ACCOUNTING PRACTICES DURING THE ECONOMIC CRISIS

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Abstract

The economic crisis can be defined as a sudden disruption of the economic conditions, a situation wherein a country's economy is experiencing a significant drop in activity, driven by a financial overset.

Coping with an economic crisis, is also to withstand a drop in the gross domestic product, lower liquidity and price increases due to inflation

Responsibility of the accounting policies is to ensure that the business has a real benefit for reimbursement of the investment made.

It is therefore imperative that in time of crisis, this important feature of accounting policies to help in solving business problems related to pressures arising from the crisis.

This article aims to analyse accounting practices during important times of crisis respectively the Great Recession of 1930 and 2008 Global Economic Crisis..

***Keyword**: Economic crisis, accounting policies, investment, recession*

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Economic crisis can be characterized by a deep instability, therefore being accompanied by an increased volatility and uncertainty. In crisis situations we are in a permanent state of unease and uncertainty in relation to the future, fear or even panic. Our defence and preservation instinct prompts us to sometimes behave irrationally and to accentuate even more this volatility as each of us, with the ability we have to screen the information and understand the phenomenon in our own way transposing it afterwards in a certain behaviour related to the market.

The question is how high does the inflation, unemployment or a country's GDP decrease should be, to be able to appreciate the beginning of a crisis.

The recession is set to have been settled when after two successive trimesters we are dealing with a country or regions' GDP decrease.

The economic crisis can be defined as "a significant decline in the economic activity for several months mirror a reduction in GDP, decreased individual income, employment reduction, reduced industrial production and consumption“.[2]

These crisis are classified as social crises (inflation rising unemployment, poverty) in financial crisis (increased volatility in the capital markets, decrease of the stock exchange and their spectacular return), political crises (which can degenerate into wars), local or international crises caused by natural disasters or economic widespread crisis. More often than not, it is difficult to say when a financial crisis becomes an economic one, or an economic crisis generates a financial crisis or vice versa. Actually we always talk of an economic crisis generated either by financial, political or social reasons. The financial crisis is a manifestation of the economic crisis and reflects a lack of confidence in the financial system, a significant decrease in the volume of transactions on the stock exchange, a misadjust in the market mechanisms.

The stock exchange is the barometer of the economy; it is the one that transacts business of different sizes and from different sectors of the economy. When the market of such businesses (real estate, oil market, labour market) suffers from maladjustment or important corrections they are certainly reflected in the profitability of businesses listed on the stock exchange and, consequently, in the price of financial assets (stocks or bonds) that always depend on the investors' expectations. The panic regarding this phenomenon in

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economics does nothing but to emphasize such corrections and induce new uncertainties in the economy. Then under these circumstances the savings and investment are reduced and then market interest rates grow. Unfortunately we are talking about a crisis only when its effects are affecting a large number of individuals and companies. But crises can exist in a dormant state and may not be so visible in a given period, although they are slowly deteriorating our existence.

There have always been periods of crisis over time, and further I will treat one of the most important the Great Recession of 1930 and implications of the accounting practices during this period.

1.THE GREAT DEPRESSION FROM 1930

The world economic crisis started in 1929 and lasted until 1933, being the longest and severe economic depression the industrialized occidental society has been through.

It caused fundamental changes within the structure of the economic institutions, macroeconomic as well as in the economic theory.

Although it started in the USA, the great Depression incurred a drastic decline of productivity, a severe unemployment rate in almost all of the world's countries.

The crisis started in the USA in October 1929 was the most severe ever known by the capitalist system, as far as the size and durations are concerned, as it affected the entire world except URSS and prolonged in some countries until 1935, if not even until 1939, with the start of the Second World War, to which start, actually contributed.

The economic crisis of the interwar period was one of overproduction aggravated by the deep decline in the purchasing power of the population. Worldwide it exploded in mid-1929, affecting the production of iron, copper, steel, coal, salt, leaving huge amounts of unsold goods in warehouses.

After a period of fantastic growth there was a period of recession, with devastating effects on almost everyone.

At the time, the US industry produced about half of total industrial output of the world. Regarding the stock market, it has increased spectacularly for 8 years prior to 1929, the Dow Jones index rose by over 600%. Mainly this was due to the fact that investments on the stock exchange were seen as a way of enrichment, then the standard of living being high, Americans could afford to make savings, money that were then invested in the stock market. Concurrently, because banks were easily granting loans, the Americans were investing borrowed money from the bank into stock exchange.

In addition, at that time, the legal framework was not a well-tuned, so that companies could increase their capital as they pleased by issuing new shares.

Then they traded "in margin", i.e. paying only a fraction of the value of shares, proceeding to sell them afterwards, in a few months at a higher price, which led to the creation in fact of a giant pyramid scheme considering most of the money invested on the stock market did not exist in reality.

2.THE CRISIS IN ROMANIA

The situation was reflected immediately worldwide also, each country being hit in turn by the fall in the US stock market.

The situation in Romania was similar to the one in the USA, the country being in process of modernization, people, especially peasants, making loans to modernize the agriculture. Also, industrialists were engaged in various projects to develop their businesses. But at that time began to feel the effects of the recession in the US.

An investigation of the Ministry of Agriculture conducted in 1932 indicated that nearly 2.5 million farmers had to repay debts contracted by 1931, worth 52 billion lei. The debt comprised only claims on banks and not the debts from individual to individual, estimated at nearly 20 billion. The reality was alarming: in each village or commune being one or more lenders, Romanian, but mostly foreigners.

In the early 1930s, the price of the quintal of wheat fell below the level of expenditures made to harvest it. Great proprietors, who had made considerable financial efforts for the automation of the agricultural process, reached insolvency.

Agricultural goods, being unprotected by any customs measure, were left to the discretion of the international competition, which contributed to lowering the respective prices by 60-70% over the period 1928-1929.

3.BANK FAILURES FROM 1930

The Romanian financial system began to be seriously affected starting 1930. It was then when companies with foreign capital withdrew from the Romanian market, trying to limit their losses and to salvage a smattering of profit. According to unofficial estimates, between October 1929 and July 1931 were withdrawn from Romania over 17 billion lei.

Therefore, the banking system collapsed, the most resounding bankruptcies during that period being the Romanian Land Bank and the Bercovici Bank, both in Bucharest. The banking crisis, announced since 1930 created a real panic among depositors, people beginning to massively withdraw the deposited money.

The crisis still felt different from one family to another. The only Romanians unaffected by the crisis were those who lived from their own production without being forced to buy something from the market.

The main anti-crisis government measures were translated into collective discharge and reduction of the officials' salaries. In 1933, the nominal wage index decreased in comparison to the outbreak year of the crisis, to 63.1%. Also, the authorities decided to force grain exports, while trying to apply a law conversion of agricultural debt.

The state budget remained in deficit for three consecutive years, resorting to increased taxation, while refinancing the deficit by employing more re-stabilizing loans. In the area of monetary circulation, the credit crunch has led in the summer of 1931, to the collapse of big banks such as the General Bank of Romanian Land, Bercovits Bank or Marmorosch Blank, the assets were taken over by the National Bank, afterwards being transferred to the state and to other banks.

4.GLOBAL ECONOMIC CRISIS OF 2008

The second half of the twentieth century was a calm period, but the economic crisis of 2008 was nevertheless the result of problems accumulated for decades. The subprime mortgages and the US are not the only reasons for it, the causes being more and more extensive. Economists Nouriel Roubini and Stephen Mihm give some very clear explanations in the book "Crisis Economics", referring to both the recent crisis and the previous ones, namely:

Crises are based on speculation on an asset class, e.g. real estate or shares. Sometimes it is a technological innovation leading to its formation, but in 2008 it was especially about a financial innovation. Asset prices are greatly inflated due to indebtedness of those involved with the speculative game. It is the period wherein the loan is cheap and easy to obtain, so it is easy to buy the desired assets, people get bolder and continue to buy including riskier assets within that category such as shares in small companies, newly listed, with low profits and big promises. At one time an event occurs (such as the bankruptcy of Lehman Brothers in 2008), but that is not the true cause, but that the bid for assets artificially inflated exceeds the demand (because prices have become too high or the central bank increases interest and the credit is more expensive etc). Prices begin to fall, those who borrowed from banks selling the assets cheaply to submit the required guarantees. In this way, the indebtedness makes the collapse much steeper than normal.

In the years before the crisis the shadow banking system proliferated, namely institutions that look like banks, act like banks borrow and give loans like banks, invest like banks but are not regulated as banks. Some examples: investment banks, financial investment services companies, non-bank mortgage lenders, structured investment vehicles, money market mutual funds, investment funds with hedging. They risked massively by excessive debt and the accumulation of "toxic" assets on their balance sheets. Because they were not regulated, the state was not forced to rescue them, but had no choice, because they would have dragged into the abyss also the innocent ones..

Financial innovations have reached unprecedented levels before the crisis. A big problem was the securitization that turns some illiquid assets such as mortgages in liquid assets, traded on the free market, which have spread worldwide (50% of which were sold outside the US) ..

Globalization has had its contribution to the fact that things have gone too far in the US: there is a surplus of money in Japan, Germany, China, emerging countries, but citizens of these countries were not satisfied with the US government securities only, thus they also bought many securitized products because they had better yields. US got to lead an existence far above the possibilities for too long because it is a superpower. If it were an emerging economy, investors would have retired long ago.

The current crisis is the effect of several financial mistakes, says Joseph Stiglitz and the reconstruction cannot be done overnight and it should be done long term. Saving rate went near zero in the US. Even after the slight recovery of the banking system, saving will not increase very much.

"Now the saving rate is somewhere around 4-5% and some analysts believe it will reach 10%," says Joseph Stiglitz.

According to Joseph Stiglitz, the curve evolution of this crisis will not be V-shaped, but will have more of an L-shape. The unemployment rate rapidly rising to 8.9%, does not highlight the seriousness of the economic situation.

"There are many individuals who have lost their permanent jobs and now work part-time. They are not included in the unemployed category. The number of individuals who lost their homes is in the millions, which is a social problem rather than an economic one".

The end of the recession does not coincide with the moment of the return to economic growth, but with the time when individuals will regain their jobs.

"The nature of the market economy in the US: we have a situation with hundreds of thousands of homeless people and many homes without inhabitants. It is a problem! Unfortunately we cannot put people in inhabited homes. When officials say that the recession is approaching to an end, refers to the moment when growth is again positive. But for citizens, the end of the recession is when they regain their jobs ", says the former World Bank chief economist.

"I think that most likely would be a cataclysmic political event such as Brexit. In other words, the member countries of the Eurozone are Democrats and one can see a hostility growing against the euro, a hostility which, unfortunately, extends toward the European project and liberal values "

"It will be the end. What will happen shall be a concrete consensus that Europe is not working anymore", so it will be decided to give up the single currency and to keep the rest.

"My concern is that just a political event (like Brexit) will be the catalyst for the change".[1]

5.ACCOUNTING PRACTICES DURING THE ECONOMIC CRISIS

Many researchers believe that changes in accounting regulations are correlated with economic crises.

Referring to the Great Recession of 1930, it brought major changes to the laws to protect investors from the US, immediately after the collapse of markets in 1929. Some researchers believe that the weakness in accounting is evident in the period following a crisis.

But to determine how weak the accounting practices are during and after an economic crisis requires a theory on how ideas and accounting practices are evolving.

There hypotheses on the evolution of accounting around crisis around as appearances of rapid change in the period of relative stagnation in agreement to the punctuated equilibrium (Eldredge & Gould 1972)

It is possible that the evolution of accounting to have been characterized by significant discontinuities compatible with punctuated equilibrium theory.

For example the introduction and adoption of the LIFO method was probably linked to the wave of inflation after the Great Recession (Moonittz1953; Davis 1982).

6.ACCOUNTING PRACTICES DURING THE GREAT RECESSION

Between 1920 businessmen were allowed to regulate their own businesses, accountants being those who assisted with the preparation of information on costs, production and sales that were sent to the Department of Commerce.

Before 1930 no law was forcing companies to audit their financial statements (Zeff, 2003: 190).

Even the public sector generated fewer requests for financial audit reports, wherefore the accountancy sector has promoted other services that could be offered to businessmen within the period.

Namely budgetary plans, implementation of cost systems, management techniques.

These were extremely important for accepting the status of public accountants.

Meanwhile the role of accounting practices has increased, often being associated with practices to minimize taxes (Mellon, 1924).

Great crisis incurred laws on bankruptcy that brought an important change on the content of accounting registers, changes in the accounting regulations of the respective countries bringing them to an agreement on the international accounting standards.

During the Great Depression the American Institute of Accountants issued the Fiscal Statements Audit. This document was one of the first attempts of the institute to provide some guidance to the accountancy profession, but practitioners of those times were not prepared for the uniform accounting concept.

Many accountants believed that the issuance of the document "Uniform Accounting" created the illusion that there were accounting and audit procedures, with a wide range of use, which led to complicity from both the businessmen and the profession.

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[1] Joseph Stiglitz

In 1927, the Stock Exchange of New York has appointed Price Waterhouse & Co. as accounting adviser, being George represented by George o.May who "gained a freedom of time and action that allowed him to lead the profession towards some reforms urgently required" (Carey, 1969: 244).

His objective in conjunction with that of J.M.B Hoxsey who was appointed executive assistant to the Securities Commission was to "make the tax statements of listed companies to be both informative and clear as possible" (Carey, 1969: 245).

Then came the Stock market crash and only in 1933, the Special Committee of Cooperation of the Stock Exchange in New York, presented the first project of accepted accounting principles.

The result was then published in the Company Accounting Audits, which listed five basic principles with reference to the most opened abuses during those years:

- No loss of profit
- No spending surplus reproached to release revenue account
- The surplus earned before an acquisition is not earned surplus of the source
- Dividends on treasury bills is not revenue
- Effects and receivables due from members or employees must be presented separately

The 6th principle, namely the donated capital cannot result in acquired surplus, was added to the 1934 annual meeting of the Institute.

Abuses on the stock market in the late 1920s, culminating with the Great Crash of 1930, along with teaching and inadequate accounting statements were proof of the need for reform.

Later there was a tendency among academics, researchers, managers of institutions and even politicians, to blame accounting regulations of the countries affected by the financial crisis and to ask governments and other accounting institutions to strive to adopt IAS and IFRS.

Moreover, many believe that if the countries affected by the financial crisis will adopt IAS and IFRS, will be able to avoid future crises.

7.ACCOUNTING PRACTICES IN THE GLOBAL ECONOMIC CRISIS (2008)

During the global economic crisis we are talking about accounting practices much more evolved and since now available in a single reporting system.

There are common standards regarding activities outside the balance sheet and accounting for financial instruments.

These tools work to analyse accounting losses from loans within projects related to financial instruments.

Thus a joint approach has been tried to the financial crisis and the overall aim to seek convergence between IFRS and US GAAP described in a Memorandum of Agreement first published in 2006 and updated in 2008.

Moreover councils expressed their commitment to work together for common standards through the development of building projects of accounting practices.

They wanted to examine the books of loan losses, including losses patterns incurred and predictable patterns.

It was also established the presentation of financial statements, the fair value measurement of financial instruments with characteristics of equity.

Several actions were undertaken during this period of crisis of Financial Crisis Advisory Group (FCAG) and Expert Advisory Panel on Fair Value in the Market declining (EAP), namely:

- Effective Financial Reporting
- The limitations of financial reporting
- Convergence of Accounting Standards
- Independence and accountability of standards bodies

8.CONCLUSIONS

Economic crises brought as a consequence the improvement of accounting practices. Accounting standards can have huge implications for business, which is why the authorities and competent bodies should always be concerned to better reporting, fair, providing to the users of financial statements a true and fair view on companies, profits and capital.

Accounting standards are profoundly involved in the economic crises, crises themselves have shaped the evolution of accounting.

Crises cause changes in accounting regulations, always bringing novelty in the area of accounting.

The desire for safety during these times of crisis led to more growth and improving accounting practices, because accountants could not provide in those periods all the garanties for their work.

Just having a good accounting system in place, we may in the future to prevent economic crises, only through a system of accounting principles, that make it impossible registering fraudulent financial transactions.

The fact is that crises have led to revision of accounting standards, and even made a step forward in terms of improving these standards, they have added a greater degree of difficulty, so users of the financial reports have a true image on them.

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