

## **PROFESSIONAL ETHICS OF ACCOUNTING AND IT'S EFFECTS ON INTERNATIONAL FINANCIAL CRISIS**

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### **ABSTRACT**

Nowadays, economic globalization has caused its advantages as well as its disadvantages to inflict all countries globally. One of the disadvantages has been the recent financial crisis known as the Housing Loans Crisis. By examining this crisis deeply whose prominent cause was default in paying off housing loans, we infer that there has been other causes beyond that. Of these factors, we can cite some of the rules and standards of accounting profession whose weaknesses make them prone to financial abuse. During the occurrence of this crisis, known as international financial crisis, the pertained rules and standards were misused by top managers of certain companies and institutions. Ignoring professional ethics, these managers manipulated the existing accountancy rules and standards for their own benefits. Therefore, of the main reasons for the occurrence of this crisis was the existence of flaw in the approval and application of accountancy rules and standards which should be in way to prevent misuse. The present research attempts to explore the structure of the recent financial crisis and its accountancy and financial reasons and finally to state the top managers' Efficiently control systems and the necessity of existence of efficient corporate governance systems in companies for preventing these misuses.

**Keywords:** *International Financial Crisis, Corporate Governance Systems, Accounting Professional Ethics, Efficiently Control System*

### **INTRODUCTION**

The term of crisis is used in the meaning of uncommon conditions in economic literature. In general, it implies unexpected problems that influences the current and future status of the organizations and affects on the planning. This term depicts important problems in the firms and the macroeconomic condition of a country that changes status of a country or international scope.

Economic crises are divided into financial and industrial groups. The industrial crises cover inflation and unemployment and financial one involve banking, monetary, debates and international system crises. This research investigates financial crises so banking and monetary crises are also studied. Bank crises are appeared due to imbalance in the bank balance sheet because of non return of loans, reduction of commercial loans, and reduction of credits from industry sector due to reduction of the loans time table and rapid receive of the long term deposits and sudden changes in the financial markets and decrease of financial systems trust and capital erosion (Burkart & Coudert, 2000:25). Monetary crises are result of domestic money value policy, amendment of exchange policies by government, limitation of the capital and interrupting of it, rapid reduction of money value against foreign exchange. Financial crises are appeared directly in monetary sector and sometimes in industry sector then transfer to financial sector (Can, 2010:24).

Numerous factors influence financial crises so the main factor is tendency toward risk in mankind and pressure on rationality (Kutluay, 2009:16). During 1820-1929 in all over the world 16 small and big financial crises have been happened. Most of these crises are local so financial crisis of 1929 in US is the beigest one (Kindelberger, 2004:360). Since then many small and big financial crises have been happened it can be referd to crises in south east of Asia in 1997-1998, Russia and Brazil in 1998 and Argentina in

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2001 and Turkey in 2001 and finally US in 2007-2008. (Civriz,2009:2). In the US crisis different factors were effective but accountancy system was important. This crisis is considered as accountancy crisis (Can,2010:32). In this research accountancy factors are emphasized and corporate governance is studied as a framework for control of frauds in accountancy and unresponsive behavior of the managers that accelerate these crises.

### **Anatomy of international financial crisis**

Since 2000 factors such as low interest rate and approval of tax codes for facilitation of dwelling purchase encouraged low income families to buy the house by long term loans and as a result demand for dwelling loan was increased suddenly. Concurrent with these events US banking system took actions to facilitate loan conditions for low income families (Civriz,2009:4). These loans were offered without any analysis of the receiver ability and only the assurance was the purchase land. At the end of September 2007 the number of the lands offered for selling by the banks reached 5.3 million units and the number of the sold lands reached 3.3 million units. The condition was return in the first two years with fixed interest rate and market interest rate in next year accompanied by increase of dwelling demand. This increase led to enhancement of inflation rate. US central bank reduced liquidity by increase of interest rate. At late 2007 interest rate reached %5 from %1. This increase led to difficulty in returning loans. By increase of interest rate the demand for dwelling loan was reduced and as a result it led to significant reduction of the house price. This reduction and inability to pay the loans caused to increase in number of the houses under requisition and finally world financial crises (Civriz,2009:5).

This question is arisen that how a financial crisis in the US banking system led to international crisis. The main reason was conversion of the payments into cash and securities for purchasing of the houses in the capital market. The houses under requisition, automobile loans and credit card debates are considered as properties (Altak,2009:11).

The main accelerator of this crisis is contracts of nontransferable properties into transferable properties. The former boss of US central bank said: the main factor was not loans but it was reselling of these loans. This trend progressed so that the bank converted the loans into purchasable securities and sold them to other banks. The buyer bank sold them to other banks and purchased among 30-40 banks and led to inflation in balance sheet of these banks. Finally, it caused to financial system bankruptcy. So many banks were affected and they announced bankruptcy (Alantar,2008:3). The crises resulted from non return of the loans lead to international issue. Of other factors it can be referred to credit institutes. They could not predict crises and after these events reduced the mentioned banks credit.

The important factor in inefficiency of these institutes was supplement of the mentioned banks. The other factor could be lack of transparency of performance of these institutes. In recent years different financial tools such as Forward, Futures and Swap were appeared in US that most of the investors did not have any information in this regard. These contracts were considered as derived products and entered as a ready to explosion bomb in the balance sheet. Financial reports of these banks were conformed to accountancy and auditing codes apparently but they could not reflect real economic and financial status. The important point in these reports was confirmation by the reliable audits. For this reason this crisis was called accountancy crisis of 2007 (Can,2010:25). Conformity of the factors to accountancy standards led to calling it accountancy crisis and as a result it was necessary to review the accountancy standards.

### **Reasons for international financial crisis**

In survey on the financial crisis factors from accountancy viewpoint the optimal cases can be called operational field (Darman, 2004:7). These fields are the main factors in financial crisis in international level. The bank and institutes managers tried to deceive the investors (Can,2010:26). In this regard, accountancy factors were effective in financial crises:

- 1-distance from accountancy standards and codes
- 2-application of creative accountancy procedures

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3-transparency problems in activities and lack of reflection of the institutes' real conditions in financial reports

4-failure of accountancy and lack of observing of indifference in reports and offering misleading reports

5-rewarding system and encouragement of higher level mangers

International financial crisis accountancy factors were mentioned and then we will explain these factors.

1-Distance from accountancy standards and codes

In accountancy procedures the functions should be conformed to specified codes and standards. One of the reasons for financial crisis is non conformity of the functions to rules (Can,2010:27). One of the basic accountancy concepts is social responsiveness. This concept necessitates the institutes to observe the rights of all social groups. Thus in intentional financial crises most of the institutes mislead the government and society and investors by inaccurate reporting and ignoring social responsiveness was one of the reasons in financial crises.

2-Application of creative accountancy procedures

Creative accountancy involves functions employed for observing codes and rules, valuation measures, standards and accountancy performance in manipulation of the numbers and manner of financial statements by the aim of uncovering the firms and institutes financial status. In other words, any misleading in financial statement is considered in creative accountancy framework. Creative accountancy can be introduced as one of the accountancy fraud tools. In other words, creative accountancy is fraud in accountancy according to accountancy standards. Institutes by the aim of escaping tax disclose their profit less or delay in reporting of their profits. Some institutes try to show their profits and assets higher than real amount for receiving credit. The important issue is that all accountancy operations in these firms are completely conformed to the standards (Can,2010:29). The above functions are considered as a part of creative accountancy that conformed to accountancy rules and these standards have been criticized (Arnold,2009:803-809).

3-Transparency problems in activities and lack of reflection of the institutes' real conditions in financial reports

By hearing transparencies we recall Gregory the owner of the biggest match factories and Kostelli system. By uncovering real numbers and reporting unreal values could introduce his company financial status significant and offered new stock to investors. He reserved the real numbers disclosed by other companies. When Saturday Evening Post asked him about his success he replied concealment (Sake,2008:54).

4-Failure of accountancy and lack of observing of indifference in reports and offering misleading reports

Investors consider the former financial statements and reports in their decision makings. Accountancy is a systematic procedure that collects positive documents and investigates indifferently according to the defined rules and standards and reports for outer organization groups. Independent auditing firms are the factors in international financial crises. These firms played role in offering misleading reports and cheating the investors. Investigation on the big and bankrupted firms' financial statements and reliable auditing reports the failure of these firms become obvious. (Zeff, 2007: 49-62)

5-rewarding system encouragement of higher level and mangers

International financial crisis accountancy factors were mentioned and then we will explain these factors

Tendency toward high income among higher rank mangers and manipulation in rewarding system led the mangers to misuse the codes and standards for their benefits and they tried to depict their profit less than real amount. Concurrent to international financial crises most of the higher rank mangers received parentage of the firm profit as reward (Kaval, 2008: 3). During this period by announcing bankruptcy of these firms the public encountered with disclosure of million dollars rewards and it was effective on public.

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Mangers rewarding system is divided into five categories in financial crisis:

#### **1-fixed and monthly salary**

**2-marginal benefits:** using the firm automobile and driver, cost of mobile, periodical check up, participation in meetings, free membership in some institutes, low interest rate loan, free education and missionary trips cost

3-periodical encouragement: performance reward

**4-middle term benefits:** facilitation of the stock purchase, membership in managing director by using the institute credit and receiving wage

**5-golden parachute:** this is the significant part in higher rank mangers rights. It means receiving considerable amount of money by the mangers in case of bankruptcy and resignation. Most of the mangers accept risk in order to receive reward of their performance and encounter the firms with problems and it is one of the reasons for financial crisis in 2007.

Mrs. Nancy Ploci, The santé representative, protested to golden parachute during approve of 700 milliards dollars aid in one of the firms. It was protest against the mangers behaviors and their thinking about economic. In case of intentional decline the government has to open golden parachute for saving by sung taxes recited from society lower class(Darman:2004:7).

### **Corporate governance and its importance**

Bankruptcy of firms such as Enron, Arthur Anderson and Word Com in US and Marconi in Britain and Adelphi, Cisco, Lucent, Global Crossing, Sun Beam, Tyco and Xerox in other countries due to corporate governance weakness introduced need to proper corporate governance as a main issue but these failures were not the motivator of corporate governance. Some failures were rooted in 1980(Mac Sol and Ply Pac) and 1960(collapse of Play Station). This issue has led to concern of many international organizations such as International Monetary fund and demand of improvements of the firms in corporate governance (Khanche1,2007). Also, this important issue led to approve of Sarbanes- Oxley Act in US and corporate governance approved by OECD and related codes in different countries (Ghanbari,2007). ICGN offered necessary codes about international firms' strategic principles in nongovernmental elves. In other innovation, CACG approved principles of corporate governance in 1999 similar to OECD. In Iran this regulation was approved by the Stock exchange organization and all firms listed in stock exchange list shall observe these rules. Indeed, the reason for trust of the investors on businesses is rooted in transparency, accountability, justice and responsibility. In sum, bankruptcy of Enron in 2002 led to attention to corporate governance that thousands people lost their jobs. All these events caused to mistrust of the investors on the current system that influences financial system negatively. These events affected not only US but also al countries.

### **Corporate governance goals**

- increase of stockholder value
- protection of the stockholders, customers, stuff and public profits
- reliability of transparency and integration in information transfer and access to correct information
- reliability of accountability and access to privileges in all levels
- directing the firms to higher level for competition ( Jalali,2008).

### **Occupational ethics in accountancy and it importance**

The skilled accountant role is key and undeniable and it influences directly and indirectly the human life and society and survival of private and governmental organizations. The accountancy needs to approval of occupational codes since they are responsible for observing all aspects and for this reason compiling ethical codes is necessary. In this article the occupational ethical principles, progress factors and international standards, educations and moral aspects considered by the organizations and universal

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revolutions, indicators and occupational behavior are defined. At first it is necessary to respond to two questions:

What does occupation mean?

Who is skilled accountant?

In reply to the first question it should be said that there is no comprehensive definition in this regard but International Federation of Accountants has referred to following features:

- having skill based on thinking gained by education, training and experience
- following regulation and believe in common value approved by the authors
- acceptance of duties and responsibility in the society

In reply to the second question it should be said that an accountant is a person who does accountancy and possess qualities motioned in Accountancy association regulation such as auditing, tax and consulting of the public.

There are other characteristics like acceptance of duty and responsibility taking regarding the public that requires observing public benefits that leads to public trust (Code,1996:Par). From accountancy viewpoint public benefits are collective happiness and welfare of the public and institutes, investors, staff, employers and commercial and financial firms and others that rely on the accountant indifference and commercial operations (Code,1996, Par). So, skilled accountants' responsibility is not limited into meeting needs of the employers (Code,1996, Par). As a result in compiling of the accountancy standards the public benefits are considered that it needs to solve four needs:

- information reliability: the society needs to credible information systems and financial information
- introduction of skilled people: employers and other actors should identify the skilled accountants.
- quality of services: assurance of quality of services is necessary.
- trust: the users should be assured that accountancy is done conformed to approved behavior framework (Code,1996, Par).

The role of these accountants in economic clarifies necessity of observing the moral and behavioral norms in order to attract the public attention and trust (Code,1996, Par).

### **CONCLUSION AND PROPOSITIONS**

Nowadays according to globalization phenomenon the term of crisis is used in the meaning of collapse, inflation, hard and uncommon conditions in economic literature. In general, it implies unexpected problems that influences the current and future status of the organizations and affects on the planning. This term depicts important problems in the firms and the macroeconomic condition of a country that changes status of a country or intentional scope. Economic crises are divided into financial and industrial groups. The industrial crises cover inflation and unemployment and financial one involve banking, monetary, debates and international system crises.

Accountancy crisis is one of the important factors in crises. This crisis is considered as accountancy crisis. International financial crisis accountancy factors are accountancy principles (Can,2010:26). In prevention of this crisis the codes and standards and principles can be improved. In other viewpoint, deficiency in standards and codes is rooted in the managers benefits so by control of accountancy and encouragement and punishment of the managers and improve of the rewarding and wage system it can be take a step in omission of the factors leading to international financial crises accountancy factors.

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