

**JOURNAL OF GOVERNANCE AND
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EDITORIAL

Dear readers!

The recent issue of the journal is devoted to several governance and regulation issues.

Patrick Velte and Markus Stiglbauer provide a state of the art analysis of the empirical research results with regard to auditor and audit firm rotation that could increase auditor independence.

Isabel Argimon, Gerard Arqué Castells and Francesc Rodríguez Tous gather empirical evidence on the effects of more or less stringency and more or less risk sensitivity in regulatory capital requirements on the observed behavior of European banks during the initial years of the financial crisis. They use the indices built in Argimón and Ruiz (2010), which capture such characteristics of capital regulation. Authors test their incidence using changes in yearly data for individual banks for 25 countries of the European Union covering the period 2007-2009.

Guoxiang Song evaluates several methods which can possibly be used to minimize the pro-cyclical impact of accounting rules on bank capital regulation.

Monal Abdel-Baki examine, using the GMM method, the impact of introducing the new capital and liquidity requirements on the macroeconomic performance of the Egyptian economy.

W.J. Pienaar, A. de Bod and J.H. Havenga highlight the significant cost-reduction opportunities possible through economies of density achievable in rail freight transport, especially over long distances, and the concomitant implications for increased profitability for railway organisations in Southern African countries

Benjamin F. Cummings and Michael S. Finke review economic theory related to investment advice that explains why financial advisors need to be carefully regulated, why principles-based regulation is more efficient than rules-based regulation, why dual regulation of financial professionals providing investment or insurance advice is inefficient and inequitable policy and why the application of a universal and uniform fiduciary standard will be difficult to implement.

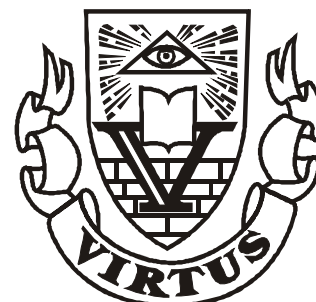
Sankarshan Acharya proves the existence of a practically implementable system of governance necessary to attain the most efficiently competitive economy without the arduous collection of private information on individual preferences through a central planner.

We hope that you will enjoy reading the journal and in the future we will receive new papers, outlining the most important issues in the field of governance and regulation.

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**IMPACT OF AUDITOR AND AUDIT FIRM ROTATION ON ACCOUNTING AND
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Patrick Velte, Markus Stiglbauer

In a current regulation draft of 2011, the European Commission (EC) plans the mandatory audit firm rotation principally after six years and with regard to a cooling off period of four years to increase auditor independence. This could complement the internal mandatory rotation (auditor rotation) by the 8th EC directive. The present paper gives a state of the art analysis of the empirical research results with regard to auditor and audit firm rotation. In contrast to the perception of the EC, the majority of the empirical results doesn't find evidence for increased financial accounting and audit quality by audit firm rotation. Furthermore, the positive effects of the internal rotation period of seven years and the cooling off period of two years by the 8th EC directive are not empirically proved yet.

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Isabel Argimon, Gerard Arqué Castells, Francesc Rodríguez Tous

The main objective of this research is to gather empirical evidence on the effects of more or less stringency and more or less risk sensitivity in regulatory capital requirements on the observed behavior of European banks during the initial years of the financial crisis. To do so, authors use the indices built in Argimón and Ruiz (2010), which capture such characteristics of capital regulation. The incidence is tested using changes in yearly data for individual banks for 25 countries of the European Union covering the period 2007-2009. Our results show that more stringency and risk sensitivity in capital regulation resulted in higher capital increases, with limited effect on risk taking. However, for well capitalized banks, higher risk sensitivity resulted in higher capital and higher risk, thus requiring striking the right balance, so as to lead to increased stability.

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Guoxiang Song

This paper evaluates several methods which can possibly be used to minimize the pro-cyclical impact of accounting rules on bank capital regulation. Improving accounting rules cannot eliminate the pro-cyclicality problem as the recently proposed expected credit loss impairment model for historical cost accounting may be moving towards using information inputs for fair values. Limiting the trading activities accounted for by fair values may reduce the pro-cyclicality. However, it cannot eliminate the impact of fair values in a liquidity crisis. The most effective method is to exclude the unrealized accounting gains or losses from regulatory capital. But it needs a report of capital ratios based on accounting measures to help regulators read the early warning signals emitted by the accounting information.

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Monal Abdel-Baki

The Basel Committee has introduced a new set of capital and liquidity requirements to be introduced by the global banking system during 2013 till January 2019. Egypt possesses a well-capitalised banking sector, yet it has been exposed to the devastating shock imposed by its popular revolution. Using the GMM method, the impact of introducing the new capital and liquidity requirements on the macroeconomic performance of the Egyptian economy is examined. The results reveal that Egyptian banks are motivated to enhance capital and liquidity ratios in the case of realizing high profits and favourable conditions at the individual banking level. On the other hand, negative macroeconomic performance and a poor business environment substantially deter the preparedness of Egyptian banks to meet the Basel III requirements. The analysis is timely given the need for compliance with Basel III as one of the requirements to raise the credit rating of the devastated economy.

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W.J. Pienaar, A. de Bod, J.H. Havenga

Road transport has replaced rail carriage as the dominant form of long-distance freight transport in Southern Africa. Road freight carriers can transport goods of various sizes and masses over long distances. This article highlights the significant cost-reduction opportunities possible through economies of density achievable in rail freight transport, especially over long distances, and the concomitant implications for increased profitability for railway organisations in Southern African countries. Traffic densification opportunities should focus on the development of transport corridors throughout the Southern African region.

REGULATING HOUSEHOLD FINANCIAL ADVICE

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Benjamin F. Cummings, Michael S. Finke

This paper reviews economic theory related to investment advice. This theory explains 1) why financial advisors need to be carefully regulated for the benefit of both the investment advice industry and for consumers, 2) why principles-based regulation (e.g., a fiduciary standard) is more efficient than rules-based regulation, 3) why dual regulation of financial professionals providing investment or insurance advice is inefficient and inequitable policy, and 4) why the application of a universal and uniform fiduciary standard will be difficult to implement.

NO-SUBSIDY MANTRA OF GOVERNANCE TO ATTAIN THE MOST EFFICIENTLY COMPETITIVE ECONOMY

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Sankarshan Acharya

This paper proves the existence of a practically implementable system of governance necessary to attain the most efficiently competitive economy without the arduous collection of private information on individual preferences through a central planner. This governance is constituted with tenets: (a) adoption of only known commonly agreed rules like (i) common civil codes of conduct and (ii) penalties for robbery, killing and usurpation of public and private wealth and (b) an irrevocable mandate to frame any new commonly agreed rule that may be discovered in future or to repeal or amend any prevailing rule which may be ascertained in future to be preferentially catering to subsets of people. The only feasible available norm for common agreement to set rules is self-sufficiency of each group like the households and companies. Self-sufficiency or no-subsidy mantra is defined by the net surplus (production minus consumption) of a group being greater than the transfer from the public exchequer to the group.

SUBSCRIPTION DETAILS

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