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Abstract

This study assesses the ed” credit rating agencies (CRAs). The accounting scandals of 2000-02, in particular the highly publicized failure of Enron in December 2001, led many to question their competence and the value of their ratings. This paper evaluates important criticisms of the CRAs discussed in a recent Securities and Exchange Commission (SEC) staff report by using evidence from empirical research studies, and suggests many promising subjects for future research. The analysis given in this paper, and the results of the suggested research (when available), should be of particular interest to lawmakers and regulators who are responsible for determining whether and to what extent the credit rating industry should be subject to statutory and regulatory oversight. Although little rigorously gathered empirical evidence supports the criticisms, many issues remain unresolved. Powerful tests related to potential conflicts of interest and alleged unfair practices are exceptionally difficult to design, and the alleged deficiencies of rating agencies' disclosure practices have yet to be analyzed. Finally, many criticisms are based on subjective benchmarks that are difficult to quantify and open to question. To date, however, accounting researchers have played only a minor role in the debate. Because they are well-versed in such areas as disclosure analysis, capital market tests, and the operation of financial intermediaries and external auditors, these researchers potentially have much to add in this regard.

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