
Financial Crisis and Accounting Information: The Need for Corporate Social Responsibility in Accounting Profession

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Abstract:

This paper wants to draw attention on several aspects regarding the causes that led to the emergence of 21st century economic crisis, pointing their implications in the balance of economic-financial mechanisms. In history, on the occasion of economic and/or financial crisis, among their causes there are mentioned causes related to managers' irresponsible actions, managers who, together with accounting professionals, chose to alter accounting data in order to create a more appealing image on the market of the company's financial status. We will underline the role of accounting in system of a more efficient, socially responsible corporatist governing, capable of recreating economic-financial balances and of regaining the confidence of the population in economic values, as well as the role of accounting in "faithfully" reflecting these values.

Keywords: financial crisis, corporate governance, financial statement, ethical behavior, users of financial information

JEL Classification: G01, G34

1. Introduction

The history of world economic crises of the last 40 years show an accelerated pace during the last half century:

Economic crisis

Period

| | |
|-----------|---|
| 1974-1975 | First oil crisis |
| 1982 | Second oil crisis |
| 1992-1993 | Recess in USA |
| 2001-2002 | Stock exchange crisis (Internet bubble) and the attack from 9/11 2001 |
| 2008-2009 | High risk mortgage loans crisis („sub prime”) |

World economic history experienced the fact that economic-financial crises were caused by the excess of confidence due to the economic growth, when old economic laws did not apply anymore and there was required a new innovational impulse that would create a new cycle of economic development.

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Technological innovations are those restarting the economic mechanisms in a new cycle of development based on technological mutations. The growth phase is explained by the emergence of fundamental technological innovations, bringing about significant production gains as well as new products. As long as the new products are available to a growing number of people from many countries, the cycle will continue its expansive phase. When markets become saturated, investments are stopped, companies shut down and recess emerges, until the next technological wave. A specific role in the emergence of scientific revolutions is held by those contractors assuming the risk of putting into practice revolutionary scientific inventions – a major risk taking into account the fact that their purpose is obtaining and selling innovating products.

Many economists spent a considerable amount of time and effort studying economic cycles. The most remarkable studies were made by Schumpeter who gathered all the studies of his predecessors. Schumpeter classified cycles, according to their duration, into three types: long, medium and short, according to the names of the economists who made a difference into this field: Kondratieff for the 40-50 years cycles, Juglar for 5-10 years cycles and Kitchin for shorter cycles. The theory of business cycles based on innovational technologies is sustained by Schumpeter (1912, 1939) or Kondratieff (1920).

Progress in transportation is considered as crucial in different historical cycles: trains in mid 19th century, automobiles at the beginning of the 20th century and airplanes after the Second World War. The new informational and communication technologies represent one of the fundamental technological waves in the history of capitalism. This technological wave refers to three areas: telephony, audio-visual and computer science. At the end of the 1990s, the phrase “new economy” was more and more used when referring to the successes of “the new capitalism”. Many analysts believe that now, at the beginning of the 21st century, we find ourselves in an ascending phase of a new long cycle caused by the computer science technology developed in the fever of investigating space trips, the solar energy technology, environment protection technologies and the central role gained by human resources.

Peter Drucker (1999) said: “We can be sure that the world emerging from the present rearrangement of values, beliefs, economic and social structures, of concepts and political systems, in other words, of the way we see the world, will be different from anything anyone could imagine today. In certain fields and especially within society and its structure – fundamental transformations already took place. The fact that the new society will be a non-socialist one, as well as a post-capitalist one it is a fact. And it is also a fact that its primary resource will be *knowledge*”.

Actual transition from an industrial society to a “post-modern”, “post-industrial” “post-Ford”, “post-capitalist”, “post-structural”, “post-traditional”, “informational” or “knowledge” society is characterized by complex and profound transformations in all fields of activity, with great *economic, social and environmental* implications on the way to a durable development of the society (Sabau, 2001).

The concept of durable development emerged quite recently out of an acute need for responsibly thinking future and is currently accepted and supported world wide. Durable development is an approach that has as goal the balancing of social, economic and environmental issues using as key point social responsibility in corporatist governing in general, including social responsibility in terms of accounting, in particular.

2. Great Financial Scandals At The Beginning Of The 21st Century And The Crisis Of Distrust In Managers And Accounting System: Causes And Morals

The beginning of the 21st century was an agitated one as far as world economic-financial life is concerned. There were many financial scandals caused by the bankruptcy of great corporations starting with 2001 (Enron Corporation) and continuing after 2002 (WorldCom, Qwest Communications, Allied Irish Bank, Adrlphia, Global Crossing, Merrill Lynch, Nortel, Parmalat, Xerox, Fortis). The succession of these manipulations of financial information worsened the stock market crisis that followed in 2002. At the end of 2002, observers noticed that the main stock market parameters decreased with more than half their values since March 2000, triggering a decrease of stock market capitalization, evaluated at 7000 billion US dollars for NYSE.

2.1 Investigating the causes of failures in the case of Enron, WorldCom and Parmalat

We will mention only several financial scandals and some of the causes that led to these failures:

***Enron (2001)**

Enron, a multinational company, activating in the power industry, was the first power company to assign the administration of contracts with suppliers and consumers to financial intermediaries, a fact that enabled the adaptation of power requirements to diversified needs. Enron was renowned for its extraordinary innovations that led to significant mutations and changes of power industry. They developed 400 types of new financial products that generated high risks and gradually worsened the status of the company.

The push to failure was made by Moody's that, planning to evaluate Enron's debts, determined the latter one to pay its bank loans, loans that were made on the ground of its stock. Shortly, Enron went from a 60 billion US dollars company to a bankrupt company in 2001.

Among the accounting practices from within the Enron group intended to unrealistically increase the value of the society, we can notice the raising of turnover by taking into account the total power sales value and not only the commission, as

stipulated by the accounting standards in the specific case of an intermediary company; the circulation of assets between the company's elements in order to create unrealistic value pluses; the deconsolidation of liabilities by transferring them to the thousands of companies controlled either by subsidiaries, or special purpose entities: SPU; the displacement of profit in order to avoid taxation (almost all these companies were in 'fiscal paradises').

Financial figures were intentionally manipulated for creating a financial value more appealing to stockholders, who are not directly involved in the process. These figures were audited by important audit companies, such as Anderson (among the Big Five of audit companies at that point).

***WorldCom (2002)**

WorldCom was one of the pioneers in the 90s economic boom, mostly based on IT and telecommunication companies. They were the second operator for landlines in USA and they ensured the circulation of half of the traffic through internet. Moreover, they were one of the telephony service suppliers of Pentagon and The Federal Aviation Administration.

With Bernie Ebbers as manager, the company entered a vast campaign of merging and purchases, which culminated with the purchase, in 1998, for about 37 billion dollars of its competitor MCI. Thus, WorldCom, which, when founded in the 80s, was only a small regional telecommunications operator, became a colossus of the IT&C world, with a portfolio of clients including many of the top 500 wealthiest corporations but, at the same time, suffocated in debts.

Things started to worsen for WorldCom even from the end of April 2002, when Ebbers, founder and president of the company, was forced to resign, being involved in a scandal referring to the 400 million US dollars borrowed from the company. Once the management was changed, a new audit report was required and there were discovered fraudulent accounting manipulations that over-estimated profit and the value of company's shares. The fraud mechanism was quite simple and consisted in the fact that, against all accounting principles, a great amount of current expenses (expenses for performing basic activity) was acknowledged as capital expenses (investments). This meant that these transactions, in stead of being immediately discharged, they were stretched for a longer period of time. In this way, the company's expenses are underestimated, at the same time leading to an over-estimation of profit, thus generating a very favorable image of the company on the market.

At the time when they went bankrupt, WorldCom owned assets of 104 billion USD, thus representing the greatest disaster in the history of the United States, far greater than Enron. The bankruptcy was declared in July 2002. The former star of New York stock market, which on July 1st 1999 had 64 USD/share, in about 3 years (July 19th 2002), had only 0.08 USD/share. The auditing of financial statements had been performed, just as in the case of Enron, by Andersen Company.

***Parmalat (2003/2004)**

As far as Europe is concerned, there is the case of Parmalat, no. 1 in Italy's dairy products industry. The company was founded in 1961 and, in 2002; it had 36.000 employees and a sales volume of 7.6 billion Euros. Parmalat fell in December 2003, when there was discovered that a 5 billion dollars bank account supposedly owned by the company did not exist. In only a few weeks, Parmalat (also involved in tourism and an important football club) collapsed in huge debts.

Managers, together with bookkeepers and auditors falsified accounting data, manipulated the market and misled the regulating authority for the Italian capital market.

The Parmalat collapse led to huge losses, which are not even completely known yet, but they are considered to be even bigger than those of Enron, reason why Parmalat was also called "Europe's Enron".

2.2 Vulnerabilities of the accounting system in the context of economic crisis from the beginning of the 21st century

All these scandals actually demonstrated the fragility of the entire plied of procedures and methodologies, regulations and supervision organizations under the circumstances in which financial data were "adjusted" for showing a more appealing image to shareholders, the main beneficiaries of financial information. The situation is so much serious as these "adjusted" figures were backed up by world wide renowned audit companies (Anderson was one of them). This proves the quasi-general character of the problem.

On this subject, ACCA (Association of Chartered Certified Accountants) students' review from Great Britain presents in their September 2002 issue, under the title "2002 – a very bad year" (Gosling, 2002), the "unfortunate accounting errors" with Enron, WorldCom, AOL Time Warner, Qwest, Xerox, Kmart, Vivendi Universal etc., errors that influenced their results with a global amount of tens of billions USD, an amount comparable to Romania's GDP (Svasta , 2009).

As a matter of fact, in February 2008, the audit report of Merrill Lynch includes the following statement made by the auditor: "we believe that Merrill Lynch maintained, in all material aspects, an efficient internal control of the financial reporting system on December 28th 2007" (Deloitte & Touche LLP), while in September 2008 the financial institution founded in 1914 collapses and is bought in extremis by Bank of America (Svasta , 2009).

The question raised is rhetorical. Can anyone have the guarantee of a faithful accounting image, even in the case of audited financial statements? And what can be done?

Moreover, these financial scandals question the ability of society and public authority to naturally limit or reduce unethical or dangerous behavior of certain participants to the economic life. A possible answer to this question would be the

putting into practice of the concept of corporate social responsibility (CSR). The European Commission already makes an effort to integrate CSR in the strategy for growth and occupation.

The financial scandals previously mentioned also confirm the crisis of distrust in the correctness of accounting financial information, which do not present of the sides of performance and showed *the dissociation between accounting, ethics and managers' responsibility* (Phillips, 2003).

Due to the causes of the financial failures of beginning and end of the 21st century, investors lost their confidence even in the case of audited financial statements. Regaining their trust in financial statements remains a goal to be reached by the present system of corporate governing. In this sense, it is relevant the study performed by Nugent (2007), a distinguished member of ICAEW (Institute of Chartered Accountants in England and Wales), referring to the existence or lack of a significant trust of investors in financial statements. His conclusions, several years from Enron and post-Enron bankruptcies, are the following (after Bota-Avram, 2009):

➤ In the United States of America, only 28% of investors have a great trust in the reality of audited financial statements, while a majority of 64% has a reasonable trust and 8% of the investors have little or no trust in audited financial statements;

➤ In Great Britain, the trust in financial statements is a little higher. Thus, more than half of the investors in Great Britain (51%) have high trust in financial statements, while 43% have reasonable trust and 6% have little or no trust in audited financial statements.

According to the study presented above, we may say that, despite the financial scandals from the beginning of the 21st century, financial statements as informational instrument on companies' activity are considered as fundamental components for evaluating the company's performance. Even if the confidence in their veracity was dramatically reduced, it still holds a significant position. Nevertheless, we should take into account the fact that this study was performed just before the great financial crisis begun and, under these new circumstances; it is most likely that its results would not be the same today. But what does world crisis bring?

3. The World Economic Crisis Beginning In Usa At The Beginning Of 2007 And The Crisis Of Distrust In Managers And Accounting System: Causes And Morals

The current economic crisis begun as a problem of sub prime lending occurred in USA, in summer of 2007. After a short period of time it reached the entire world economy. The USA holds 26% of world GDP, being, at the same time, the main global consumer. That is why it was expected that an American crisis would have a strong impact on Asia, Europe and Latin America markets.

Sub prime lending (having high risk) represented the starting point for loans crisis. Investors, trying to get rid of financial products based on the system of "sub

prime lending”, directed investments towards speculations based on the price of the basic goods. Thus, more and more critical situations occurred, expressed in dramatic decrease of prices in real estate transactions. Gradually, the volume of liquidities available on the global credit market recorded sudden and significant decreases, a fact that led further to a decrease of the trust in the financial system, an increase of credits’ price, more and more reduced access to credit market resources. There emerged the so-called “credit crisis”, which further transformed into a global economic crisis.

The beginning of this crisis was marked by the bankruptcy of some local banks from US: February 2nd 2007, Metropolitan Savings bank from Pittsburg, Pennsylvania; September 28th 2007 Net Bank from Alpharetta, Georgia; October 4th 2007 Miami Valley Bank from Lakeview, Ohio. The first important bank that went bankrupt was New Century Financial, specialized in sub prime real estate, being the second mortgage financing institution in USA. It was followed by the collapse of investment bank Bear Sterns in spring of 2008. They were saved from bankruptcy by Fed intervention, which supported with 30 billion dollars the purchase of the investment banks by JPM Morgan Chase (Batrancea, 2009).

These were followed by the nationalization of the British bank Northern Rock for the amount of 3 billion pounds and the intervention of Fed with the 2 giants, Freddie Mack and Fannie Mae, with a federal help of 100 billion dollars. In September 2008 Lehman Brothers went bankrupt, Meryl Lynch is taken over by Bank of America for 50 billion dollars, AIG announces they intend to sell 20 billion dollars shares in order to correct the 35% decrease of their shares on New York stock market.

The bankruptcy of the investment bank Lehman Brothers, the fourth financial American institution, was the greatest in American corporate history, far beyond the 2002 collapse of WorldCom and the 1990 collapse of Drexel Burnham Lambert. The institution, founded in 1850, was forced to ask American authorities for protection after the company’s market value decreased in 2009 with almost 100%.

Central banks from more and more national economies had to inject important amounts in order to ensure the survival of bank systems and, in order to fight back the effects of liquidity crisis, they had to create financing plans for supporting bank systems, the nationalization of great international banks, such as the establishment of higher demands for collaterals in covering the deposits held by the populations.

The scale of these financial earthquakes that shook the financial economy of the latter three years is very well shown by Peston who says that: “global financial economy has never been subjected lately to such tests consisting in a mixture of fatal combinations of accidents and trust testing” (Peston, 2008).

3.1 Investigating the causes of present global economic crisis

“The present economic crisis is the result of the activity of a bank and financial global segment with incorrect regulations in which managements overestimated the growth of companies’ profit, but also personal welfare, thus creating a culture of an unprecedented risk assuming. Toxic financial products, of “new engineering”, based on debts, created the illusion of value by “wrapping” high risk assets (for example, mortgages on over-evaluated properties of people who could no longer afford them) and presenting them on the market as high values with low risk and high profit. Thus, the prices of properties in USA begun to collapse and owners could not afford to pay their loans, which were held by the global financial system. They turned into vulnerable assets with a questionable value. Under these circumstances, financial-banking institutions were forced to reconsider their positions, since they faced major losses, lack of liquidities. The ones over exposed collapsed. The after effects reached eventually real economy where investments are more and more difficult to achieve and trust in companies eroded” (Hardisty, 2008).

In the history of world economy there was experienced the fact that financial crises were caused by the excess of confidence generated by economic growth when the old economic laws did not apply and management confronted with a lack of adequate counteraction strategies and policies. This approach is sustained by the specialist of World Bank, John Hegarty, (Hegarty, 2009), who says that “at the root of the collapse of the market lies the optimism felt during a long period of growth, low interest rates, volatility, as well as the failure of policies referring to:

- ✓ *Financial regulations*, which were not able to notice the concentration of risks and adverse initiatives in the background of the boom of financial innovation

- ✓ *Macroeconomic policies*, which did not take into account the accumulation of systemic risks within the financial segment and on real estate market

- ✓ *Global financial architecture*, where a fragmented supervision system completed the incapacity of identifying growing vulnerabilities and liaisons”

In a 2008 report of The Authorized Accounting Professionals Association, there are identified two major categories of determining factors that triggered the credit crisis in USA:

Main factors:

- ✓ Failure of corporate governing (shareholders’ interest should come first)

- ✓ Failure of institutions to appreciate and administer correctly the existing interconnections between the inherent risks of a business and the remuneration and incentives system, which were not created to the best interest of shareholders;

- ✓ Errors in the process of risk identification and administration;
- ✓ Weak influence or even a minimal power of risk management departments within banks;
- ✓ Weaknesses of the financial reporting and regulation system.

Secondary factors:

- ✓ Far too high complexity of financial products, together with managers' poor experience as far as risks associated to these products are concerned;
- ✓ Human errors expressed in failure to understand cultural influences and motivational factors such as rigidity in thinking and lack of desire to adapt to change;
- ✓ Lack of management's correct understanding in planning business models, leading to a poor management supervision;
- ✓ Lack of a more rigorous supervision from the non-executive managers, a possible cause being the inadequate understanding of the complexity of the business;
- ✓ Inadequate habits resulting from a market that has been too long a fertile medium for speculative transactions.

As a conclusion, we may trace several *driving forces* that led to the propagation of the economic-financial crisis:

- ✓ Inadequate macroeconomic policies and unsustainable models of economic development;
- ✓ Nationalization as temporary solution for surpassing liquidity crisis followed by the reversed process for balancing risk distribution between the public and private segments;
- ✓ Lack of discipline of financial institutions and rating agencies in providing information regarding risks and assets' value;
- ✓ Market regulation and supervision;
- ✓ Tight cooperation between supervision and regulation agencies (taking into account the global character of the financial crisis);
- ✓ Making governing mechanisms more efficient for a better risk management;
- ✓ Deficiencies in corporate governing systems and inadequate risk administration;
- ✓ The incapacity of supervision and regulation agencies to cope with financial innovations;
- ✓ Perfecting the accounting and supervision regulations for financial institutions in order to counteract mainly the inadequate connection between the issuers of accounting and audit standards;
- ✓ Existence of deficiencies in financial reporting and regulation (especially as far as extra-balance instruments are concerned)

3.2 Searching solutions for fighting back the present crisis

Looking for anti-crisis solutions became a challenge for all economic-financial institutions. The prime minister of UK, Gordon Brown, declared in March 2009, at the meeting of The Group of Twenty (G20) that “Europe holds a special position in the world for responding to the new challenges of globalization precisely due to the achievements obtained by The Union during the past 60 years: the largest single market, which includes over 500 million people, a successful economic cooperation unique in the world, the most complex framework for environment protection, as well as the most ample program of development”. At this reunion, the Chairman of the European Parliament, Hans-Gert Pötering, in his introductory speech, declared: “The G20 reunion of April 2nd in London offers a vital opportunity for the leaders of the industrialized world and those of the emergent countries to work together in creating a mutual agenda required for economic stability”.

In this context, the anti-crisis solutions suggested at G20 Summit in April 2009 were:

- ✓ Rebuilding trust, development and work places;
- ✓ Repairing the financial system so that crediting can be recommended;
- ✓ Strengthening financial regulation for trust building;
- ✓ Financing and reforming international financial institutions for surpassing crisis and preventing future ones;
- ✓ Promoting global trade and investments and rejecting protectionism as fundament of prosperity;
- ✓ Starting an inclusive reconstruction, on new and durable basis

3.3 Vulnerabilities of the accounting system in the context of the present economic crisis

Many voices state that accounting norms, even if they did not represent by themselves causal factors of this crisis, did not help preventing it. In this context, accounting is accused of supporting a distorted reality of activity and, thus, there is again questioned the credibility of the accounting profession. It is true that all financial crises are, in fact, crises of success and belong to the functioning mechanism of financial markets. Financial crises are caused by the excess of confidence generated by economic growth when the former economic laws are not applied anymore and management faces a lack of adequate strategies and policies of counteracting. So, if we consider the cyclic character of the economy, we can be resigned with this crisis and conclude that it could not have been avoided and it would have happened sooner or later.

But, under the circumstances of the development, in parallel with the development of economy, of the accounting profession, wouldn't one expect that this latter one should have been prepared correspondingly to the economic growth?

And when the first signs of lack of liquidity appeared, as early as 2005-2006, shouldn't bookkeepers have been able to draw an alarm signal?

Even if they were not direct causes, many authors mention, among the causes that maintained and triggered financial crisis, also other causes referring to *accounting practices*, such as:

- ✓ The incapacity of the accounting model to cope with these innovations enabled the putting out of the balance sheet of certain financial assets;
- ✓ Issues referring to assets' recognition, determining the entities included in the consolidation perimeter and de-consolidated entities;
- ✓ The complexity of certain hybrid instruments increases the difficulty of their adequate evaluation;
- ✓ Fair value and its pro-cyclic effects.

Analyzing the causes of this crisis in the context of accounting practices, there were many who said that an element with a major role in the perpetuation of this crisis was generated by the use in accounting of the concept "fair value".

Among those sustaining the usefulness of "just value" as evaluation basis in accounting, there is Sir David Tweedie, Chairman of International Accounting Standards Boards. In one of the reports issued by IASB, he said: "the role of accounting is that of reflecting facts and not that of ensuring stability when this does not exist" (IASB, 2008, after Bota-Avram 2009). This conception is shared also by significant representatives of financial audit, such as Richard Sexton, one of PricewaterhouseCoopers managers, who comments: "the role of accounting is not that of creating reality, but of reflecting it as it is".

In this context, many specialists bring solid arguments *pro fair value*, so that "fair value" should continue to be considered as basis for evaluation of accounting:

- ✓ It is the only basis for evaluation that includes derived instruments;
- ✓ It limits the practice of marking earnings by discretionary selling assets;
- ✓ It is more desirable an imprecise system based on fair value, than a precise but irrelevant historical cost;
- ✓ The inexistence of active markets does not justify the abandonment of the fair value, but the development of evaluation methodologies;
- ✓ Fair value did not generate financial crisis and its abandon will not sole problems;
- ✓ It is not justified to transfer the discourse in the segment of maintaining capital. Why are not capital maintaining tests reconfigured?
- ✓ Discarding fair value when markets are decreasing would deprive investors of useful information and would affect the impartiality of accounting and the independence of the normalization agency.

Among the arguments *against fair value* brought by various authors, we may enumerate:

- ✓ Fair value cannot match the precision of the historical cost;
- ✓ Lack of active and liquid markets makes fair value a subjective one;
- ✓ Risks implied by using models (past is not an acceptable basis for predicting the future);
- ✓ It does not reflect management's intention of keeping the asset, but only of selling it;
- ✓ It provides the perspective of market participants and not that of the company;
- ✓ The purpose of accounting is not that of evaluating the company (this is the job of the market);
- ✓ When market decreases, the evaluation based on fair value can determine the not meeting capital maintaining criteria;
- ✓ Fair value is pro cyclic, in the sense that it accelerates market decrease by encouraging sales for meeting capital requirements.

All these have the purpose of winning back the investors' trust in the accounting profession and in corporate management with social responsibility. But this can not be achieved unless by adopting certain measure that would ensure more transparency, more public supervision, in the context of neutral accounting regulations, independent of interest groups.

4. Stakeholders' Need Of Financial Information And Financial Statements

The general framework for drawing up and presenting financial statements elaborated by IASB (par.7) stipulates the fact that accounting information should satisfy the informational necessities of a group of main participants to economic life (stakeholders): *current and potential investors, employees, financial creditors, suppliers and other commercial creditors, clients, government and its institutions, as well as the population.*

Even though the information included in synthesis financial statements (product of financial accounting) are generally addressed to external users, *the corporate governance* of the company also uses the information included in financial statements in order to achieve its goals. According to OCDE, "corporate governance represents a set of relationships between the management of a company, its Administration Council, shareholders and other interested parties". In other words, corporate governance consists in the system through which companies are managed and controlled. As a result, the seven categories of financial statements users, according to IASB, are supplemented with *the system of corporate governance of the company.*

Accounting appears as an encoded language, addressed to only a small circle of adepts. Each of the users of accounting information manifests different requirements. The corporate governance of a company uses financial reporting as

administration and control instruments or as a communication means. Shareholders want to know if they still should trust their investment. Bankers want to evaluate the profitability of the company and to estimate the risks they assume. Suppliers need to know whether the short term solvability of the company allows them to continue, risk-free, their deliveries. The state determines profit tax and other taxation that the company has to pay. Local authorities are concerned with maintaining the economic network of their town or region. Employees and their union representatives require an analysis of the accounting results (Capron., 1994).

A more detailed presentation of the way in which accounting information included in financial statements is used by each category of users is presented below:

Table 1. Users of financial statements and their information needs

| Category of users | Economic decisions elaborated by each user on the basis of financial statements |
|----------------------------|--|
| Potential investors | <ul style="list-style-type: none"> • <i>Abstention, prudence or refusal in investing capital;</i> • <i>Decision of investing capital on the background of a friendly business environment.</i> <p>When choosing a type of investment, the factor determining the investors' decision depends on the <i>interest</i> followed in the respective company. Therefore:</p> <ul style="list-style-type: none"> ▶ If it is followed the development perspective of the company, respectively future development, the investors to be (or majority shareholders, in the case of already existing investors) will be interested in <i>the level of the period's result that will generate a future increase in shares' value.</i> ▶ If it is followed the immediate gain within a 12 months period of time, that is an earning of distributed <i>dividends</i> type and earnings resulting from exchange rates, potential investors (or shareholders, in the case of already existing investors) will be interested in the level of this type of earning. |
| Current investors | <ul style="list-style-type: none"> • <i>Maintaining, increasing or reducing invested capital;</i> • <i>Total withdraw of invested capital;</i> • <i>Control of the obtained results of profit and dividends that can be distributed.</i> |
| Employees (Unions) | <ul style="list-style-type: none"> • <i>Jobs security;</i> • <i>A reasonable level of remuneration, correlated with the stability of the company;</i> • <i>An adequate system of insurances;</i> • <i>Providing certain types of incentives and material stimulants, including professional opportunities.</i> <p>In Note 8 of statements in „Information regarding employees, administrators and managers” are included all these</p> |

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| | <p>information. In France, at companies with over 300 employees, there is drawn even a “social balance sheet” that serves the interest of the employees. This includes information referring to:</p> <ul style="list-style-type: none"> - Employment and jobs offer; - Remuneration, participation to profit and social security expenses; - Hygiene and safety ; - Other work conditions; - Professional training; - Professional relations; - Life style of employees and their families, if it depends on the company. (N.Felegă, I. Ionaşcu, 1998: 52 – 53). |
| <p>Financial creditors (Banks and other credit institutions)</p> | <ul style="list-style-type: none"> • <i>Granting, restricting or stopping crediting, according to client’s trustworthiness;</i> • <i>Applying castigations in the case in which loans are not paid back in due time (interest rate and credit rate;</i> • <i>Requiring the starting of insolvency procedure in the case in which a certain pay back period stipulated by law is over passed (30 days).</i> |
| <p>Suppliers and other commercial creditors</p> | <ul style="list-style-type: none"> • <i>Trustworthiness of the client company (buyer) that is its solvency and liquidity, according to which they can project their policy ;</i> • <i>Requiring advance payments, letters of credit etc.;</i> • <i>Continuity of client’s activity;</i> • <i>Maintaining, increasing or stopping deliveries;</i> • <i>Annulling already closed contracts.</i> <p>Commercial creditors are, in general, interested in a company for a shorter period of time than financial creditors, unless they depend on the continuity of the company’s activity, as their main client.</p> |
| <p>Clients</p> | <ul style="list-style-type: none"> • <i>Economic-financial performances of the supplying through which there is tested the capacity of the supplying company to ensure the supplying necessity of the client company with the required volume, quality and structure of goods and services;</i> • <i>Continuity of supplier’s activity, in order to make sure that it has access to good and services on along term basis; this interest is manifested especially when there is a long term collaboration with the respective company or when they depend on it.</i> • <i>Negotiation regarding purchase contracts;</i> • <i>Maintaining, increasing or ending contracts with the</i> |

| | |
|--|--|
| | <i>supplier.</i> |
| Government and its institutions | <ul style="list-style-type: none"> • <i>Drawing ups strategies and fiscal policies</i>; the data from companies' accounting are used by financial agencies in order to determine the basis of assessment, for determining certain taxation: on income, VAT, on dividends, on wages etc. On this basis, the state calculates its national income, the GDP, the national accounts and it is able to formulate macro-economic predictions. • <i>Fiscal control</i>; in the countries where accounting is connected to fiscal, accounting information are used in the activity of control performed by fiscal authorities. • <i>Determining castigations for not paying fiscal debts</i>; • <i>Providing or stopping financial resources in state investment policy</i>; • <i>Establishing certain economic-financial indicators on a macroeconomic level.</i> |
| Corporate governance | <ul style="list-style-type: none"> • <i>Determining investment and financing policy</i>; <ul style="list-style-type: none"> - <i>Increasing solvability and financial autonomy</i>; - <i>Strategy of reimbursing debts and recovering accounts receivables</i>; - <i>Ensuring short and long term financial balance</i> • <i>Determining wage policy</i>; <ul style="list-style-type: none"> - <i>Personnel strategies: training, hiring, firing</i>; • <i>Determining the commercial policy</i>; <ul style="list-style-type: none"> - <i>Strategies for choosing the best commercial partners</i>; - <i>Strategy for recovering accounts receivables</i> - <i>Improving the image of the company through</i>: <ul style="list-style-type: none"> ✓ <i>Increasing products '/services 'works' quality</i>; ✓ <i>Observing the contractual clauses drawn with commercial partners</i>; ✓ <i>Advertising</i>; ✓ <i>Increasing the commercial fund.</i> • <i>Identifying the ways of improving activity, correcting deviations from objective parameters</i>; • <i>Establishing short and long term strategies</i>; • <i>Knowing and avoiding bankruptcy risk.</i> |
| Population | <p>The financial stand of the companies is a major interest for the following categories of population:</p> <ul style="list-style-type: none"> • <i>Financial analysts „make figures speak”</i> when their opinion is required on giving or refusing a loan, purchasing shares, launching a new products, diagnosing the “health” of a company; |

| | |
|---|---|
| | <ul style="list-style-type: none"> • <i>Political representatives of local communities</i> are interested in the financial stand of companies for calculating their contribution to local economy, forming labor, tendencies related to the company's prosperity and its field of activity etc.; • <i>Environment agencies</i> are interested in the non polluting policies promoted by companies, respecting the environmental norms; • <i>Consumers' protection offices</i> are interested in the justification of price increase, the report quality-price for goods and services etc.. |
| <p>Courts of law and need for proofs in courts</p> | <ul style="list-style-type: none"> • <i>Judiciary accounting expertise</i>, based on financial statements in the case of litigation between the participants to the economic-social activity. Through accounting there is pursued the determination of truth and a fair solving of the trial, starting from the investigation of documents and accounting records. Due to the fact that accounting information is based on documents, accounting represents a means of evidence in business milieu. |

“Even if not all user's requirements for information can be satisfied by financial statements, there are requirements common to all users”, is underlined in IASB General Framework, paragraph 10. At the same paragraph there is mentioned the fact that “Since investors are providers of risk capital for a company, providing financial statements that satisfy their necessities will also satisfy the majority of other users' necessities”.

Precisely this orientation of the content of financial statements for satisfying especially the accounting information needs of **investors**, was the impetus to use “creative accounting” techniques or financial manipulations for artificially increasing the performances of the company, and, implicitly, its stock market performances. In this context, an important role in creating the causes of the great financial crises previously presented was held by:

a) *financial engineering* venturesome used for creating value for shareholders (piling up of financial assets, with no industrial basis, intended to create stock market value for shareholders by all means: merging-purchases, venturesome financial actions, share redemption, hazardous use of financial derivatives with the assuming of complex risks;

b) *the insufficient evolution of the financial-accounting management system as compared to the current economic-financial business system* so that:

- on the one hand, the supervision of risks engaged in financial businesses can not be handled by financial managers and
- on the other hand, the accounting system in the current period of unprecedented informational revolution based on knowledge does not succeed anymore to absorb, with adequate methods and

techniques, the entire palette of transactions and financial engineering for the purpose of reflecting a “faithful image” in accounting.

c) *The insufficient development of a corporate governance model* that would maintain a balance between shareholders’ objectives and the objectives of the other categories of participants to the economic life

5. What Can Be Done?

The crisis of developed market and chain spreading of its effects since 2000, launches the permanent and global challenge from the company of insuring a high quality *corporate governance and a financial reporting*, which apparently is neither a regional problem, nor an accidental one.

5.1 Corporate governance and the need of corporate social responsibility

We appreciate that, during the process of investigating the system of solutions for overcoming crisis, one should pay special attention to the investigation of the solution for making corporate governance more effective. In this sense, the key point in adopting the company’s management policies should begin with the “Triple Bottom Line” approach, meaning the maintaining equilibrium between *the three pillars*:

❖ *Achieving economic objectives*; that is the maximization of performances for shareholders. This goal can be reached on the basis of traditional financial-accounting criteria (based on profit, cash flow, rate of return) or criteria derived from the theory of creating value for shareholders (Economic Value Added, Market Value Added).

❖ *Accomplishing social objectives* implying the maximization of performances for all the participants to the economic life (stakeholders), that is from employees to the community, from suppliers to clients and from investors and creditors to the state and from managers and corporate governing, keeping in the center of attention shareholders.

❖ *Accomplishing environment objectives* what implies the unfolding of an activity that should not affect the community and environment, thus developing optimum environment performances, as a result of their activity, companies can be held responsible for a number of residual result, noise, pollution, soil contamination, water contamination. In this sense there can be adopted an eco-compatible behavior through environment protection measures, preserving natural resources, ISR. Moreover, companies may encourage and support environment protection procedures by imposing international and/or European norms regarding management and products for suppliers from their supply chain. Another example is represented by investments and localization of production capacity in other countries, this being able to determine a direct impact on the economic and social development of these countries. Thus, it is

supported the durable development of the entire society, according to limited resources and environment.

Achieving a corporate governing based on the three pillars of performance (economic, social and environment) requires the adoption in practice of the concept of *corporate social responsibility (CSR)*, a concept with broad applicability in the current economic context.

But what does corporate social responsibility mean? How could one define this concept?

Adopting social responsibility in business appears as an answer to the strong economic, social and legislative pressures on companies' activity, an answer to the industrial revolutions that marked world economy, culminating with the economic crises we mentioned. In order to find solutions for overcoming crisis, economic life should be rearranged on new values. It was required a process of remodeling action behavior and modalities. Companies started to understand and to accept the idea that, in order for a business to succeed, companies should offer and provide adequate work conditions, should ensure collective rights to their employees and should cooperate with unions, non-governmental organizations and governmental institutions.

Corporate responsibility is actually a complementary and effective agreement between the company and the society where it unfolds its activity. CSR is defined by the way in which business milieu aligns its values and expectancies with society's needs and requirements. This includes not only clients and investors, but also its employees, suppliers, community, the state, groups of special interest. In other words, this is society as a whole. CSR is, in fact, the way in which business milieu commits to align itself to the expectations of society.

The Romanian economist Mihail Manoilescu was one of the main promoters of this doctrine in Europe, publishing in Paris, in 1934, the book *Le Siècle du corporatisme. La doctrine du corporatisme intégral et pur*, where he analyzes from a historical, economic and social point of view the basis of corporate doctrine. In the new economic space of the 21th century, corporate social responsibility holds a central position.

Companies from strongly industrialized countries demonstrated, especially after the 50s, their weaknesses in correctly taking into account the fundamental needs of the society – laor, food, life quality, the necessities of the present generation and of future ones. Nowadays, population and civil society believe that it is not longer enough for a company to asert that its only concern is with creating profit for shareholders, as long as they use operations that fundamentally affect (either in a positive or a egative way) the life of the community where they act. In this context, a growing number of companies adopt CSR, as part of their organizational structure and business strategies. More and more organizations begin to be aware of the fact that they can contribute to a sustainable development, managing their operations so that they would achieve economic growth and fair play and at the same time ensuring environmental protection and promoting social responsibility, including protection of the consumers' interests.

On an international level, United Nations Organization, European Union and the Organization for Economic Cooperation and Development are three of the most important institutions that became involved in drawing up a framework that would define CSR and would determine indicators through which this could be evaluated in a transparent way. CSR is a very broad concept, which begun changing the world we live in. The nowadays society is interested both in the financial results of companies, as well as in the way in which they conduct their business.

From the point of view of the extent to which corporate social responsibility can be applied, this can refer to:

❖ *Fair commercial practices*, according to the writtent and unwritten rules of market economy, towards business partners, suppliers and consumers;

❖ *Observing laws*; without respecting the legality of actions, including through the prompt and qualified intervention of supervision instruments for solving conflicts and enforcing justice, the corporate system loses its security and legitimacy for all social layers;

❖ *Adequate work conditions and observing the rights of the employees*; according to the new management approaches regarding the safety of human capital;

❖ *Rational ecological administration*, as major objective of durable development, through actions for environment protection, using different methods and instruments for:

- evaluating the impact on the environment of the used production procedures and technologies;
- adopting the necessary precautions and establishing emergency plans if required;
- participating to the elaboration of environment policies;
- including ecologist objectives in commercial strategies and current activities;
- organizing ecological trainings;
- informing the population;
- participating to the life of the community – “company as citizen”, using different forms of support and help in solving community problems.

Returning to the interest of the various categories of users (stakeholders), the corporate social responsibility applied in the relation with these categories, may be delimited according to the category of users, as follows:

✓ Corporate governance: accomplishing social objectives should refer first of all to the level of the structure of corporate governance through: ensuring the independence of administrators and managers from different levels, observing shareholders’ rights, information transparency, a system of efficient internal control and audit, characterized by transparence and independence.

✓ Clients: the balance between quality and price, the correct and on due time informing, ethics and balanced contractual relations;

- ✓ Employees: jobs, incentives (bonuses, promotions), work hygiene and safety;
- ✓ Creditors: payment on due date of credit rates and corresponding interests;
- ✓ Suppliers: ethics and fair contractual relations;
- ✓ State: payment on due date of taxes, environment protection, observing the laws;
- ✓ Population: job opportunities, development of the local market, healthy environment, sponsorships.

The key points of CSR include business management, supply chain management, environment protection, standards referring to the relations with employees, with the community, human rights and social equity. CSR does not represent only the fulfillment of an obligation towards the society; it can also imply a real advantage. Thus, by using an efficient program of social responsibility, companies may enjoy the following advantages: increase of their chances to access capital, improvement of their brand image, sales increase, attracting, maintaining, motivating and training personnel, improvement of the decision making process, improvement of risk management and cost reduction.

Taking into account the always growing interest referring to the risk implied by the environment, as well as the issues related to different products and services, it is obvious the fact that a company has to ensure social responsibility in order to facilitate the socially sensitive image of a company.

5.2 Ensuring a quality financial reporting

As far as the strengthening of the financial-accounting is concerned, at the April 2009 G20 Summit, there were concluded the following:

- ✓ The issuers of accounting standards should speed up the collaboration with regulation and supervision agencies in order to improve the evaluation standards and to provide and obtain a unique set of high quality global accounting standards;
- ✓ Once the come-back is ensured, there are required urgent measures for improving capital quality, quantity and homogeneity on an international level. For the future, regulations should prevent excessive outturns and to stipulate the formation of a resources reserve”.

Thus, in the context of world economy globalization, it is necessary, now more than ever, a convergence of the two great accounting systems: the Anglo-Saxon system and the Continental system, with the elimination of their weak points and retaining their strong points, validated by the present crisis of each system. It is necessary that all the accounting professionals should be united, should be open to discussions and idea exchanges in order to found a viable accounting system.

There were concrete actions in accounting performed by the various agencies of accounting profession. In this sense, the actions of the International

Accounting Standards Board (IASB) adopted as a result of the financial crisis, were expressed through the following (IASB, 2008):

- ✓ On October 31st 2008, the publishing of the results obtained by the group of experts regarding the evaluation based on fair value under the circumstances of an inactive market;
- ✓ On December 18th 2008, issuing a standard referring to consolidation issues;
- ✓ In March 2009, IASB suggests a new approach for acknowledging and increasing information for elements out of the balance sheet;
- ✓ In March 2009, increase of requirements regarding fair value and the risk of fair liquidity;
- ✓ In March 2009, IASB clarified the approach of included instrument on the occasion of the reclassification in and from the category of financial assets evaluated on the basis of fair value.

International Ethics Standards Board for Accountants – IESBA within IFAC drafted a strategic action plan for January 2008 – December 2009, for fighting the negative effects of the crisis. The declared objective of IESBA is that of “serving the public interest by determining high quality ethical standards for accounting professionals and facilitating the convergence of national and international ethical standards, thus pursuing the increase of quality and services provided by the counting professional” (IESBA, 2008). The main measures stipulated in IESBA action plan (2008) refers to:

- ✓ *Reviewing the Ethical Code of the Accounting Professional* issued by IFAC, especially the requirements referring to insuring his independence, but only after a period of stability, estimated around the beginning of 2010;
- ✓ *Improving the communication* with law givers, norms givers, leaders of professional accounting organizations, members of the profession with other parts interested in the convergence of national and international standards;
- ✓ *Organizing public consultations* on three major projects for the period starting with 2009, such as:
 - Frauds and illegal acts;
 - Conflicts of interests;
 - Insuring support for implementation.

The International Ethics Standards Board for Accountants (IESBA) held recently on March 29, 2010 at New York, to discuss all the weakness which have met before in adopted the *Code of Ethics for Professional Accountant*. The work plan for 2010-2012 includes the IESBA's intention to complete two high-priority projects from its previous work plan:

- *Conflicts of Interest*. The IESBA will expand existing guidance for professional accountants, whatever their role, who face

conflicts of interest. This will include the types of situations that give rise to conflicts, the mechanisms that can serve as safeguards in a conflict situation, and ways to manage conflicts; and

- *Responding to Suspected Fraud or Illegal Acts.* The IESBA will provide guidance for all professional accountants on how to respond when encountering a suspected fraud or illegal act. This will include the threshold for taking action, the types of actions that may be taken, the process for responding, and the timing of any disclosure.

The IESBA also plans to begin a project that addresses the application of the "related entity" definition in the IESBA's *Code of Ethics for Professional Accountants* (the Code) to audits of collective investment vehicles.

In addition to its standard-setting activities, the IESBA plans to continue to assess what additional material or activities would be useful to support those who are adopting and implementing the Code. To further its objective of facilitating convergence of international and national ethical standards-including independence requirements-the IESBA will liaise closely with national standard setters and regulators to identify and understand their perspectives on convergence and to seek their views on how the Code can be a catalyst to achieve greater convergence.

An important lesson that accounting profession needs to assimilate after these crises and which should mark the corporate audit activity consists in "approaching audit from a broader point of view, being identified several connections that should exist between audit, corporate governing and social responsibility of corporations: (Sikka et al. 2009). Moreover, renowned researchers (Porter, 2009) launch the idea that "the main key in ensuring corporate responsibility towards the population following their activity would be the three-lateral collaboration between accounting professionals specialized in audit activity, meaning the three categories: external auditors, internal auditors and audit committees.

6. Conclusions

The consequences of the economic crisis that came one after the other since the beginning of the 21st century, culminating with the current economic crisis were devastating. They led to huge losses suffered by the economy players, either companies, financial institutions or the state and generated major economic unbalances (decrease of global GDP, down fall of stock market parameters, increase of unemployment, increase of budget deficit in countries from all over the world, decrease of life quality). These effects became more acute in the context of the current crisis, appreciated as more disastrous than the crisis of 1930.

These crises led to the distrust of the market in the ability of companies to recover and, implicitly, to a decrease of demand, manifested by the investors in the capital market. Their confidence was betrayed and the need to regain this lost confidence is acute. The process of re-establishing world order has to focus first of all on *regaining investors' confidence*. For this purpose, the task has to consist

primarily of ensuring corporate *governance* based on *social responsibility* and, at the same time, ensuring *quality financial reporting that is believable and responsible*.

It is important that corporate governance should focus on the maximization of the global performances of the company, acting responsibly through the maximization of performances focused on satisfying the three categories of needs: economic needs (for shareholders), social needs (for stakeholders), environmental needs (protecting the environment). At the same time, it is likely important that the accounting professional should be aware of the fact that his/her attitude and behavior or, when these services have a decisive impact on communication, to adopt such a responsible attitude.

The time of the paradigm “*we are separated and competing*” is gone and its place is gradually taken by the new paradigm “*we are connected, we cooperate and we compete*”, while the impulse of the American saying “if you can’t beat them, join them” becomes the current orientation in world economy at the beginning of the 3rd millennium in all fields, including business milieu. It is time for corporate governing to act, learning the lesson of economic failures: the orientation of corporate governing towards the “separation” of shareholders’ interests from the interests of the other participants to the economic life was inefficient and irresponsible, with the final purpose of creating wealth for shareholders. The final purpose of “competing”, that is, of existing in the economic life, is ensured in both cases. The difference is represented by the durability of the business. Thus, the objectives of corporate governing succeeded, until now, to reach a limited existence of business and the proof is the sequence of economic failures. The new paradigm focuses on the long term objective achievement, under circumstances of durable development, but only if the corporate governing adopts social responsibility in relation to all the participants to the economic life.

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