The Role of Accounting Profession in Development of Capital Market

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ABSTRACT

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Capital markets as financial instrument plays an important role in the economy. In these markets financial information is one of the major and valuable resources and has important contribution in making integrated and competitive markets. In this paper the role and effect of the accounting profession in the development of the capital markets has been studied. The results of the study indicate presence of accounting profession as interface between favorable investment opportunities and users of financial information is a need in development and growth of capital markets. In order to develop the capital markets, accounting research with a focus on users and potential investors and also reporting procedures based on user`s needs and regulating financial transparency by legislating appropriate international standards have been suggested.

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INTRODUCTION

Capital markets are the main mechanism facing today’s global economy in absorption and optimum allocation of saving resources into investing consumptions and financing massive projects. We can search the importance of these markets in topics such as absorption of foreign investment, rise of national economy to the international level, a place to safe trade, place to finance macro-economic projects and etc. accounting also as a profession that created earlier than capital market is effective in economy development and will be. And always in creating effective financial information and also in control and monitoring is among of important tools. In this attempt has been tried to express role and major capabilities of accounting profession that can be effective in the development of capital markets reviewed and analyzed and to provide some guidelines to this development.

The role and effects of accounting society and accounting profession in growth and development of capital market can be reviewed by many angles. So we will explain some of these angles:

Accounting and Capital Market as Economic Tools:

Capital markets are the main mechanism facing today’s global economy in absorption and optimum allocation of savings into investing consumptions and financing massive projects. Capital market is the place to create economic arrangement. It means the capital is allocated into profitable entities with economic value added[1]. Capital markets are capable to lead a large amount of liquidity from unproductive activities to productive ones and accelerate the investment process.

Undoubtedly, the development of capital markets requires a careful and effective monitoring and financial control.

Accounting is an important controlling tool in developed economics. As an example, accountability of managers and response requesting of investors and creditors is carried out through accounting information and reports. Accounting society has well passed these tests of applying financial controls. Development of capital market depends on not manipulated prices system, not pretermitted transparency and reliable information in an efficient market. That is impossible without accounting profession in the heart of the market.

Accounting Purposes and the Development of Capital Market:

Accounting is a social activity. Any social activities has it’s purposes and objectives. Including functional interpretations from accounting purposes as a social activity is helping people outside the organization to control and monitor manager’s activities and etc[1]. This interpretation shows that accounting profession is a mechanism that basically follows capital market development. Accounting important purposes and the objective of capital market development is in one direction in the functional perspective.

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Accounting purposes are a subset of objectives of involved groups in the profession which are joint among all of the groups. These groups are the accounting profession, the companies and the user [3]. Capital market is formed from the companies and the users that the third group—accounting profession—is their interface. The joint part of these three groups is real information that appears in the statements [4]. The real information is necessary for development of capital market and one of basic prerequisites to efficient market.

Accounting Information and Capital Market:

In fact, accounting information presented with the aim of providing the necessary data to investors and creditors in making investment decisions. Information that extracted from financial statements apart from its importance to creditors and competitors, widely used in anticipation of future cash flows in capital market. Thus helps investors and other interested people in assessment of future risk and return[5].

On the one hand, investors search for maximum profit and return with minimum risk and for that investors be encouraged to invest in an asset, return of the asset must be greater than the other options[6]. And in the other hand, an entity’s value depends on its profitability. So managers with the aim of maximizing investor’s wealth, must interact between efficient investment opportunities and investor’s expectations [7]. The interaction can be well established by reliable accounting information such as net future flows.

In a statistical research has shown that information about cash flows (cft), past earnings (Ei -), future earnings (Ei +) and operational income (IO) has a significant effect on investment level [8]. This research approves that accounting information widely affects capital market.

Accounting services in the capital market:

Examples of the usefulness of the accounting profession in the development of the capital market can be mentioned as following:

1- Enhance the comparability of financial information of national and international entities by different mechanisms such as foreign currency exchange and etc
2- Different pricing procedures such as Arbitrage and etc
3- Checking the adequacy and timeliness of financial information
4- Important causes of market inefficiency is lack of transparency, shortage of information about companies listed on the Stock Exchange, weakness of monitoring and control through rules and regulations [9]. In developed countries, there is an independent institution called the "Securities Commission" with the authority of setting accounting standards who guarantees reliability, timeline publication and transparency of accounting information by legislation of accounting standards.
5- Providing update information such as preparation of consolidated financial statements according to international accounting standards.
6- Information monitoring and scrutiny by auditors such as monitoring capital increase.
7- In some cases, companies and creditors deal to prepare statements according to accounting standards and generally accepted principles. The deal provides information requirements of creditors and credibility of companies.
8- Information availability costless.
9- Flexibility of reporting standards caused companies not incur costs of unnecessary information that not useful for the users. In fact, companies not involve in activities without profit. The flexibility makes information available to the users and helps them in making quick decisions.

International accounting and ultra-border capital market:

Global capital market is a fact. All financial services be evaluated on a global scale and the risk has a global contribution. Today, entities have a tendency to act globally and gain part of their capital and profit through developing to the international level. It’s obvious, first they need to publish their information according to the international standards in the target region (e.g. country or city and etc) which requires professional interposition of accounting profession and second an internationally developed capital market required.

In an empirical analysis the effects of IFRS reporting of euro zone entities on capital market in fiscal 2005 was studied. More specifically, they analyzed the effect of mandated IFRS reporting on the implied cost of equity capital, percentage bid-ask spreads, the price impact of trades and the frequency of zero-return days. The descriptive analyses indicate major structural breaks or changes in the capital market variables [10].

Globalization of capital market causes the capital to move more freely. It makes capital to move where talented production theme exists in order to utilization of these talents. But after globalization of capital market and its fluidity, if there is no monitoring or financial control and in absence of adequate information we will witness great crisis such as South East Asia crisis (1997) or México crisis (1994). Consequently, with ultra-border development of capital market the need to financial control and information through accounting profession is sensible. The need requires existence of an institute formed from professional accountants with authority of controlling, monitoring and even setting standards.
Synergy of Accounting Profession and Capital Market:

Accounting has been found earlier than capital market. But by development of capital market beside separation of ownership from management, demand for accounting and improving financial reporting standards has been increased. Synergy of accounting and capital market is one of most important reasons that keeps accounting beside capital market. Because of the demand of accounting and capital market to each other is a requirement the synergy occurs. Accounting with transparent and reliable financial information causes market’s efficiency and with development of capital market the demand for accounting shows itself.

Capital market rewards high quality reporting through some encouragements such as simplification of capital availability and etc. It penalizes low quality reporting through some punishments such as increasing cost of capital or limiting financing resources accessibility and etc. actually, capital market itself is an incentive to high quality accounting.

In other hand, accounting and reporting standards plays an important role in helping capital market mechanism. It makes the capital to flow in interest of both companies and investors. For example, AICPA, formed a committee who’s responsible for studies about information needs of investors. As a result of these studies, the committee prepared a framework. Based on the framework information divided to two parts named significant and No significant. The basis of the division was “how investors evaluate companies?” The studies are very important because it’s for Identification and improvement of reporting based on the users [11].

Conclusion:

According to results of this paper, presence of accounting profession in heart of capital market in order to development of capital market is a need although it concludes development of both. Certainly, changes should be done in both in order to improve their quality.

Accounting researches by an institute formed from both accountants and capital market professionals with authority of legislating rules and regulations and setting standards based on current users needs and potential national and international investors must be done. Even regulating these researches in order to improving transparency and quality of information is our offer. Also accurate and costless models such as Artificial Neural Network in order to anticipate future return and risk must be presented. Financial analysts with rich experience in the accounting are very useful to improve the quality of analyzing financial information.

REFERENCES