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STUDY OF THE FINANCIAL CRISIS AND ACCOUNTING STANDARDS-IDENTIFYING THE KEY IMPACTING FACTORS AND IMPLICATIONS

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ABSTRACT

Several American lawmakers and financiers blamed the U.S. accounting standards for the financial crisis, claiming that the No. 157 accounting principle—which requires financial products to be measured using "fair value"—significantly exacerbated the situation. Some countries updated their fair value accounting standards in response to the controversy. The financial crisis significantly impacted China's new accounting standards since they heavily rely on fair value calculation. As a result, we need to improve accounting standards. Control or clarify the specifics of the fair value standards. Bolster theory research and the expertise of the accounting personnel.

INTRODUCTION

Financial institutions like Citigroup, Merrill Lynch, UBS, AIG, and The Blackstone Group have raised a collective voice against the No. 157 U.S. accounting principle. This principle, they argue, worsens the financial crisis by inflating losses on mortgage products. However, accounting and economic experts present a contrasting view. They attribute the issue not to the principle but to the financial institutions' double standards and practical approach. These experts argue that financial institutions are quick to embrace the benefits when the value of financial products rises but are equally quick to shift blame and criticize valuation principles when values decline.

Philip Goeth, leader of DTT's Asia Pacific financial services, argues that the current financial crisis is primarily an economic problem, not an accounting one. He underscores the importance of maintaining the fair value principle, stating that it provides the most accurate method to depict a company's financial position, particularly regarding financial derivatives. Despite criticism, fair value played a pivotal and trusted role during the subprime mortgage crisis, enabling investors to uncover the truth about asset values and restore faith in the financial system.

Federal Reserve Chairman Ben Bernanke emphasizes the importance of fair value accounting, stating that abolishing it would obscure companies' actual market assets. IASB Chairman David Tweedie also defends fair value, asserting that while financial sectors may criticize it, they have yet to propose viable alternative solutions. He suggests that discussions should focus on improving the understanding and application of fair value accounting standards post-crisis.

INTERNATIONAL ACCOUNTING STANDARDS ON FAIR VALUE CHANGES

Despite the accounting profession's belief in fair value as a valid method, external pressures have necessitated some adjustments. In response, the FASB issued clarifications on fair value measurement, allowing the use of financial models for asset trading. Similarly, the IASB revised accounting standards to reclassify assets and reduce the need for market valuation in non-active markets. These changes were aimed at alleviating pressure on the financial sector during the crisis.

While adjustments to fair value accounting may enhance financial statements, they cannot single-handedly address underlying financial sector issues or avert crises. The fundamental purpose of accounting is to accurately and objectively reflect capital states and outcomes. Furthermore, changes in fair value accounting pose challenges concerning assumptions, estimations, valuation models, and data sources, rIII. Enhancing Accounting Standards in Response to Financial Crisis

A. Refinement of Accounting Standards and Error Correction Mechanisms

The financial crisis underscored the imperative for continuously enhancing accounting standards, particularly in rectifying market failures. While the issuance of Accounting Standard No. 39 marked progress, opportunities for improvement remain, notably concerning the valuation of financial assets. Instances of arbitrary selection and the absence of mechanisms for correcting market-driven accounting errors were evident. In light of this crisis, three focal points should guide the formulation of accounting standards: Firstly, categorizing standards by business type and scale, catering to diverse entities such as financial institutions, manufacturers, and multinational corporations vis-a-vis small and medium-sized enterprises (SMEs). While China has established accounting frameworks tailored to different enterprise sizes, elevating these standards to a unified level is warranted. Secondly, balancing stakeholder interests encompasses governmental and major investor concerns and those of creditors, small-to-medium investors, and other relevant stakeholders. Thirdly, expeditiously instituting accounting principles to address market failures.

B. Precision in Fair Value Standards Implementation

Despite conscientious considerations in formulating fair value guidelines, practical implementation still needs to be improved. Ambiguities persist regarding the determination of fair value measures and ensuring reliability. A broad spectrum of accounting method choices and subjective judgment calls complicates matters. To address these issues, enhancements to the fair value accounting theory are imperative, focusing on delineating detailed fair value specifications and formulating operational guidelines. Clarifications should include: 1. Criteria for fair value versus historical cost utilization; 2. Preferred methodologies and available options for fair value determination; 3. Specific measures for assessing fair value across diverse asset and liability categories; 4. Processes for fair value adjustments.

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C. Fortifying Fair Value Theory and Practical Application

The application of fair value measurement lags in jurisdictions with nascent legal frameworks and developing markets. As China transitions to a market economy, bolstering fair value theory is pivotal. Efforts should prioritize advancing objective fair value accounting principles, assessing the feasibility and efficacy of fair value measurements, and enhancing the quality and reliability of accounting information. A concerted focus on theoretical research and guidance can bridge the gap between theory and practice.

D. Advancing Market Economy and Valuation Techniques

Market prices serve as optimal benchmarks for fair value determination. Thus, fostering a robust market economy with efficient capital and financial markets is indispensable for supporting fair value applications. Sustained efforts are needed to cultivate mature capital and secondary trading markets, aligning with national market price information networks. The active promotion of open information resources and a comprehensive market price system are warranted. In instances where market data is lacking, clear regulatory frameworks should guide the estimation of fair value, including enacting unified criteria and user guides. Technical assistance should facilitate the application of present value methodologies, encompassing considerations such as future cash flow estimation and discount rate determination.

E. Strengthen professional judgement in accounting and ensure fair value accounting is applied correctly

Fair value, a reflection of market prices, is a dynamic concept that can rapidly change in market transactions, particularly in response to shifting economic conditions.

The inherent unpredictability, instability, breadth, and diversity of fair value make its determination a challenging task, necessitating the use of sound professional judgement by the personnel.

Confidence in your correct and reasonable professional judgment will lead to a better application of fair value, enhancing its relevance and dependability. Conversely, a lack of professional judgment can harm the economy by misusing fair value criteria.

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