

Regulatory arbitrage through financial innovation

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Despite the existence of accounting standards, there still remains a degree of flexibility in their interpretation and gaps between rules. It is alleged that management practises “creative compliance” to influence the picture of financial performance portrayed in the annual report. This practice is not necessarily “illegal” because it need not violate the letter of any rules, but may challenge their spirit. Since accounting is an integral part of the regulation and governance of the corporation, the practice of creative compliance makes accounting regulation appear weak and ineffective. Traces and analyses the objectives underlying the design and implementation of one major creative accounting scheme through a case study of financial innovation in convertible securities. The evidence highlights the pressures on management to perform on specific accounting ratios, and the extent to which companies were willing to go (with assistance from bankers and lawyers) to practise creative accounting. Shows that the conventional restraints on these practices, such as auditors, analysts and the media, have not been effective. What emerges is an unbalanced conflict between the regulators and the regulated corporations, where the latter, having access to significant financial and professional resources, appear to have a consistent upper hand.

Keywords: [Accounting principles](#), [Corporate governance](#), [Financial innovations](#)

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