



## Analysis of the Current Financial Crisis from an Accounting Point of View

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### Abstract

The subprime mortgage crisis which started from early 2007 has gradually become the evolution of the global financial crisis, thus will inevitably bring a significant impact on the real economy over the next period of time. This paper is to elaborate on how the accounting will impact the financial crisis, as well as the development of the accounting, from the point of view of accounting standards, disclosure of accounting information and the accounting measurement attributes.

**Keywords:** Subprime mortgage crisis, Accounting standards, Accounting information disclosure, Accounting measurement attributes

### 1. Introduction

In April, 2007, applies along with American New Century Financial Company to go bankrupt, symbolizes the loan crisis official eruption. In a period of time following that, the crisis was not gradually reduced as was expected. Instead, it became more and more severe. Since the beginning of 2008, the mortgage crisis became further worsened, with many old financial institutions trapped in a difficult situation. First, Bear Stearns suffered from liquidity crisis, and was finally acquired by JP Morgan at a price of \$10 per share; at the same time, Freddie Mae which took up half of the market share in US mortgage loan market went into difficulty, and was taken over by the US government in September. Later, Merrill Lynch Securities, the third largest investment bank in US, was acquired by Bank of America; the fourth largest investment bank Lehman Brothers declared to apply for bankruptcy protection due to huge loss in MBS and CMBS caused by the mortgage loans. Also, the world largest insurance company AIG was also faced with bankruptcy due to huge loss and was practically taken over by the US government. From the above cases, it proves what Green Span, former chairman of US Federal Reserves said, US is now in a unprecedented financial crisis now, with an increasing possibility in leading to economic recession.

Looking closely into this issue, we can find that many causes contributing to this crisis. One reason is that, since 911, the US Federal Reserves has cut down the interest rate for 13 times. As a result, the low interest rate policy led to bubbles in the property market. After then, the Federal Reserves began to raise the interest rate for 17 consecutive times, which then causes breaks of the property bubbles and further the mortgage crisis. Another reason is that, financial institutions are highly interest in high-leveraged investment tools, while at the same time, the government lacked regulations prior occurrence of this crisis. From an accounting perspective, the essay is going to analyze the impact of this crisis and enlightenment for the future development of accounting.

## **2. Accountant influence for this financial crisis**

### *2.1 Accountant criterion*

#### 2.1.1 Transaction finance property measurement

Regarding Chinese accountant the criterion, the financial tool divides into following four kinds: (1) includes by the fair and just value measurement also its change works as time profit and loss financial property or financial debt, if the transaction finance property and the finance are in debt (2) have invest (3) loan and the receivable fund to the due (4) may supply the sell finance property.

The transaction finance property and the financial debt, mainly is refers to the enterprise the financial property or the financial debt which will sell for the near future in either returns buys, for example the enterprise take will earn the price difference as the goal the stock, the bond, the fund which will buy from two levels of markets and so on.

International accountant the criterion request (generally for market price) carries on the value appraisal regarding the transaction finance property in the end of the period according to the fair and just value. When the current price on market is higher than the cost price, surpasses the part to count for the company works as the time income; Likewise, if the current price on market is lower than the cost price, then should be lower than the amount to include the company when the time loses, this process namely is called Mark-to-Market.

US Financial inventory accounting Criterion Committee formulates 157th accountant the criterion, requests to the finance property according to the fair and just value measurement, and will change includes works as the time statement of profit and loss.

In reality, the domestic financial organ is generally makes the disposable computation in the end of the month, regarding certain overseas throws the line, as a result of internal request by day computation investment profit and loss, therefore, Mark-to-Market is calculates day after day based on the same day market closing price, and writes down the same day profit and loss.

Explains with examples, the investment bank buys the secondary loan bond in front of the loan crisis by 98 US dollars/units, the original plan sells after the bond rise in price earns business price difference the income. But after loan crisis eruption, because this kind of bond foundation finance tool (secondary loan with collateral) has the serious issue, on July 10, 2007, US enlightens the investor service company to announce solemnly, reduces to the total value approximately 5,200,000,000 US dollar 399 kind of secondary mortgage loan bond credit rating. The same day, Standard and Poor Company also announced that, will be able to decline to 612 kind of this kind of bond rating, the total value reaches as high as 12,000,000,000 US dollars. Influence is declined which the bond rating, loans the bond the price to fall rapidly secondarily, some large-scale organization investor even does not hesitate 6 to fold or lowly price transfer, the sell secondary mortgage loan bond, the quick short stopping damages in order to. According to the above estimates, the investments abroad bank only loses in the secondary loan bond surpasses 40%.According to international accountant criterion, even if has not sold secondary loan bond, also cannot belong to has to the due class finance property, therefore still needed to carry on the corresponding property depreciation according to the market price. For example the market price is 60 US dollars/units, then needs to carry on the property according to per unit 38 US dollars to reduce records, its loss includes the company to work as directly time profit and loss. This also meant after the financial organ has the securitization mortgage property, even if has not undersold, has not realized loses money, this causes the financial enterprise dynamically to reflect thoroughly in the mortgage property aspect investment in the statement of profit and loss, but did not look like before might hide in the property debt table.

#### 2.1.2 Correlation finances grow the measurement question

Finance derivation tool is the emerging financial tool which in the traditional finance tool (for example cash, stock, foreign exchange, bond and so on) in the foundation grows, including forward, the stock, falls the time (exchange) and the option, as well as has forward, the stock, falls the time (exchange) and in the option one kind of or many kinds of characteristic structured finance tool.

Because this financial crisis involves to massively has grows about the finance the content, how grows accountant regarding the finance to measure the question, also is an unusual crucial question. If the transaction object exists actively in a transaction, the information transmission rapid, in the supervising and managing mechanism perfect market, then the present market price had reflected all public information, the present market price is the fair and just value manifests specifically, this time the fair and just value is the transaction number is multiplied by the market price; But if this derivation finance tool does not have the active market the similar derivation finance tool existence active market, if then its fair and just value should refer to the similar derivation finance tool market price, and determined after the suitable difference adjustment; If the similar derivation finance tool does not have the active market, then should use the suitable idea price model computation determination, the examination fair and just value change produces Benefit or the loss looked it is writes down the property debt table as the ownership interest to take the comprehensive income. When

uses counts the price model computation determination derivation finance tool the fair and just value, if can use the extraneous information, should better not have to use internal information.

For instance, in certain situations, under not the public transaction condition exchange produces market signals and so on market price compared to the interior estimated the cash current capacity commutation value determined the not public marked price finance tool the fair and just value possibly has the significance. Regarding certain financial tool, the enterprise in determined when its fair and just value may have two kinds of choices, take immediately settles accounts the value as the foundation, or take the anticipated settlement value as the foundation. When determination not public marked price finance tool fair and just value, with many is uses the interior to estimate the future cash current capacity the commutation value will take the measurement foundation. Regarding puts with other similar financial tool in the same place forms the combination to carry on the risk management the financial derivation tool, also is usually says "the pack" the phenomenon, this time, the single item

Finance tool fair and just value determined should consider "pack" the influence, should establish in the value foundation which the similar financial tool combines, but is not the single item finance tool may observe or in the estimate market price. Thus it can be seen, the finance grows the measurement possibly can have the person subjective ingredient, therefore the measurement price is by no means with the real value consistent, therefore will possibly have the huge uncertainty in the future to the financial risk.

## 2.2 Disclosure of accounting information

### 2.2.1 The lack of transparency and mobility in the structure of products.

International Organization of Securities Commissions (IOSCO) has issued securities of Exchange Traded species information disclosure standards, the implementation of the various countries and regions, not differences. The issuer of securities products, the founder, the guarantor, and the trustee, asset pool, trading rules, transaction information, legal instruments, after-sales service, investor education have overt and standard specification. However, many times credit derivatives MBS and CDO is not only a narrow range, but not active trading; not only in the over-the-counter transactions, but institutional investors are mostly one-on-one transactions; not only the market price formation mechanisms, and credit rating price discovery mechanism for institutions of the lack of competition; not only limited transaction information and transaction information of little value to the public; not only liability, SPV tools such as tables and clear tables conditions, and criteria and non-uniform table; not only the issuer information was incomplete, and the lack of prudent investors Review mechanism; In other words, the structure of OTC products that lack of transparency and liquidity, the price formation mechanisms and impeded discovery mechanism, form the structure of the potential risks of products.

### 2.2.2 Risk management and lack of prudential supervision

International Securities Supervisory Association organized President (IOSCO) technical committee the work team to investigate 11 large-scale international investment bank fluidity and the credit risk service situation, which has formed "about Loan Crisis Risk management Report of investigation". They found that in sub-loan market, the securities industry is only the business intermediaries, the investment through an intermediary to obtain financing and management commission, pays little attention to risk management is not only positive but also quite a few loan products in the off-market transaction, there is no high-frequency market transactions and the fair market value, it is difficult to timely management of market risk; a number of institutions had no choice but to "outsourcing" their internal risk management, reliance on credit ratings measure the risk of sub-loan products, resulting in the sub-loan crisis, many securities companies in line with statutory net capital requirement, but it can not meet the company's liquidity needs; the lack of interim financing, the ability of securities companies, but also because of the liquidity and insolvency merger, spread the risk of sub-loan crisis, the proliferation of the sub-loan crisis.

Significant changes in the external environment to the users of financial statements are now more concerned about the information disclosure requirements, such as the fair value of short and long-term liabilities from continuing operations and asset impairment calculations, to require disclosure of information by adding liquidity and credit policy information, which users of financial reports is worth special attention.

Therefore, the main body of the financial report must disclose all related to the management of credit risk, liquidity risk, market risk, capital management, as well as continuing operations in the uncertain policy. Disclosure of fair value must be the fair value is determined through an active market quotations or estimates derived using valuation techniques.

## 2.3 Accountant measures the attribute

Fair value accounting has been promoted by makers, in their view, fair value is the basis of accounting measurement, it can make a better accounting statements reflect the economic reality. Therefore, the fair value is increasingly being incorporated into the new and revised accounting standards are. However, fair value is a double-edged sword. In the market to the good, the so-called fair value of financial assets lucrative, financial institutions reflect the profit and loss

account on a lot of profit, which is easier to allow asset managers and traders the breeding of blind optimism, but also to the distribution of shareholder dividends increased by more than the impulse, these actions are not conducive to financial institutions to enhance ability to resist risks. Once the economy down, the market space to see when the value of financial assets related to underestimate the time, according to the requirements of accounting standards, financial institutions have been requested in accordance with the provision of different attributes of the assets set aside or reduce the owner's equity. This will affect the profitability of financial institutions and the level of capital adequacy ratio. In order to circumvent the adverse effects resulting from, financial institutions will be bound to intensify efforts to sell the assets. Market into a transaction that is the fall in asset prices - Extraction provision, a reduction of the rights and interests - panic selling - a further fall in prices - must continue to increase the provision for a reduction of the rights and interests and the continued provision of a vicious cycle, eventually lead to a result of these financial institutions The lack of liquidity can not solve and the problem of insufficient capital adequacy ratio and the fall. Well-known investment bank Bear Stearns and recently filed for bankruptcy protection as well as the Lehman Brothers collapse this reason.

### 3. Crisis on the impact of accounting

International Accounting Standards Board (IASB) is scheduled for October 13 in a special meeting on global credit crisis at the fair value accounting (Fair value accounting) and off-balance-sheet accounting (Off-balance-sheet accounting) for discussion and through a relaxation of fair value accounting standards. IASB amendments to IAS 39 provide that the bank which assets can be re-classified so as to avoid the need to mark-to-market (mark-to-market) results. IASB said in a statement: "the provisions of the revised, in accordance with International Financial Reporting Standards (IFRS) accounts of the enterprise board, the new criteria will be reclassified based assets."

Financial Accounting Standards Board (Financial Accounting Standards Board, referred to as: FASB) 10 later issued an explanation, further elaborated in accordance with the market price (mark-to-market) accounting standards. This explanation permission finance enterprise is higher than these property current selling price to the partial fluid low property the level to carry on the fixed price.

ASB and the United States Securities and Exchange Commission (Securities and Exchange Commission) on September 30 issued a joint statement outlined how to determine the best use of, the transaction is not active in the asset pricing. FASB published to explain the above and further clarified the application of the statement.

The Council said the move means that the listed banks in Europe and the United States compared with the industry does not place under the wind, which respond to the requirements of European finance ministers to revise the criteria for the call, and lifting their concerns.

All these phenomena show that the financial crisis sweeping the globe has changed the development of accounting, the accounting will necessarily result in the measurement and disclosure aspects of the properties to draw lessons from the financial crisis, as to how to develop in the future, we will wait and look forward to it.

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