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Akinwande AbdulMaliq Atanda and Olufunmilola Fareedat
Idowu

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ATANDA, Akinwande Abdulmalik

Strategic R&D Unit,
Datatric Research Consulting, Nigeria.
datatricng@gmail.com

&

IDOWU, Olufunmilola Fareedat

Research Consultant,
Department of Banking and Finance & Accounting,
Olabisi Onanbanjo University, Ago-Iwoye, Ogun State, Nigeria
funmigold4real@yahoo.com

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Atanda Akinwande A. and Idowu Olufunmilola Fareedat

Abstract

The ravaging global financial crises that have engulfed most developed nations and spread to emerging economies in the South and West poles of the globe have been found to emanate from United State unpaid housing mortgages. The crises have resulted to decline in consumer wealth, economic activities, foreclosures, decrease in aggregate demand and high lending defaults triggering different bail-out initiatives in most vulnerable nations. This paper evaluates the evolution of the crises, causes, effects, transmission channels and the contributions of the Accountants in the financial turbulence. On the basis of the critical assessment, proper policy outlooks were proffered like greater transparency, corporate governance, and strategic financial risk analysis, standard reporting and financial stability checks to be fostered and instituted by the international accounting standard board in order to facilitate effectiveness of the bail-out plans.

Keywords: Global Financial Crises, Bail-Out, Accounting Standards, Mortgage Crisis, Financial burbles, Financial Stability

1. Evolution of the Global Economic Crises

The Global recession, financial crises or the Credit Crunch in the late-2000s is considered by many financial analysts to be the worst financial crisis since the Great Depression of the 1930s. It resulted in the collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world. In many areas, the housing market also suffered, resulting in numerous evictions, foreclosures and prolonged vacancies. It contributed to the failure of key businesses, declines in consumer wealth estimated in the trillions of U.S. dollars, and a significant decline in economic activity, leading to a severe global economic recession in 2008 (Wikipedia, 2011).

The Global financial crisis which officially began in August 2008 as a mortgage crisis later developed into a full blown financial crisis and the prospect of its snowballing into a major economic crisis is not farfetched. This is not unexpected, because of the contagion effects of financial prospects on the other sectors and economies through international transactions and linkages (Akingunola & Sangosanya, 2011). Earlier before the global economic meltdown, the sub-prime lending was a major contributor to an increase in home ownership rates and the demand for housing in America (Maku, Atanda & Adesoye, 2009). The mortgage crisis in the United States was precipitated by pile-up of unpaid mortgages leading to foreclosure of assets to mortgagors, whose crashed values impacted assets-backed securities (financial derivatives) negatively, both within the US financial market as well as in Europe and parts of Asia.

However, Maku, Atanda & Adesoye (2009) further enumerated that the macroeconomic turbulence translated to financial-mortgage defaults by home owners hence increasing foreclosure rates. Rising foreclosure rate coupled with over building the boom years led to an excessive supply of housing and these in

turn led to decline in housing process. Once housing prices started depreciating, re-financing became more difficult and home owners began to default on loans as their loans reset to higher interest rates. Then Mortgages are repackaged as Mortgage Backed Securities (MBS) sold to financial institution (banks, hedge funds) and investors around the world. The main default of subprime mortgage debtors meant that Mortgage Backed Securities became bad loans to banks, financial institution and investors who bought these securities. Bank became unwilling to lend to each other. The bad mortgage seems to have been derived from two human needs that largely drive economic in structured society--homes and energy.

The current financial crises on developing countries have been identified to include financial contagion and spillovers for stock markets in emerging markets, decline in remittances to developing countries and the FDI as well as equity investments will be under serious pressures. Others include inability of banks (especially those under pressure) to end as much as they have done in the past, Aid budget under pressure and the capital adequacy rates of development finance institution will labour be under great pressure. The countries at the risk are:-Countries with significant exports to crises affected countries such as the USA, Asia, EU and BRIC nations (either directly or indirectly); Countries exporting products whose prices affected or products with high income elasticities; Countries dependent on remittances; Countries that heavily depend on FDI, portfolio and FDI finances; Countries with sophisticated stock markets and banking sector with weakly regulated markets for securities; Countries with a high current account deficit and with pressures on exchange rates and inflation rates; Countries with high government deficits; and Countries dependent on foreign aids.

2. Causes and Effects of the Global Financial Crises

The financial crisis was triggered by a liquidity shortfall in the United States banking system in 2008. The collapse of the U.S. housing *bubble*, which peaked in 2007, caused the values of securities tied to U.S. real estate pricing to plummet, damaging financial institutions globally. Questions regarding bank solvency, declines in credit availability and damaged investor confidence had an impact on global stock markets, where securities suffered large losses during 2008 and early 2009. Economies worldwide slowed during this period, as credit tightened and international trade declined. Governments and central banks responded with unprecedented fiscal stimulus, monetary policy expansion and institutional bailouts. Although there have been aftershocks, the financial crisis itself ended sometimes between late-2008 and mid-2009.

Also, the activities and actions of the financial analyst and accountants in the past have been established to contribute to the emergence of the global financial turmoil that engulfed both developed and developing countries like Nigeria, Ghana, South Africa, Angola and Zimbabwe etc. In a report submitted to the United States Senates, evidenced revealed that the crisis was not a natural disaster, but the result of high risk, complex financial products; undisclosed conflicts of interest; and the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of the economy. Similar findings are also reported in other engulfed nations where the global financial crises prevail.

Critics argued that credit rating agencies and investors failed to accurately price the risk involved with mortgage-related financial products, and that governments did not adjust their regulatory practices to address 21st-century financial markets. Likewise, peculiar arguments have evolved from the accounting arena that ineffective corporate governance and managerial capacity, high prevalence of financial frauds, in compliance to corporate ethics code of

conduct and financial standards resulted to the worsening of the global financial crises in developing countries.

Also, critics such as economist Paul Krugman and U.S. Treasury Secretary Timothy Geithner have argued that the regulatory framework did not keep pace with financial innovation, such as the increasing importance of the shadow banking system, derivatives and off-balance sheet financing. In other cases, laws were changed or enforcement weakened in parts of the financial system.

Increased debt burden or over-leveraging has also been attributed as one of the causes of the global financial crises. Prior to the crisis, financial institutions became highly leveraged, increasing their appetite for risky investments and reducing their resilience in case of losses. Much of this leverage was achieved using complex financial instruments such as off-balance sheet securitization and derivatives, which made it difficult for creditors and regulators to monitor and try to reduce financial institution risk levels. These instruments also made it virtually impossible to reorganize financial institutions in bankruptcy, and contributed to the need for government bailouts. Also, both market-based and regulatory solutions have been implemented or are still under consideration to reduce the economic, social and welfare effects of the global financial crises in terms of unemployment, high poverty prevalence, high income distribution gap, increase in crime rate, increase in bankruptcy and merger, foreclosure, low level of demand for financial products, capital and money market crash, low economic output and excess debt burden.

However, the effects of the global financial crises in emerging and developed economies, the economic impacts is likely to include:- weaker exports revenue; further pressures on current account and balance of payments; lower investment and growth rates; lost employment; lower growth translating into higher

poverty; and more crime, weaker health system and even more difficulties in meeting the Millennium Development Goals (Maku, Atanda & Adesoye, 2010).

3. Global Financial Crises in Developing Countries: The Transmission Mechanisms*

The channels through which the global financial turmoil affects developing countries may be classified into financial channels and real channels. The financial (direct effects) include effects through stock markets, banking sector (borrowing from advanced economies, foreign ownership of banks, exposure to sub markets) and foreign direct investment. The Real Channels (indirect effects) include effects through remittances, export, imports terms of trade and aid.

3.1 Financial (Direct) Effects

There are a number of important channels through which the global financial crises might affect SSA countries. In particular these are three direct financial channels through which this crisis might spread to SSA.

These are:-

i. Portfolio flows – The number of stock markets in SSA has significantly increased over time though is still small in capitalization, there were five stock exchange in 1989, but there are 16 currently. Some stock markets in SSA such as those in Ghana, Uganda, Kenya, Nigeria and Mauritius have experienced an extra ordinary performance over the past few years, thus attracting significant share of portfolio inflows.

The current financial crises have put these financial flows at risk. Indeed, the enhanced risk aversion of investors jointly with the tightening of global credit conditions, the deterioration of the macroeconomic and political

* Extracted from Maku, Atanda and Adesoye (2009).

environment of some countries in the region, as well as the increased volatility of capital markets and exchange rates have led to a reduction of portfolio inflows in SSA. The countries in the region mostly affected by this phenomenon have been South Africa, Nigeria and Kenya. Moreover, foreign-currency – denominated bonds issuances by SSA countries ceased in the first half of 2008, after having reach a value of US \$6.5 billion in 2007. However, lower portfolio inflows may result in only a limited number of countries with developed stock markets.

ii. Banking system – international private banking activity through both cross border lending and local market activity (i.e. lending through local affiliates) is relatively limited in SSA countries. Indeed in the third quarter of 2007 international claims (i.e. claims denominated in foreign currency) to SSA accounted for only 6% of their total amount, while in Europe and Central Asia, and in Latin America and East Asia they accounted for 43% and 20% respectively. While, SSA is less vulnerable to shocks in global interbank rates caused by financial turmoil. However, the current financial crises might affect SSA by deteriorating its domestic banks. Indeed, foreign ownership of banking sector in SSA has increased over the last decades and overall it is currently comparable to that of advanced countries. In principle, this implies that parent banks located in these countries might start to withdraw fund from their African subsidiaries in order to offset losses in home countries, this increasing SSAs banks' chances for bankruptcy and financial collapse. This is not generally correct, even through countries with a high share of foreign owned banks might be more at risk to the financial crises than those with few foreign owned banks.

iii. Foreign Direct Investment (FDI) – In 2007, net FDI inflow to SSA amounted to about US\$25 billion and according to the IMF they have continued to grow during 2008. This has been mainly due to the fact that investments in the region have offered diversification opportunities as well as return rates

higher than those in mature economies FDI flows have been directed mainly to services sectors like telecommunication and have benefited a selected number of SSA countries especially those with natural resources endowment.

3.2 The Real (Indirect) Channels

Besides financial channels, there are five real channels through which the crisis might spread to SSA. These are trade in goods and terms of trade, services workers remittance, Official Development Assistance (ODA), and effects of China and India.

i. Trade in goods and terms of trade: Before the outbreak of the financial crises, SSA countries benefited from increases in commodities prices but also suffered from it, especially from oil and primary grains. The continuous demand for natural resources (e.g. by China and India) played a major part in the effect. See the IMF's Regional Economic Outlook (REO) on Sub-Saharan Africa, October 2008 in favour of oil rich countries and agricultural net exporters. Terms of trade improve steadily throughout the region since 2003. However, the global financial crisis and lower global growth started to dampen demand for SSA's exports with the consequent slump in process. Though, terms of trade are expected to adjust sharply by the end of 2009.

ii. Services: Commodities are important for SSA economic growth. However, African growth clearly shows that there was a growth turn-around in the mid 1990s, long before commodity prices began to rise and that growth rates were roughly constant over the past five years when commodity prices increased rapidly. Indeed, there is a more complex picture of African growth as improved services (e.g. financial, tourism and real estate services) have contributed more than half of African growth in the last decade (and perhaps surprisingly a 60% contribution in the case of Zambia) with the share of services in incomes increasing by 5 percentage points over the last 15 years.

So, while SSA is expected to feel the fall out of the global financial crisis, this may go beyond the effects through lower commodity prices. There are several other channels such as the effects on recent drivers of growth including tourism and other services which will equally dampened prospects for receiving investment and remittances. According to the IMF's Regional Economic Outlook on SSA (October, 2008), SSA exports are projected to grow by only 3% in 2008 and 2% in 2009, against a value of 4% in 2007.

iv. Worker's Remittances: Remittance flows to Sub-Saharan Africa have experienced a significant growth recently, increasing from a value of US \$1.7 billion in 1995 to a value of US \$ 19 billion in 2007, an they have been a powerful poverty reduction mechanism in the region. But news suggests that remittances to Kenya (which depend on the US economy) have been hit hard, with the Central Bank estimating a 38 percent year – to – year drop in August.

According to the World Bank, the global financial crisis is expected to reduce remittances sent to SSA. Indeed, even if remittance are less volatile than official development assistance (ODA) and foreign direct investment (FDI), the significant slowdown in global growth is expected to reduce the growth rate of remittance flows to SSA from 42% in 2007 to just 6% in 2008. A rise in anti – immigration hostility during the economic downturn might worsen the situation.

iv. The effect of China and India: China and India have played an important role in SSA over the last years in terms of aid, trade and investment. China has offered loans and grant to several oil and mineral rich countries of Angola, Gabon, Republic of Congo, Equatorial Guinea and Nigeria. In the same way India has offered aid to the region especially in the IT and health sector. China and India are also among the largest trading partners and foreign investors in SSA: 13% of African exports (86% of which oil) go to China about

10% of FDI in Africa. As a consequence, the negative impact of the financial crisis on China and India will have a consequent detrimental effect also on SSA.

v. Official Development Assistance (ODA).

Official development Assistance (ODA) flows to SSA have increased since 2000 reaching a net value of US\$20billion in 2006. Some of the countries that rely on aid are mostly Tanzania and Rwanda. Indeed, foreign aid made up 30% of Tanzania budget and more than 50% of the Rwanda's national budget. Although it is difficult to predict the effect of the financial crisis in ODA, it is likely that the fall into recession and fiscal constraint of donor countries will lead to a reduction in aid flows to SSA and to the impossibility to honour the G8 commitment to double ODA to Africa by 2010. The magnitude of the impact of all the effects previously described varies dramatically among the SSA countries depending on a series of factors. The amount held of reserves, the external current account balance, the fiscal balance and the level of external debts.

4. The Way Foreword: Bail-Out and the Roles of Accountants

The resultant effect of the slowdown has posted into short fall in export revenues resulting into trade deficits and the depreciation of global currencies precipitated by external shock resulted in high cost of importation of industrial inputs translating to the high cost of production and subsequent decline in output (Akingunola & Sangosanya, 2011) and these led to urgent call for financial accountants and auditors services for strict evaluation of activities and filling for bankruptcy and firms liquidation.

However, recognizing the immediate need of government intervention policies in terms of decrease in taxation at major levels and increase in spending to accelerate recovery; also the role of the monetary authorities in stabilizing lending rate, cash flow management and efficient liquidity system, the

accountants roles in positioning the economy and the financial sectors towards the recovery path should not be under-rated and neglected. Therefore, the accountants are expected to make significant contributions in the ways highlighted as follows:

- Strict and high level of transparency and accountability in financial related activities.
- Effective corporate governance framework and systems should be instituted based on the current global meltdown features as its affect individual financial components units.
- High level of corporate ethics and code of conducts compliance by the professional accountants.
- Con-current review of financial activities in accounting and financial departments across the economy by the international accounting standard boards.
- Strict compliance of accounting and financial information disclosure standards as prescribed by the international and local accounting standard boards in order to reduce the level of fraudulent activities.
- Effective and efficient review of loan applications and ensure asset backed leveraging system rather than considering customer credibility solely.
- Ensure the means of avoiding necessary financial risk that might result to bankruptcy and liquidation in order to protect employment status.
- Regulators should have necessary access to financial information for financial stability check.

- Greater transparency in the reporting of financial executives' compensation, and ensure that boards of directors play a greater role in the setting of executives' pay.

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