are not possible, corporations could be allowed to include international alternatives in their menu of possible choices. For example, firms could be allowed the choice of being governed by the corporate laws of a given jurisdiction, not necessarily one in which their operations are located. Some firms already choose to list their securities in exchanges far away from their home base. Similar freedom to choose the applicable financial reporting regime

[11] See Esty and Geradin (2001) and Kane (2000).
[12] See Trombetta (2001).

will help improve both the financial reports, as well as the reporting standards in the direction of reducing the cost of capital of firms.

Since the rules promulgated by the FASB and the SEC are the only game in town for all publicly traded firms in the U.S., the rule making bodies come under heavy lobbying pressure from various interest groups whenever strong disagreements exist among them. Under regulatory competition, rule-makers would be spared such lobbying pressure. Those who find a particular set of rules unsatisfactory would then have the freedom to switch to another set. If none of the competing standards offer them what they want, their ability to pressure rule makers for changes is attenuated.

Unlike public utilities, which are justified because the cost of competitive provision of their services is too expensive, the cost of competitive provision of accounting standards and other regulatory mechanisms is relatively small. The cost of running a standard setting organization is no more than some tens of millions of dollars. Market capitalization of the New York Stock exchange alone is $12 trillion and even a .01 percent savings in cost of capital for the firms listed in the NYSE would amount to $12 billion per year.

A competitive model of financial reporting will help resolve the standard-setting problem in an incentive-compatible fashion. Various standard-setting bodies will try to set standards which attract as many firms as possible from either a targeted or a universal set of firms. Each standard-setter will have to assess the appeal of its standards to a large number of firms on the basis of their comparability on one hand, and representativeness relative to the peculiar circumstances of the firms' environment on the other. If the IASB, for example, chooses its standards to be close to the standards appropriate for the U.S. market, it would make its own standards more appealing to firms that would like to attract U.S. investors for its securities. On the other hand, issuers with operations in economies that differ structurally from the U.S. in important ways may conclude that the choice of such a standard will make their reports less informative relative to their local circumstances, and therefore less informative to the investors familiar with such circumstances.

Every standard-setter will have to make such delicate judgments and trade-offs about managers' and investors' own decision-making in choosing its reporting rules. Once the accounting rules are issued, the managers and investors will exercise their own choices among the available standards and prepare their reports. If these reports are acceptable to the investors, they will place a higher value on the securities of the firms whose reports are more satisfactory. Investors' willingness to pay a higher price will lower their cost of capital, and benefit the agents who participate in the firm. Managers, watching this investor preference, will then tend to choose to adopt the standards favored by the investors. Managerial action will direct more revenue or reputation and recognition to the favored standard-setting bodies. This revenue or reputation will have an effect of its own on the choices standard-setting bodies make in selecting standards.

It is difficult to predict the ultimate number of rule making bodies in accounting that may survive under a competitive regime. This number itself, and the location and distribution of the surviving bodies, would be a beneficial outcome of the competitive process. A competitive financial reporting standards regime may, but need not, lead to a convergence of standards set by various bodies. Competition between states in the U.S. for corporate charters, and among countries for registration of ships has not led to identical standards. However, the competition does throw up some surprising survivors. Few would have anticipated that the small state of Delaware would win the corporate charter sweepstakes by a long margin (over 300,000 corporations are registered in Delaware). Nor would anybody have anticipated that Panama and Liberia with their small populations would account for 170 and 76 million tons of registered commercial shipping (compared to 14 million tons in the U.S.)

A competitive regime will encourage the standard setters to try harder and provide more responsive service to their clients. Competition among states for corporate charters induces the Division of Corporations in Delaware to stay open till midnight each day.

It is often argued that the financial reporting standards created after years of hard work by the Accounting Standards Board, the Financial Accounting Standards Board and the Securities and Exchange Commission are the best in the world. Many countries use the U.S. standards as benchmarks to fashion standards appropriate for their own economies. Why should the U.S. give up its current model in favor of another that includes accounting anarchy as a possible outcome?

Such conclusions about superiority of one set of standards over another are often based on the assumption that more detailed rules covering more contingencies are better. We have seen no evidence that firms subjects to such standards have a lower cost of capital. Leuz (2001) compared the bid/ask spreads and market turnover for firms who choose between the U.S. and international GAAP in Germany's New Market. Aside from their choice of GAAP, both samples of firms are subject to the same regulatory regime. The study finds no significant differences between the bid/ask spreads and market turnover of the two samples of firms. If these empirical measures are taken as surrogates for information asymmetry in the security markets, the U.S. and international GAAP seem to have no discernible effect on the magnitude of this symmetry. I am not aware of any more direct comparison of the cost of capital of the two samples.

Botswana (1997) estimated that the cost of capital of firms followed by relatively few analysts is significantly lower if they disclose more information in their annual reports. Botosan and Plumlee (2000) found similar results for larger, more widely followed firms. These estimates suggest that the cost capital related to differences in disclosure policy chosen by the firms within the U.S. GAAP may be in 0.2 to 0.5 percent ranges. They did not assess the cost of capital differences that might be related to measurement standards. Botosan and Plumlee also found that greater and more timely disclosure through publications, other than annual reports, is associated with higher cost of capital. They attribute this result to the possibility that frequent and timely disclosures cause market volatility, raising the cost of capital. Hail (2001) found even stronger results for Swiss companies. These studies suggest that the relationship between financial reporting and cost of capital may be complicated. Experimentation with a variety of reporting systems may be necessary to identify efficient standards.

More strict or detailed standards are not necessarily better standards for all segments of the economy, or for the economy as a whole. This issue emerged as the "Big-GAAP, Small-GAAP" controversy which led the FASB to begin to differentiate some of its standards by the size of firms to which they are applicable. Differences in market development and economic environments of various industries within the U.S. have lead to many industry-specific standards, and to exclusion of some industries from standards framed for general application. No single set of standards have been shown to be the best suited for all firms. Nor is it possible to identify with confidence a set of standards that are best for the economy of a country as a whole. Under these circumstances, it is reasonable to create a mechanism that has a fair chance of arriving at a single or multiple sets of standards to the extent they are found to be efficient through market competition.

The argument for regulatory monopoly in accounting is often based on the assumption that in the absence of such regulation, there will be no standards. There is a significant amount of evidence to the contrary. The demand for auditing, for example would exist even in the absence of government regulation to require auditing of publicly held firms.[13]

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[13] For example, see Simunic and Stein (1987), Blackwell et al. (1998), and Titman and Trueman (1986). High quality of audit can be used by higher quality firms as a signal to credibly convey their quality to the

U.S. Versus International GAAP

In order to achieve its growth objectives, the Lisbon Council of European Union's heads of state decided to promote a single, deep, and liquid financial market through adoption and enforcement of a single set of financial reporting standards. Adoption and enforcement of the standards written by the International Accounting Standards Board is under consideration for this purpose. Adoption of a single EU-wide standards is justified by the need to establish and enforce high quality standards for all; to create a level playing field, and to prevent regulatory arbitrage. This conclusion is based on the premise that the global markets "urgently demand" high quality international accounting standards.

The U.S. SEC's call for meeting the challenge of global securities markets will be met through cooperation and adaptation of regulatory regimes within the EU and between the U.S. and the EU. Development of new trading technologies and globalization of markets is said to exert pressure toward convergence of accounting which is sought to be met by the SEC in the U.S. and by the EU through regulatory fiat. The U.S. and EU regulators have debated the relative "quality" of FASB and IASB standards under the presumption that permitting firms to prepare their reports using lower "quality" standards is bad public policy.

In the U.S. SEC has resisted allowing the use of alternatives to U.S. GAAP by firms whose securities are traded in U.S. markets. In Europe, the EU

investors. Such signaling is possible in presence of price premium charged by audit firms, which are perceived to provide services of higher quality (Datar et al., 1991).

seems to favor the IAS, and uses the following argument to persuade the SEC to allow the use of the IAS in U.S. markets:

> Another crucial question for analysts is whether or not the capital markets can operate efficiently in an IAS environment. The view is that they can and do. Clearly, users (including U.S. investment funds) are already using the IAS as the basis for informed investment decisions, and are doing so without having a U.S. GAAP reconciliation (response to Question 5).

Being based on the ability of users to protect their own interests by taking the differences among standards into account, this argument is valid. However, coming from the EU, it would be worth keeping in mind that users (including U.S. and European investment funds) are already using financial reports prepared utilizing a wide variety of standards, including many that differ substantially from both the FAS and the IAS. When it comes to yielding foreign firms access to European capital markets, the EU should consider its own argument.

An important concern of the U.S. SEC in allowing alternative standards to compete in the U.S. markets is whether such competition may put companies that use more conservative standards at "competitive disadvantage with respect to recognition, measurement or disclosure. (SEC, Q. 6)" This concern is based on the idea of functional fixation—inability of investors to distinguish between appearances and economic reality. The ability of investors to make such distinctions depends on their sophistication and analytical effort. While there is evidence that developed stock markets, significantly populated by sophisticated institutional investors, are quite good at distinguishing appearance from reality, one cannot conclude that no one is ever misled, even when confronted by financial reports based on a single set of standards. Allowing multiple sets of standards will require even greater sophistication on the part of investors, putting investors without the appropriate expertise at a disadvantage. Such disadvantage for the lay investors already exists; it is not peculiar to a regime of competitive accounting standards. In making policy, we must balance any additional disadvantage to the "non-experts" from competitive regime against the advantages of having lower cost access to more investments, and the possibility that competitive standards will be better suited to the needs of the investors, lowering the cost of capital of firms.

Implementing A Competitive Regime

How will compliance with the standards be monitored and enforced under a competitive regime? Under the present monopoly regime in the U.S. the SEC oversees the rule making by the FASB, financial reporting by registrants, and performance and standards of auditors who verify these financial reports. The SEC devotes a good part of its attention to rule making by the FASB, suggesting items for its agenda, engaging in discussions with the FASB and registrants, and occasionally overriding the FASB standards. In reviewing the reports submitted by the registrants, the SEC staff focuses on U.S. GAAP. U.S. auditors learn and practice U.S. GAAP. The SEC monitors the performance of these auditors, and disciplines them, relative to how they certify the compliance of financial reports with U.S. GAAP. How would these functions of securities regulators change under a competitive regime for financial standards?

The SEC's oversight function in standard setting will expand to include organizations, stateside and overseas, whose standards are made available to

U.S. registrants. To reduce this workload, responsibility for direct oversight over standard setting bodies may be shared among the members of IOSCO. Further, the need for such oversight would be diminished under a competitive regime, allowing more room for innovation and judgment by rule-makers. Security regulators' oversight will be directed at the rule making process and the set of standards, not on individual rules. Investors, not regulators, will be the ultimate arbiters of what is acceptable or best in accounting standards.

The SEC's oversight for the fairness of financial reports submitted by registrants will continue under the competitive regime. When reports appear to be unfair, the regulators will continue to raise questions with the registrants and their auditors. Unfairness of reports arising from a failure to comply with the chosen reporting or auditing standards will trigger disciplinary action against the registrant or the auditor. When unfairness persists in spite of the conformance of reports to their chosen set of financial standards, the regulators will ask the makers of the rules to address the problem.

While some provinces of Canada allow competitive auditing standards, U.S. auditing standards remain monopolistic. Disciplinary functions for auditors are shared among the government and self-regulatory organizations at federal and state levels. Independent of whether the U.S. adopts a competitive model for auditing standards (see Dunmore and Falk, 1999), quality assurance through peer review, public oversight and reporting, and disciplinary action for auditors will continue. Security regulators can require an audit by individuals and firms who are subject to an appropriate acceptable oversight and disciplinary regime.

In the U.S., for example, the SEC could require that a registrant who uses IASB standards get its reports audited by auditors subject to a regulatory regime acceptable to the SEC.

Under a competitive regime, a support staff either, at the IOSCO or at the respective standard-setting bodies, could serve and assist national security regulators. This staff would be financed from the revenues gathered from corporations who choose to use the standards of various rule-making bodies. This staff will supplement the expert resources of national regulators and address any queries from them about the compliance of financial reports of a given registrant.

Concluding Remarks

Jurisdictional choice of accounting standards is an obvious parallel to jurisdictional choice available for corporate charters to U.S. domestic corporations. Choice of incorporating themselves in one of many available jurisdictions is also available to many multinational corporations. This paper argues that making such choices available to corporations worldwide will improve the efficiency of corporate governance and accounting standard setting.

The argument for competitive financial reporting standards is not an argument for eliminating such standards. Instead of lowering the cost of capital, elimination of standards will create anarchy in which the meaning and informativeness of financial reports will be lost. Fortunately, a competitive approach to standardization leaves open the possibility that the corporations and investors, when given a choice among alternatives, will choose less demanding standards that approach a "free for all." It is possible for competition to lead us to a conclusion that no standards are most preferred by investors.

Monopoly regulatory regimes for accounting standards within many national boundaries have helped develop their capital markets and financial reporting over the past seven decades. Globalization of a diverse world economy has led policy makers to push financial reporting in the direction of active harmonization of standards across national boundaries. Harmonization across national boundaries should not necessarily mean extending the national standards monopolies to global scale. Economics, and information and communications technologies indicate that we could do better if we move from monopoly toward competitive accounting regimes, nationally and internationally.

Competition has served us well by developing efficient frameworks in the fields of corporate charters, banking, maritime shipping, and stock exchanges. At the time of this writing, competition in e-commerce is giving rise to policies, standards and assurance services for privacy on the Internet without help from regulation.[14] Competitive interaction among standard-setters, business firms, and investors across the globe will lead us to better accounting practices and standards, and lower cost of capital.

[14] See Duh, Jamal and Sunder (2001), and Jamal, Meier and Sunder (2001).

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