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PhD Thesis

ABSTRACT

THE INTERPLAY BETWEEN ACCOUNTING AND ECONOMIC CRISES – AN ANALYSIS OF ACCOUNTING REGULATIONS

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CONTENT OF THE THESIS SUMMARY

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Content

INTRODUCTION

Reflecting the magnitude of the global financial crisis in 2008, some academics started examining causal relationships between accounting, accounting regulations and the crisis. In terms of "accounting crises (or scandals)" and accounting regulations, there has been significant amount of literature, but such literature is yet to be developed to illustrate and understand the relationship between economic crises, accounting and accounting regulations. Therefore, *the motivation for choosing this research topic* relies on the need of a deep analysis of accounting change during periods of economic crises.

The main purpose of this thesis is to explore the interplay between accounting and economic crises, particularly with an emphasis on how crises drive changes in accounting regulations. In this research we will investigate various economic crises that occurred in different countries, over different time periods and their impact on accounting and accounting regulations. Moreover, our attempt is to identify factors of major economic crises which led to changes of the accounting regulation in the history, which would contribute to the accounting history literature.

Literature revealed some examples of economic crises that shaped the evolution of accounting, both in thought and practice. For instance, the United Kingdom's commercial crises from the nineteenth century, the Great Depression (1929 – 1933), the Mexican crisis (1994), the Asian crisis (1997), the Russian crisis (1998), the US corporate crisis (2001 – 2002) and the Global financial crisis (2008), are crises that sculptured not only the accounting regulations of those countries affected by the crisis, but also the accounting at the international level. Hence, in this thesis, our goal is to analyze the accounting changes that occurred during the aforementioned crises.

Before starting the analysis on the interplay between accounting and economic crises, we do believe that the reader should be firstly introduced into the sphere of knowledge of economic crises and the evolution of accounting, as we do consider this to be an important step in understanding and interpreting the relationship between these two. Therefore, *the first chapter* of the thesis presents the conceptual framework and the typology of the economic crisis.

Over the years, researchers started to associate more and more the economic crises with accounting, in the sense that they either saw accounting as a factor that triggered the crisis or as a solution to it. Furthermore, the burst out of the recent economic crisis had such a huge impact on people's welfare that the topic of crisis became probably one of the most discussed topics around the globe. Thus, we attempt to elaborate an analysis, using one of Google's tools, to find out whether Google users or better said, the large public has made the same association, as the researchers, between accounting and crisis. This analysis will be conducted at the beginning of our scientific approach, as it is very important to demonstrate first that, people do believe that there is a relationship between accounting and economic crisis and only then to elaborate a dynamic analysis of this relationship.

The *second chapter* provides insights on the history and evolution of accounting and the discussion is mainly focused on whether accounting is progressive and if accounting changes are evolutionary. In this chapter, we attempt to understand the essence of the 'progress' notion, as it implies not only changes but improvements, too, and to analyze the historical record in order to find out if is legitimate to use the word 'progress' when we talk about history, especially the history of accounting.

Further, the *third chapter* presents a chronological overview of the impact of major economic crises on accounting and accounting regulations. More specifically, in this chapter we will analyze the worst economic crises, in the history of humanity, starting with England's commercial crises from the nineteenth century and ending with the recent economic crisis from 2008, and will try to emphasize that these crises brought changes on accounting and accounting regulations.

To illustrate the relationship between the economic crises and accounting, this chapter will briefly point out the historical cases of economic crises that led to changes in accounting, through the lens of punctuated equilibrium evolution. Punctuated equilibrium is a theory through which we attempt to demonstrate that economic crises, regarded as a major external shock, caused a sudden change in the evolution of accounting and accounting regulations. Moreover, economic crises might be comparable to a collapse in biology, as they select the accounting regimes, accounting regulations and even companies for survival, by testing their ability to adapt to the new conditions.

As we have already mentioned, in this thesis we also attempt to determine the factors of economic crises which led to changes of the accounting regulations. Particularly, our intention is to identify the indigenous and exogenous factors which determined accounting regulators to modify the accounting regulations during periods of economic crises. By indigenous factors, we refer to factors coming from inside the accounting system, more exactly accounting itself. Our purpose is to establish if accounting regimes (Historical Cost Accounting and Fair Value Accounting) were one of the factors which triggered or accelerated the crises and if this determined whether regulators modified the accounting regulations.

Hence, in the *fourth chapter* we will investigate whether Historical Cost Accounting, as regulated in the 1920s, was one factor that triggered the Great Depression of the 1930s. Researchers started to be concerned with this problem in the 1930s, immediately after the Great Crash. Previts and Merino, in their book, *A History of Accounting in America*, claim that "there are references […] providing the hard historical evidence that deviations from historical cost-based, conservative accounting led to the crash of 1929" (Previts & Merino, 1979: 227). Also, our analysis will mainly focus on the debate which arose among academics, during the Great Depression, regarding the Historical Cost Accounting and the so-called *deviations* or *departures* from Historical Cost Accounting.

The fifth chapter of the thesis will investigate if Fair Value Accounting, as regulated by the International Accounting Standards Board (IASB), was a factor in triggering the recent economic crisis or was just an accelerator of it. The current economic crisis (2008) precipitated several discussions, in this respect, with many researchers blaming Fair Value Accounting "for creating the crisis for reporting unrealized losses" (Andre *et al.*, 2009: 3). Thereupon, we have conducted two studies that address the concepts and themes underlying specific recent criticisms to Fair Value Accounting. In the first study, we have elaborated a qualitative analysis of a significant amount of academic articles, analyzing the relation between crisis and fair value accounting. In the second study, we conducted a qualitative and quantitative analysis on the Comment Letters, received by the IASB, on the Exposure Draft on Fair Value Measurement, in 2009 and 2010. Our intention, in the second study, is to identify whether the business community and the regulatory bodies do associate the recent economic crisis with Fair Value Accounting, and what were their thoughts regarding to this subject. The main objective of this chapter is to produce generalizations about accounting regimes and the role they play in triggering or accelerating economic crises.

Nonetheless, there is still one more thing that we need to examine in our thesis and it concerns the exogenous factors which led to changes of the accounting regulations, during periods of economic crises. By exogenous factors we refer to factors coming from outside the accounting system that influence the accounting standards setting-process. For instance, in our thesis, exogenous factors are considered to be the political and institutional pressures.

Therefore, in *the sixth chapter*, we will demonstrate that political and institutional pressures are factors that determine the accounting standards-setters to change accounting regulations during periods of economic instability, such as an economic crisis. Our analysis will be focused on the political and institutional pressures on the international standard-setter (IASB), during the global financial crisis started in 2008.

The IASB claims to be an independent standard-setting body, a not-for-profit private sector organization that provides public accountability through the transparency of their work (IASB official website). Since its foundation, in 2001, the IASB has been able to set standards with relatively little political influence in its governance or standard setting process. Furthermore, the IASB was extremely successful in maintaining its independence from political influence (Power, 2009; Whittington, 2005), while the accounting profession and the users of financial reporting have a bigger say in standard setting (Perry & Nölke, 2005). However, since the occurrence of the global financial crisis, in 2008, all this has changed, a rebalancing of power has occurred, and political bodies have gained influence at the expense of other stakeholders, such as the accounting profession and users. The main cause of this sudden change was the fact that political actors, and not only them, but also other stakeholders (such as academics, investors, bankers and even some accounting practitioners), started to view accounting standards as a key-factor that contributed and amplified the consequences of the crisis upon banks, financial markets and the overall economy.

The political actors embarked various strategies to (re)gain and maintain power, which, all together, altered the balance of power in the institutional field; and their main goal was to get involved, more than ever, in the standard setting process of the IASB. Thus, both individual accounting standards and the process of standard setting were influenced. Consequently, the last chapter of the thesis will provide a deep analysis of the events surrounding the global financial crisis, in order to understand how institutional and political bodies have influenced the international accounting standards-setting process, using both institutional theory and public interest theory of regulations to better understand this process. Additionally, in this chapter we will describe how political actors have sought to influence the global standard setter (the IASB) and how the IASB has responded to such pressures.

In a nutshell, the thesis finishes by offering some concluding remarks and by highlighting the contribution we have made in research development, in the area of economic crises and accounting evolution, as well as to present the limitations of our research and future prospects of research in this field.

The thesis has been developed by combining the information out of the archival method with individual interviews. The analysis consists in a considerable amount of historical and current research data (such as academic articles and books), along with the examination of non-academic data (such as articles from newspapers, official reports of different organizations, press releases and comment letters). Also, our research has combined the theoretical aspects with the practical ones, so that the work that we have done provides a clear overview, logical sequence and continuity. Moreover, we would like to highlight, since the beginning, that this thesis has been developed by using the qualitative research methods as it aims to analyze the evolution of accounting and accounting regulations during periods of economic crises, and particularly to provide a deep understanding of the interplay between accounting and economic crises.

RESEARCH METHODOLOGY

In any scientific research, particularly in accounting area, aiming to find a solution to a certain problem, it is necessary to use the research tools and methods designed to facilitate the scientific research in general (Mustata, 2008: 13). There are various methodological approaches that can be used when conducting research activities. First, we will discuss all these methodological approaches and then we will explain which methods we have chosen for this thesis and why.

Research Approach

The research approach depends on how well the research questions have been formulated, and the level of knowledge that exists in the area of the research subject. There are three features of the research approaches, as follows:

(1) *Exploratory*. The aim of an exploratory study is to gather as much information and knowledge about the study problem area as possible, meaning that the problem is analyzed from different points of view. Also, Patel and Davidson in their study, suggest that the wealth of ideas and creativity are very important elements in explorative studies because their main purpose is to attain knowledge that can lay a fertile ground for further studies (Patel & Davidson, 1994);

(2) *Descriptive*. The descriptive studies are often used in those research areas where there already is knowledge and only the essential aspects of the phenomenon are looked upon. These aspects must be described in a detailed and fundamental manner;

(3) The *hypothesis testing* approach. These types of studies are used when there is sufficient knowledge and information, in the research area, to form new theories. Researcher's mission is to collect information and to develop hypotheses that will be tested in the empirical world and which will result in either acceptance or rejection (Patel & Davidson, 1994).

In this thesis we will use all these three research approaches. All the chapters of the thesis use the exploratory and descriptive approaches, and in the fifth chapter that consists in a study on the IASB's Comment Letters, we will be using the hypothesis testing approach, too. Moreover, in our thesis, we gathered a considerable amount of data about the study object, using various sources of information. The information collected can be split in two categories: (1) academic data – such as research articles, working papers, books and other academic resources; and (2) non-academic data – such as newspapers' articles, official reports of international organizations, press releases of different organizations and accounting boards, comment letters, other different types of letters and other non-academic sources. Furthermore, this collection of data provided us with an extensive background on a variety of views on the subject of our research, and enabled us to develop tested hypotheses.

Research Perspective

The scientific research has two major perspectives, as follows:

(1) The *positivistic approach*, based on scientific rationality. In this type of researches, measurements usually replace judgments and estimations; and explanations come from a cause-effect relation. Also, in these studies, the knowledge is empirical and usually consists on experiments, quantitative measurements and logical reasoning.

(2) When the researcher approaches the study object from his/her own understanding, then the *hermeneutic approach* can be invoked. Under the hermeneutic approach, the researcher uses his/her own knowledge, impressions, thoughts, and feelings in order to understand the study object, and tries to see the whole picture in a research issue. The difference between the positivistic approach and the hermeneutic approach is that the hermeneutic one is more qualitative and is based on interpreting reality through people's thoughts, motives and goals (Christenson, 1982).

In this thesis, we are more biased towards the hermeneutic approach, although we do consider the positivistic approach as being fundamental for our research, because we have used the scientific rationality, too. Our thesis has been conducted based on our interpretations of the phenomenon we are studying, which is the interplay between economic crises and accounting. Also, we will try to understand the studied phenomenon by presenting other people's thoughts and concerns on the study subject, and only then we will frame the whole picture of the phenomenon, based on our interpretations.

Research Design

There are three main ways of reasoning and demonstrating a theory:

(1) The *inductive* approach is a reasoning that constructs or evaluates general propositions that are derived from specific examples and observations, as opposed to the deductive approach, in which specific examples are derived from general propositions (Melville & Goddard, 1996). In the inductive approach the research follows earlier explorations, the researcher is primarily conducting observations on reality and from these a conclusion is drawn, and a theory is formulated;

(2) The *deductive* approach can be described as the process of reasoning from one or more general statements regarding what is known, to reach a logically certain conclusion. Deductive reasoning involves using given true premises to reach a conclusion that is also true. The researcher examines whether the existing theories are combined with reality by making comparisons to these existing theories (Kam, 1990);

(3) The *abduction* is a form of logical inference that goes from data description of something to a hypothesis that accounts for the reliable data and seeks to explain relevant evidence. It can be also seen as an approach where the researcher uses a combination of both, the inductive and the deductive reasoning, leading to one analysis containing empirical findings, together with previous theories (Alvesson & Sköldberg, 1994).

From our point of view, this thesis is a combination of both deductive and inductive approaches. Our thesis has been developed by using three main theories: punctuated equilibrium theory, institutional theory and public interest theory of regulations; and the research questions and hypotheses were formed from these existing theories. Nevertheless, we have also presented, in the thesis, some specific observations, which provided us with a better understanding and also confirmed the existing theory. Moreover, we tried to condense the information gathered, into a brief summary format, and based on our own fundamental knowledge, about the studied phenomenon we have established a link between the objectives of our research and the findings that derived from the collected data.

Research Method

Research can be conducted using quantitative or qualitative methods or a combination of both. The *quantitative* research can be defined as an organized empirical investigation, of a certain phenomenon using mathematical and statistical tools and techniques. The main purpose of the quantitative research is to develop theories and models concerning the studied phenomenon. The process of measurement is the main tool used in the quantitative research, because it provides the fundamental connection between empirical observations and mathematical/statistical expression of quantitative relationships.

The *qualitative* research method aims to gather an in-depth understanding, trying to penetrate every observation, targeting the variables that are hard to classify and quantify. The qualitative research also investigates the reasons and the context of decision making, and not just the results. The main intention of qualitative research is to obtain a deeper knowledge than fragmented information generated by quantitative methods. A vital part of the qualitative approach is the researcher's understanding or interpretation of the information. Qualitative data is often suited for research projects that try to find or understand a specific pattern within the investigated area (Holme & Solvang, 1997).

Moreover, qualitative methods have enjoyed a growing popularity in the past decade throughout the social sciences (Bryman & Burgess, 1994; Denzin, 1994; Jensen, 1991; Marshall & Rossman, 1999; Morse, 1994), especially in domains traditionally inclined to more positivistic methods (Black, 1996; Ritchie & Spencer, 1994).

The main research method of our thesis is the qualitative method, as the goal of the thesis is to obtain a profound knowledge of the accounting and accounting regulations' evolution during periods of economic crises. Moreover, the purpose of the thesis can be accomplished only by using qualitative data, because quantitative data would not allow us to achieve a deep understanding of the studied object. Therefore, we do believe that only a qualitative research will enable us to better understand why each of the economic crises studied led to changes in accounting and accounting regulations and to identify the factors and reasons that determine regulators to change accounting regulations, during periods of economic crisis. Only in the fifth chapter of the thesis we will be using the quantitative research method, as we attempt to quantify the information gathered from the Comment Letters, which will helps us obtain relevant conclusions towards respondents' opinion related to the Fair Value Measurement.

Quality of the Research

The conclusions of any research must accurately identify and describe the phenomenon that was investigated. In order to achieve this, the researcher must be concerned with the validity and reliability of his/her research (Ryan, *et al.*, 2002). *Validity* refers to whether the research actually measures the things it aims to measure. Lekvall and Wahlbin (1993) have divided validity in: constructive, internal and external. Constructive validity means that there is a correct relationship between the empirical findings and the theories used. Internal validity refers to the presumption regarding cause-effect or causal relationships. External validity refers to findings of a study that can be generalized and for instance, the conclusions that might describe other situations than the specific case studied. *Reliability* takes into account the quality of measurement and clarifies if the findings of the study can be replicated by using the same research method (Lekvall &Wahlbin, 1993).

To ensure the validity of our thesis we tried to use as many sources of information as possible and to interlink them. We have carefully tried to emphasize, in the conclusions of this thesis, that there is a relationship between economic crises and accounting and we have also described the indigenous and exogenous factors that led to changes in accounting and accounting regulations, during periods of economic crises. Furthermore, we do believe that it is difficult to evaluate the reliability of our study as we have mainly used, in our thesis, the qualitative research method. However, we can state that the reliability of our study is supported by the examination of the underlying literature aforementioned.

BRIEF OVERVIEW OF THE THESIS CHAPTERS

Next we will make a brief presentation of the six chapters' content, of the thesis, the main results obtained and the conclusions drawn in each chapter.

Chapter 1

Economic Crisis - Conceptual foundation and theoretical grounding position in the sphere of knowledge

The first part of this comprehensive research project aims to introduce the reader into the sphere of knowledge of economic crises, as an important step in understanding and interpreting this type of crisis. Nevertheless, from the very beginning it is extremely important to highlight that in this study crises are regarded as a positive thing that challenges us to re-evaluate our lives, thoughts, principles, etc. and for us, the academics, to re-evaluate our research agendas.

The definitions of a crisis vary from one domain to another, from one researcher to another and from one country to another. This research attempts to study only the economic crises, so the following paragraphs will focus on the definition of economic crises. From an economic perspective, the literature uses both discrete and continuous measures to define a crisis. *Discrete measures* take usually the form of binary variables, which define a crisis as occurring once a particular threshold value of some economic or financial variable has been breached. *Continuous measures* of crisis incidence overcome the problem of defining particular thresholds by measuring crisis intensity on a continuous scale.

Ribstein (2003) in his research has defined economic crises as "periods of sharp drops in economic activity that cause widespread changes in expectations about future economic prospects and are frequently sandwiched between periods of speculative frenzy in the economic and political markets." (Ribstein 2003: 83). Nevertheless, it must be mentioned that a crisp definition of the term "economic crisis" is not available.

We define economic crisis as “a sharp dislocation of economic conditions”; in other words a situation in which the economy of a country experiences a sudden downturn brought on by a financial turmoil. An economy facing an economic crisis will most likely experience a falling Gross Domestic Product (GDP), a drying up of liquidity and rising/falling prices due to inflation/deflation. An economic crisis can take the form of a recession or a depression, also called as the *real economic crisis*.

Many economists believe that crises result from the economic cycles in which the economic development goes through phases in such a way that a fall is followed by a growth and the growth is followed by a slowdown or a decline (Baran, 2011; Littleton, 1933; Ribstein, 2003; Tomkins, 1978; Zeff, 1972). It is a curative process, well known in the past and that will also exist in the future. Crises always verified the ‘health’ of branches so that ineffective players left and were substituted by new and more effective ones. The coherently devised theories explaining the cause of economic cycles appeared for the first time at the end of the 19th and at the beginning of the 20th century.

Reinhart and Rogoff (2009) have classified the various kinds of macroeconomic crises. From their point of view there are seven types of crisis, four of them are defined using a quantitative criterion while the other three rely on the occurrence of a specific event. Three types of crises (inflation crises, currency crashes, and currency debasements) represent cases where a currency’s purchasing power declines sharply. Two types of crises (bursting of asset price bubbles) are cases that reflect asset value declines, either a large across-the-board equity price decline or a large decline in bank net asset values (banking crises). Two other types of crises (external debt and domestic debt crises) refer to defaults on government debt.

Furthermore it should be taken into consideration that economic crises may vary in the extent to which accounting is implicated as an underlying causal factor. For example, the inference that poor accounting leads to the inflating and bursting of asset bubbles and ensuing scandals was reflected in centuries of post-crisis accounting regulations in the US and UK (Littleton 1933, Chatfield 1974, Baskin & Miranti 1997, Banner 1997, Partnoy 2000, Ribstein 2003). Littleton (1933) has argued that accounting evolution has been strongly influenced by waves of business failures. For instance, bank minimum capital requirements and mandatory reporting to the federal government were required under US law in the 1860's (Huntington & Mawhinney, 1910) in response to Civil War crises.

The topic of the economic crisis is a constantly important subject of the day and during its course an extraordinary attention has been paid to finding a solution to this issue. A great amount of information and opinions about the problem of the crisis create an essential basis for the analysis of the status quo and, on the other hand, enable one to achieve a large extent of alternative solutions requiring a great effort to attain the optimum results. The situation in financial markets affects all of us.

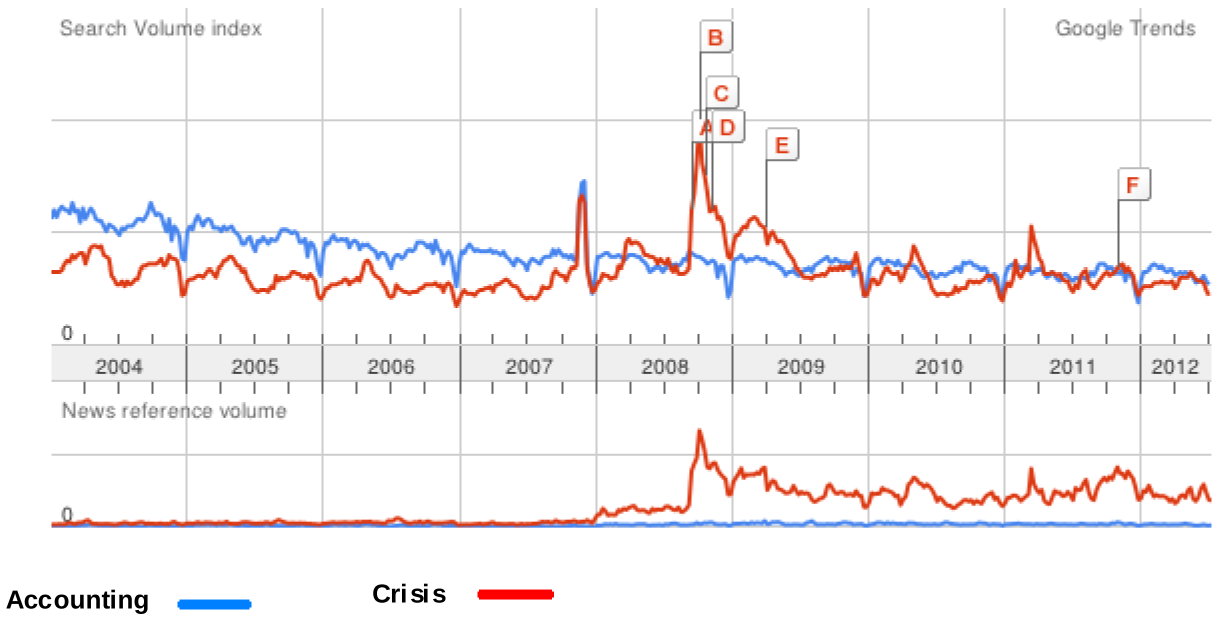
Google is the biggest web database in the world reflecting people interest about our world and beyond. Moreover Google analyzes and creates useful statistics based on very complex algorithms, emphasizing relations and interactions between different topics and people. Therefore an analysis has been conducted to compare the world interest in the topic of this research. The analysis was set up by using *Google Trends,* which shows how often a certain topic or topics have been searched on Google over time. Taking into consideration the fact that the topic of this research is the interplay between accounting and crisis, the two terms that were used in this analysis are: "accounting" and "crisis".

Google Trends discloses:

- a portion of Google web searches to compute how many searches have been done for the terms entered, relative to the total number of searches done on Google over time - Search *Volume Index graph*;
- the number of times the topics appeared in Google News stories - *News reference volume graph.* When Google Trends detects a spike in the volume of news stories for a particular search term, it labels the graph and displays the headline of an automatically selected Google News story written near the time of that spike. Currently, only English-language headlines are displayed.

The figure below (Figure 1) represents the number of searches of the terms “accounting” and “crisis” relative to the total number of searches done on Google, since 2004 until today.

Figure 1. Google searches of “accounting” and “crisis” since 2004 until today



A US announces plan to ease financial crisis
Mail & Guardian Online - Sep 19 2008

B America's financial crisis
Detroit Free Press - Oct 8 2008

C NSE to find ways to fight financial crisis
Economic Times - Oct 23 2008

D Financial crisis
Daily Times - Nov 14 2008

E G20 agrees to trillion-dollar plan to fight crisis
Calgary Herald - Apr 2 2009

F Greek eurozone crisis
BBC News - Nov 3 2011

The conclusions that can be drawn by analyzing the above graph are that Google users became more interested both in “accounting” and “crisis” in the fall of 2007, exactly on the same time with the first signs of weaknesses of the US financial institutions. Further in 2008 people started to panic due to the spread all over the world of the US market crash and this is why in the second semester of 2008, the word “crisis” was more searched that “accounting”. But by the end of 2008 both terms get on a similar trend of interest.

Even if the Google data may contain inaccuracies, this may be a starting point on understanding the link between crisis and accounting on people’s mind. The most interesting part of the graph is the fall of 2007, when both trends were on an ascending line and it can be considered that people who were interested in crisis, were also interested in accounting, seeing it either as a factor or a solution of the current crisis.

Chapter 2
Insights on the history and evolution of accounting

The history of accounting is not be viewed as a natural evolution of administrative technologies, but it can be viewed “as the formation of one particular complex of rationalities and modes of intervention among many, a complex that has itself been formed out of diverse materials and in relation to a heterogeneous range of issues and events” (Miller *et al.,* 1991: 396).

Research studies on the evolution of accounting have a long tradition. Transformations in accounting knowledge and practice have been influenced by many factors, such as economic, social and political pressures, (Tomkins, 1978) ad hoc influences like wars, periods of economic decline and labour disputes (Miller *et al.,* 1991).

Furthermore, Hans Hoogervorst, the Chairman of the IASB, claims that “it is a sad truth that most initiatives to strengthen the international financial architecture to reap the fruits from the on-going liberalization of capital movements have been taken under the pressure of some kind of crisis” (Hoogervorst, 2002: 16). International accounting regulations - International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) can be regarded as part of this international financial architecture, defined as a “set of measures that can help prevent crises and manage them better in the more integrated international financial environment”. (World Bank webpage)

Within the study of accounting history more generally, one of the most important debates of the recent years has involved the consideration of the extent to which accounting can be viewed as progressive and accounting change as evolutionary. Nowadays accounting has become an object of study less as a technical, as in the past, and more as a social phenomenon, consensus as to what constitutes an improvement becomes harder to secure (Napier, C., 2001:7). Accounting change is one of the most controversy topics in the history of economic science.

Anthony Hopwood, in his critique of historical accounting research The Archaeology of Accounting Systems (1987), has stated that “accounting has more frequently been seen as becoming what it should be. A teleological trajectory of development has provided a basis for understanding changes in the accounting craft. ... [A] relatively unproblematic progressive and functionalist interest has been imposed all too readily on the residues of the accounting past” (Hopwood, 1987, p.206). Progressivist trend can indeed be detected in central works o historical accounting research, although Hopwood gives few specific references to justify his criticism.

Littleton states that accounting has not been static, also the growth in professional audits and the expansion of cost accounting are evidence of how accounting helps to solve emerging problems of business planning and control. Also, Littleton emphasis that “progress” lies in the ability of accounting to solve present-day problems. Littleton’s historiography is a dynamic one: accounting “came from definite causes; it moves toward a definite destiny” (Littleton, 1933: 362).

Moreover, Littleton’s statement supports Hopwood’s accusation that the view of accounting history adopted by historians seems to embody teleology: a belief that accounting has some ultimate end to which it is tending. The path to this ultimate end may not be a direct one, suggesting that accounting changes could be assessed by the extent to which they work towards the ultimate end - they would in that sense be “progressive” - or move away from the end - they would in that sense be “regressive” (Napier, C., 2001: 9).

Many historians of accounting have admitted - as does Hopwood and Littleton – that accounting impacts on society and from an idealistic view of accounting has the potential of contributing to social improvement through its embodiment of rational calculation. This means that if accounting is seen as a form of rational calculation then it has the potential to be progressive, because rationalization is itself progressive (Napier, C., 2001: 17).

Furthermore Hopwood (1987) considers that traditional historians took accounting as unproblematically representing a potential for technical improvement. This view is developed by Broadbent and Guthrie (1992), who have described the context of research into present-day accounting practice as “technical accounting”. Under this view they stated that: “changes to accounting systems are seen as being progressive and reforms to accounting practices are based on the notion of teleological trajectory. Changes in practice are therefore seen as being manifestations of functional progress and system improvements” (Broadbent & Guthrie, 1992: 10).

In terms of technical progress, claims have been made that accounting has been subject to periods of stagnation or even decline. Raymond de Roover (1955: 409) has contemptuously dismissed the period between the publication of Pacioli’s Summa, the first printed treatment of double-entry bookkeeping, in 1494, and the transition to more sophisticated corporate accounting in the nineteenth century, as an “Age of Stagnation”. Also Edwards (1988: vi), is noting that “change does not, of course, necessarily mean progress”, and he gives an example of a relative decline in the quality of financial reports published by British companies during the 1920s, as these tended to disclose less than many financial reports published before World War I.

Nobes (1991) has proposed a cyclical model for UK standard setting. He specifically addresses the question as to whether UK accounting standards in the 1970s and 1980s provided evidence of progress, defining this in terms of the ability of the standard-setter to resolve conflicts, discover unique answers or impose standard solutions (Nobes, 1991: 271). From Nobes point of view progress in accounting means the ability to solve problems, where solution is defined in terms of obtaining “answers” or at least “consensus”.

This identifies a problem with using a concept of progress in historical explanation, meaning that if we focus on a relatively short period of time we might observe a particular pattern of change (improvement, stasis or decline), but this pattern need not be the same as that observed over a longer period of time, within which the shorter period is included. According to Napier (2001:19) this situation is consistent with the “evolutionary progress”.

Cyril Tomkins set out his view of the development of accounting, in an unpublished working paper that formed the basis of thought on historical accounting research of the Social Science Research Council committee discussed by Hopwood (1985). Tomkins’ view is a remarkable echo of Littleton (1933). “Developments in accounting came about in the first place in response to economic social and political pressures, but, thereafter, acted as an enabling device to assist further developments” (Tomkins, 1978: 9).

Miller *et al.* (1991) research study emphasize the fact that the transformations in accounting knowledge and practice has been influenced by a variety of agents and agencies of the accounting profession and their institutional forces that shape actions and outcomes and the rationales that set out the objects and objectives of accounting.

To conclude it is legitimate for many accounting historians to tell their stories in terms of progress when they are working on a relatively small scale. However, it is not legitimate to say that accounting is progressive and accounting changes are evolutionary, as long as many researchers recognize that what is progress for some may be degeneration for others, and what appears progressive at one point of time may not seem so with the benefit of hindsight.

Chapter 3

The impact of economic crises on accounting thought and practice – A chronological approach

This chapter presents a chronological overview of the worst economic crises in the history, starting with the nineteenth century, and their impact on the accounting thought and practice, of those countries affected by crisis. To illustrate the relationship between the financial crisis and accounting, this chapter will briefly point out the historical cases of crises that led to changes in accounting, through the lens of punctuated equilibrium evolution. The research model for analyzing the change process is based on the model proposed by Alexander and Servalli. This model suggests the "possible relevance in considering accounting change (or non-change) of both path dependency (the idea that what you do today is influenced by what made logical sense yesterday), and the concept of punctuated equilibria (the idea that a major external shock causes a sudden change - a departure to a new path)" (Albu & Alexander, 2010: 3).

Many researchers believe that changes in accounting regulations also appear to be correlated with economic crises. Extensive changes to bankruptcy statutes and the Companies Act followed economic crises throughout 19th century Britain (Littleton, 1933). Major changes to United States (US) investor protection laws occurred after the market crashes of 1907 and 1929, and the Enron and WorldCom scandals presaged passage of the Sarbanes-Oxley Act in 2002 (Seligman, 2003; Grundfest, 2002). Some researchers believe the weak in accounting is evident in the aftermath of a crisis. But, it is considered that in identifying how weak accounting is during and after an economic crisis, it requires a theory of how accounting though and practice evolves, and a shift in perspective to the effects of ex-post selection by the economic environment instead of only ex-ante choice by human agents. Prior work in evolutionary theory in biology allows an evolutionary process to be formalized for any biological, cultural, or economic system (Price, 1970, 1995; Frank, 1995, Page & Nowak 2002, Kerr & Godfrey-Smith, 2009).

Within this framework, this research attempts to hypothesize the evolution of accounting around crises as bursts of rapid change amidst periods of relative stasis consistent with punctuated equilibrium theory. (Eldredge & Gould, 1972; Gould & Eldredge, 1993; Grundfest 2002) Furthermore it is likely that accounting evolution has been characterized by significant discontinuities consistent with punctuated equilibrium theory. For instance the introduction and widespread adoption of LIFO method was likely related to the surge in inflation after the Great Depression (Moonitz, 1953; Davis, 1982).

During the nineteenth century the United Kingdom faced many commercial crises, which led to Bankruptcy Acts that improved the content of the books of accounts, which were called, at that time, “statements of affairs” (Littleton, 1981: 284). Later, “a classical period of thought and practice, as delineated by the events surrounding the great depression of the late 1920s and early 1930s, marks a maturity point in American accounting thought and practice” (Previts & Merino, 1979: 215). Also, the end of the twentieth century is characterized by depression periods which led to crises in different parts of the world, such as Asian countries, Mexico and Russia. All these crises, together with the United States (US) corporate crisis (2001-2002) led to changes in accounting regulations, of the aforementioned countries, bringing them into line with the International Accounting Standards (Bhimani, 2008; Lin, Chen, 2000; Mooskooki, 2002; Rahman, 1998). Finally, the current financial crisis continues this trend, resulting in several changes to the IAS and IFRS (see Figure 2).

Figure 2. Chronological overview of the worst economic crises

1) ***England’s commercial crises from the 19th century***
2) ***The Great Depression of the 1930s***
3) ***Mexico’s currency crisis (1994)***
4) ***The Asian financial crisis (1997)***
5) ***The Russian financial crisis (1998)***
6) ***The US corporate crisis (2001)***
7) ***The global financial crisis (2008)***

England's commercial crises from the 19th century

In the 19th century many social and industrial changes had taken place and the attention was directed to the laws of bankruptcy, which led to enacting several new statutes. The following tabulation places these bankruptcy statutes and the crises in chronological sequence:

Crisis – 1815	
	1825 – Bankruptcy statute
Crisis – 1825	
	1831 – Bankruptcy statute
	1833 – Bankruptcy statute
Crisis – 1836	
Crisis – 1847	
	1849 – Bankruptcy statute
Crisis – 1857	
	1861 – Bankruptcy statute
Crisis – 1866	
	1869 – Bankruptcy statute
	1883 – Bankruptcy statute

(Source: Littleton, 1981)

The conclusion that can be drawn, by analyzing the above tabulation, is that probably there is a relationship of cause and effect between the crisis and the statute which follow it so closely. Statutes were enacted within ten years after the crisis of 1815, within six years after that of 1825, within four years after that of 1857, within three years after the crisis of 1866 and within two years after that of 1847. "The subsequence of events, therefore, seems to have been: a financial crisis, extensive business failures, a new bankruptcy statute" (Littleton, 1981: 277).

The Bankruptcy Act attempted to secure better protection creditors, who here represent the general public, and to decrease the losses attendant upon business failures. Consequently, the bankrupt was required to deliver his records and books of account to the official assignee, chosen by the Court. Passing the last hearing in court was contingent upon a favourable report by the official assignee as to the accuracy of the accounts. As a consequence it was the regular practice to employ an accountant to insure correctness of the statements (Littleton, 1981: 279).

The Great Depression of the 1930s

During the 1920s businessmen were left to regulate their own affairs; accountants were asked to assist management in preparing information on costs, production, and sales to be forwarded to the Commerce Department. Prior to the 1930s, no laws or regulations obliged corporations to have their financial statements audited. (Zeff, 2003: 190) Since the public sector generated few demands for audited financial reports, accountants promoted other services that they could provide the businessman. Budgeting, implementation of standard cost systems, and other management accounting techniques were extremely important in gaining acceptance for public accountants during the 1920s (Newlove G., 1975). Meanwhile the social role of accountants came to be seen as minimization of taxes (Mellon A., 1924).

Immediately after the Great Crash, in 1929, the American Institute of Accountants, with the support of the Federal Reserve Board, issued the *Verification of Financial Statements*. This paper is even today remembered by some older accountants, as the "Auditor's Bible". This document was the first attempt of the institute to provide guidelines to the accounting profession, but the practitioners of those days have clearly express their opinion that they were not ready to receive the concept of uniform accounting.

In addition many accountants believed that the issuance of the document "Uniform Accounting" had created an illusion that there were accepted accounting and auditing procedures in widespread use which led to complacency on the part of both the public and the profession. An editorial in the *Journal of Accountancy* condemned any suggestion "for uniform systems of accounting and auditing for all sorts of business conditions" as extremely dangerous because that implied to many investors a degree of assurance that could not be given by auditors faced with the uncertainty that existed in the business sector ("Editorial", *Journal of Accountancy*, May 1929: 356-357).

In 1927 the New York Stock Exchange (NYSE) appointed Price, Waterhouse & Co. to be its accounting adviser and having George O. May as representative, who “acquired the freedom of time and of action which permitted him to lead the profession in some urgently needed reforms”. (Carey, 1969: 244) Further the NYSE appointed J. M. B. Hoxsey to the new post of Executive Assistant to its Committee on Stock list, in recognition of the need for more effective monitoring of financial reporting by listed companies. Hoxsey’s objective was in accordance to May’s to “make financial statements of listed companies as informative and reliable as possible” (Carey, 1969: 245).

In 1930, following on the heels of the 1929 stock market crash, the NYSE sought out the Institute for advice on the policies it should adopt with respect to the financial statements of its listed corporations. After three years of deliberations, a blue ribbon committee of the Institute provided the Exchange with a philosophy and a framework for dealing with the accounts of listed companies (Zeff, 2003: 191). In 1930 J. M. B. Hoxsey opened the door for cooperation between the NYSE and CPAs, at the annual meeting of the AIA. May became chairman of the Special Committee on Cooperation with the NYSE. The committee presented in 1933, its first draft of accepted accounting principles, “as so generally accepted that they should be followed by all listed companies” (Carey, 1969: 177); and submitted six recommendations to the institute and exchange for approval the following year (Previts & Merino, 1979: 238).

The NYSE agreed to five of six recommendations; they rejected the requirement that “all listed companies…disclose the accounting methods employed” (AIA Minutes 1932: 62f). The aforementioned cooperation resulted in the publication of *Audits of Corporate Accounts,* which listed five basic principles that dealt with the most overt abuses of the 1920s:

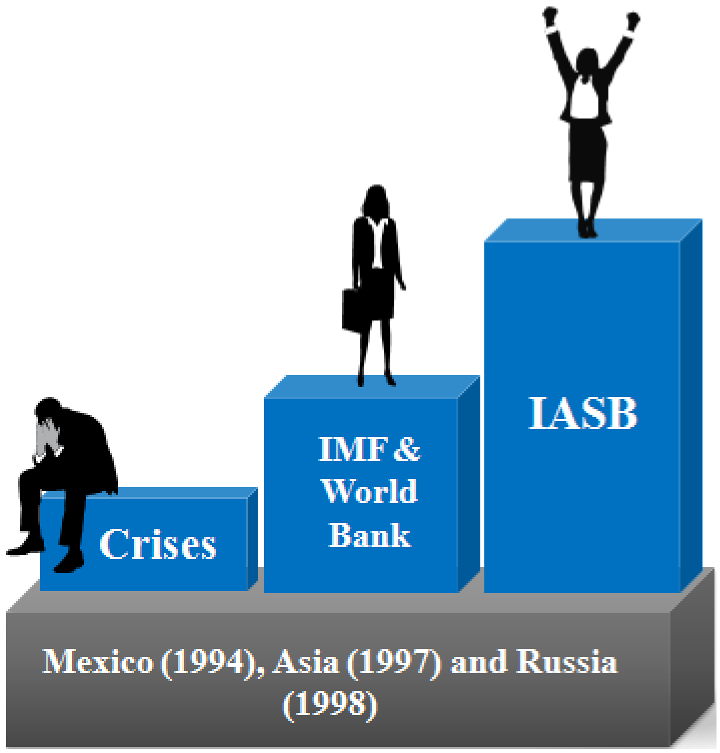
1. no unrealized profit;
2. no charges of expenses to surplus to relieve the income account;
3. earned surplus prior to an acquisition is not earned surplus of the parent;
4. dividends on treasury stock are not income;
5. notes and accounts receivable due from officers or employees must be shown separately. (AIA, Yearbook, 1934: 14).

A sixth principle – (6) donated capital does not result in earned surplus – was added at the annual meeting of the Institute in 1934. These basic views indicate that accountants had recognized the validity of the argument that the inability, or perhaps unwillingness, of the profession to properly aggregate capital and income had been one of the major reasons for unsatisfactory reporting in the previous decade (AIA, Yearbook, 1934, pp. 196-197).

Many historians consider that the Great Crash, from 1930s had a profound effect on the subsequent evolution of American accounting thought and practice. (Dorfman, 1959; Littleton, 1933; Previts & Merino, 1979) Also political leaders' reaction was slow, and they neither blamed accountants for the debacle of the 1920s nor looked to the profession for protection in the 1930s. In the United States of America, the stock market abuses of the late 1920s which culminated in the Great Crash, "together with inadequate accounting tenets and disclosures … pointed to the need for reform " (Defliese, 1981: 107).

The end of the twentieth and the beginning of the twenty first century is characterized by depression periods which led to crises in different parts of the world, such as ***Mexico (1994), Asian countries (1997) and Russia (1998).*** There was a trend, at that time, among academics, researchers, directors of international institutions and even politicians to blame the accounting regulations of those countries affected by the financial crisis and to ask the governments and the other accounting institutions to make efforts in order to adopt the IAS and IFRS. Furthermore many consider that if the countries, affected by the financial crisis, will adopt the IAS and IFRS, then they will be able to avoid future crises. The following sections of this study aims to justify that the crises, from the end of twentieth century and the beginning of the twenty first century, are one of the rationales used by IASB to gain global dominance, with the International Monetary Fund (IMF) and World Bank (WB) as messengers (see Figure 3).

Figure 3. Mexican, Asian and Russian crises were one of the rationales used by IASB to gain global dominance, with the IMF and WB as messengers



(Author's projection)

The US corporate crisis (2001)

This part of the study emphasized that the sudden tide of official US views showing receptivity to some form of accounting convergence, was not independent of the 2001–2002 crisis in financial reporting. Before 2001 the principles-based accounting and the quality of international accounting standards developed by IASC have not gained support among US financial market and accounting regulators. Only after a period of extreme instability, the significance and potential of IFRS' role was only brought into light. But the recognition of this role was insufficient to effect change. An institutionally legitimate infrastructure for the production of international standards is required to promote the convergence.

The global financial crisis (2008)

The IASB and the FASB have announced, on March 24th 2009, their further steps in response to the global financial crisis. The two boards have agreed to work jointly and expeditiously towards common standards that deal with off balance sheet activity and the accounting for financial instruments. They will also work towards analyzing loan loss accounting within the financial instruments project. These steps have reaffirmed a commitment to a joint approach to the financial crisis and to the overall goal of seeking convergence between IFRSs and US GAAP described by a Memorandum of Understanding first published in 2006 and updated in 2008.

Moreover the boards have expressed their commitment work together towards common standards by developing the IASB projects on consolidation and derecognizing as joint projects once the FASB has completed its short-term amendments to its existing standards. Furthermore, the boards have agreed to issue proposals to replace their respective financial instruments standards with a common standard in a matter of months, not years. As part of this project the boards have proposed to examine loan loss accounting, including the incurred and expected loss models. The boards also discussed the projects on financial statement presentation, fair value measurement, financial instruments with the characteristics of equity and the conceptual framework.

Moving forward, two of the most applauded actions taken by IASB were the set up of the Financial Crisis Advisory Group (FCAG) and the Expert Advisory Panel on Fair Value in a Declining Market (EAP). Therefore it is relatively important to discuss in this study some aspects related to these two groups and their role in providing guidance to IASB during the 2008 financial turmoil. In May 2008, and in response to the recommendations of the Financial Stability Forum in their April 2008 report Enhancing Market and Institutional Resilience, the IASB formed the EAP. The advisory panel would assist the Board in reviewing best practice and producing guidance on measuring fair value when the market is no longer active. The EAP comprised measurement experts from preparers and auditors of financial statements, users of financial statements, regulators and others. They have met on several occasions and the panel identified practices that experts use for measuring and disclosing financial instruments when markets are no longer active.

FCAG is a high level group of recognized leaders with broad experience in international financial markets that publishes its recommendations related to accounting standard-setting activities, and other changes to the international regulatory environment following the global financial crisis. The FCAG was formed at the request of the IASB and the US FASB to consider financial reporting issues arising from the crisis. (IFRS Press Release, 28 July 2009) The FCAG published, on 28 July 2009, its final report. The report lists four principles of financial reporting and lists a number of recommendations related to accounting standard-setting activities as emphasized in Table 1, and other changes to the international regulatory environment following the global financial crisis. The matrix below contains a summary overview of measures undertaken by the IASC Foundation and the IASB responding to the recommendations of the FCAG (with additional notes on measures undertaken by the FASB).

Table 1. A summary overview of measures undertaken by the IASC Foundation and the IASB responding to the recommendations of the FCAG

FCAG Recommendation	Corresponding measures undertaken by IASC Foundation/ IASB and FASB
Principle 1: Effective Financial Reporting *Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of those standards.*	***March 2009*** - the IASB and the FASB agreed to undertake a project to simplify and improve their standards on financial instruments, moving forward as a matter of urgency but with wide consultation; ***April 2009*** - The IASB started to work with the FASB as part of its comprehensive project to ensure global consistency in impairment approaches; ***June 2009*** - The IASB has taken its first step in exploring alternatives on the feasibility of an expected loss model for the impairment of financial assets; Also in *June 2009* the Board has reconsidered the appropriateness of an entity's recognition of gains or losses as a result of fair value changes in the entity's own debt because of decreases or increases, respectively, in its creditworthiness; ***July 2009*** – the IASB and FASB decided to prioritize to the financial instruments project, also the Boards made substantial progress on converged and improved standards on consolidation and derecognition (i.e., on off-balance sheet issues) and the other areas within their Memorandum of Understanding.

Principle 2: Limitations of Financial Reporting *In their joint conceptual framework project, the Boards should clearly acknowledge the limitations of financial reporting*	***In early 2010*** - the IASB and the FASB have published Phase A of their joint project for a common conceptual framework which deals with the Objective and Qualitative Characteristics of financial reporting by the end of the year. This part of the framework also addressed clearly the limitations of financial reporting.
Principle 3: Convergence of Accounting Standards *Because of the global nature of the financial markets, it is critically important to achieve a single set of high quality, globally converged financial reporting standards that provide consistent, unbiased, transparent and relevant information, regardless of the geographical location of the reporting entity*	The IASB and FASB agreed to work as a matter of priority on projects related to their Memorandum of Understanding that was updated in ***September 2008*** and will seek to avoid any unnecessary divergences in the interim period.
Principle 4: Standard Setter Independence and Accountability *To develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest*	Starting with ***March 2009*** - the IASB and FASB has announced to work jointly and expeditiously towards common standards and the joint and comprehensive financial instruments project was the main focus and chief priority of both Boards for the balance of 2009; ***September 2009*** - the IASC Foundation publishes its proposals on the second part of the Constitution Review. In the document the IASC Foundation proposes to establish a procedure for the possibility of an accelerated due process that would allow in exceptional circumstances a shorter than the currently allowed 30-day minimum comment period.

(Author's projection based on the information disclosed on FCAG Report, July 28, 2009 and FCAG letter to G-20, January 4, 2010)

Chapter 4
Historical cost accounting during the Great Depression

The premise from which we start this part of our research, is the statement made by Previts and Merino, in their book *A History of Accounting in America* (1979) that: "There are references to the post World War I period providing the 'hard historical evidence' that **deviations from historical cost-based, conservative accounting led to the crash of 1929**" (Previts & Merino, 1979: 227).

Hence, we attempt to analyze all the historical data which might provide us insights into the evolution of American accounting, prior and after the Great Crash, from 1929. Particularly by focusing on the discussions, which were related to the events surrounding the Great Depression, regarding the accounting regimes. From the beginning, it is very important to highlight that in 1920s and 1930s, researchers were extremely concern of both accounting models: Historical Cost Accounting (HCA) and the so-called *deviations* or *departures* from Historical Cost Accounting. Furthermore, we must also understand accounting practitioners and researchers' concern, during those times, as there were many people, among bankers, regulators and investors, who started to blame accounting practice for triggering the crisis. Consequently we have developed a hypothesis, as follows:

H1: American accounting, regulation and practice, was a factor which triggered the Great Depression from 1930s.

During the 1920s accountants and political leaders have considered of working closely with businessmen to limit cutthroat competition; and they all came to the conclusion that the primary responsibility of the accounting profession was to ensure that business has received a *fair return* on its investment. Moreover much of the profession's attention had been directed in securing legislation for accountants and little had been done in the areas of cost accounting (which seemed to be ceded to industrial engineers) and municipal accounting (which was dominated by economists).

Before the World War I, many accountants have argued that, since most companies paid out all reported earnings as dividends, *conservatism* and *sound values* (according to Epstein and Jermakowicz (2010: 323) the *sound values* is "the equivalent of the cost of replacement of the service potential of the asset, adjusted to reflect the relative loss in its utility due to the passage of time or fraction of total capacity that has already been utilized") should be reflected in the balance sheet. Also the relatively weak position of bankers with respect to corporate business also seemed to negate the importance of income determination in financial reporting.

Furthermore, after the World War I business management has started to adopt a new financing strategy that was called "the regularization of dividends" (Sobel, 1969: 32f). This *regularization of dividends* had two ramifications. Businessmen turned to the small investor, who during the war had become accustomed to investigating in bonds as a source of equity capital. The rationale was that if business could pay out regular dividends than it could attract these investors. This strategy was extremely successful, at that time, and many "companies maintained a surplus cash position and the corporate demand for bank loans plummeted accordingly" (Sobel, 1969: 262).

At the same time, bankers have become active participants in the equity markets, and they like all other sectors of the nation, had a vested interest in fostering the illusion of prosperity. This is the reason why, at that time, the *sound value* accounting or conservatism seem attractive. Also, before the Great Depression, banks has increased their purchase of stocks and bonds, and keeping the investor happy was as important to bankers as it was to business management, and nothing that would have dampened investor expectations was likely to be countenanced.

Many bankers and businessmen, at that time, has considered that the emergence of the small investor as a major source of equity capital might brought increased demands for greater accountability on the part of management and extended the function of accounting profession. Although, according to Previts and Merino, there is little evidence that "investors considered financial reporting and independents audits important" (Previts & Merino, 1979: 219). Moreover investors ignored the warnings that pure speculation was a nonproductive function that was extremely dangerous and potentially destructive when unregulated and fed by low margin requirements.

Many corporations from those periods were attracted to a guaranteed return of 20 percent on money lent to speculators and many managers could see no reason to expand their productive facilities because they could never realize the same return. Thus the productive capacity remained dormant while corporate and banking funds fuelled the speculative fever. Previts and Merino (1979), in their book has described the case of the company International Harvester. They have found out that the financial reports of the aforementioned company, in 1928, has emphasized that the corporation spent too much money in stock and that the direction of investment was dangerous. Also the corporate funds were being diverted to nonproductive uses that would not support the economic growth. “It would be foolhardy in view of this attitude to suggest that accountants had the authority or the mandate to limit reported earnings to realized operating income” (Previts & Merino, 1979: 211). Hence, management would not support such an accounting model, and there was no user group demanding conservatism or *sound value* accounting.

There were many inadequacies in the American accounting theory and practice prior to the Great Depression, in the 1930s. For instance, Stephen Gilman, while evaluating the accounting theory in the post World War I period, has found out that the “income determination had not become the focal point of financial reporting” (Gilman, 1937: 57). Moreover Gilman believed that one of the paradoxes of accounting was the fact that the maturity of large corporations, the income tax laws, and rapid advances in cost accounting ought to have led to the primacy of the income statement (Gilman, 1937). Prior to the Great Crash most accountants believed that any theory must be *pragmatic* (useful, practical and leading to desirable social consequences) and *adaptive* (needing to meet the changing demands made upon the profession). Also there is little evidence that any user group would have supported efforts to report only income from operations; but to do so would have limited, or at least dampened, the wave of optimism which swept the US.

Moreover there were many critics at that time, of the accounting theory and practice during the 1920s, stating that accountants abdicated the stewardship role and placed greater emphasis on the needs of management, permitting too much flexibility in financial reporting. Also, at that time, accountants have worked in an era marked by massive official indifference and they did not have the authority or the power to handle corporate abuses.

There are many conclusions that can be drawn by analyzing the historical data regarding the American accounting, prior and after the Great Crash, but before we enumerate these, we must take into account the fact that, during those times, accountants have lived in an era of total indifference towards accountants role in a corporation and in the society. Thus, we do consider that there are no reasons for which we or others should blame accountants for the corporate frauds of those times.

In the 1920s companies started to become more interested in their stock exchange market activity (by selling their shares, bonds and stock), which was considered an *unproductive* function, than in their *productive* function; as the former one determined them to create fictive incomes and thus a fictive surplus, to gain a better place on the market, and subsequently to attract more investors, who could bring more money.

In this research we have presented two cases of corporation (Dodge Brothers and Ivar Krueger), which were misleading the financial statements, even without fraud, as the law (we could not use the words accounting regulations here, because accounting was not regulated in the 1920s) allowed then to record, or not record, some strange transactions, and so the management could earn more money. These examples represent an illustration that greed and fraudulent accounting are nothing new in the business world, and determine us to remember the fall of Enron Corporation, in 2001, and Lehman Brothers, in 2008.

Another important conclusion that can be drawn is that the Great Crash from 1929 has caused a sudden change in the area of accounting research and practice. Accountants started to work together with regulators, to develop accounting principles which will prevent the occurrence of another economic crisis in the future. Thus, accountants' main concern, after the crash, was the economic recovery and financial stability. Hence, these facts and events, related to the changes in accounting research and practice, which were made immediately after the crash, are in accordance with the punctuated equilibrium evolution theory. Historical cost allocation model became the dominant theory of accounting in US, during the late 1930s. Also, there are many references which state that HCA was the main accounting regime, in US, in the 1920s too, although there were no clear rules and principles which would impose that.

In Table 2, we have elaborated an overview of accounting researchers' perspective on the accounting regimes, before and after the Great Crash (1929), and as it can be seen the majority of accounting researchers were favouring the HCA model. As a note, HCA model has two forms: (1) unmodified HCA – meaning that we do not do anything to those numbers before we record it, into accounting (i.e. the purchase value); and (2) modified HCA – meaning that we do all kind of things to those numbers, for instance we amortize or we impair. During the 1930s only Littleton (1933) and Sweeney (1935) were accepting the modified HCA.

During the 1920s there was no concept of what we call today Fair Value Accounting, although there were some accounting researchers who believed that in the financial statements should be recorded the present market value, of a certain asset. But during those times their believes, on the present value or market price, were not accepted by the accounting regulators and other researchers.

Also in the 1920s three researchers considered that the financial statements should reflect both the historical cost value and the present value. The first researcher who has stated explicitly that the balance sheet should have two columns, one for the historical cost value and another one with the present value, was Greer (1929). But accountants did not empathized with his idea and they have argued that this could create confusion.

Therefore, in this part of the thesis we present an illustration of the fact that, more than 80 years ago, people had the same discussions and concerns related to accounting, accounting regulations and accounting regimes and their role in a crisis. Thus, it is obvious that history repeats itself and we do believe that it repeats itself exactly, but we need to learn from the past for only so we will be able to avoid future crashes and crises.

In a nutshell, we do not consider that American accounting, regulation and practice was the factor triggering the Great Depression of 1930s, so *Hypothesis 1* is not validated, but we do believe that the greed of some businessmen from those times, whom determined their accountants to book the fraudulent transactions, might had an influence in triggering the crisis of 1929 and fuelled it.

Table 2. Overview of accounting researchers' perspective towards accounting regimes, prior and after the Great Crash, from 1929

Historical Cost Accounting (HCA)		Present/Economic Value Accounting (EVA)		Both HCA & EVA
Name	*Comments*	*Name*	*Comments*	*Name*
DICKSEE (1907)	Unmodified HCA	**CANNING (1929)**	Support the multiple valuations	**COLE (1908)**
SIMPSON (1922)	Unmodified HCA	**SCOTT (1931)**	The actual value	**GREER (1929)**
HATFIELD (1922)	Unmodified HCA	**MACNEAL (1939)**	"Economic Value Accounting"	**CANNING (1929)**
ESQUERRE (1924)	Unmodified HCA	**PATON (1948)**	"Present Values" – BS approach[1]	
LITTLETON (1933)	Modified HCA (depreciation)			
Kohler (1934)	HCA – IS approach[2]			
SWEENEY (1935)	Modified HCA			
SCHMALENBACH[3]	Unmodified HCA			
HEALY[4]	HCA			
BLOUGH[5]	HCA			

(Author's projection)

[1] BS – Balance Sheet
[2] IS – Income Statement
[3] He was a German accounting researcher
[4] He was a founding member of the SEC
[5] He was the first chief accountant of the SEC

Chapter 5

Fair value accounting during the Global Financial Crisis

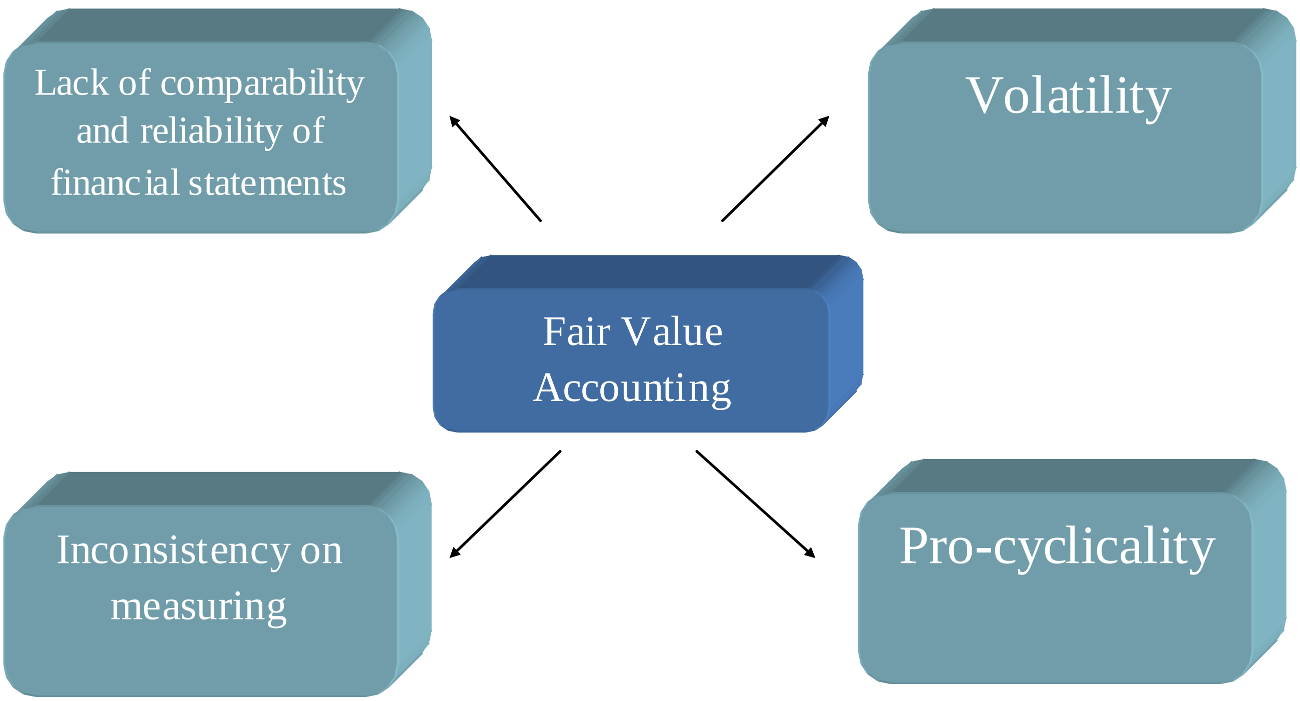
Fair Value Accounting or Mark-to-market Accounting is the dominant accounting regime of the 21st century. Fair value accounting is a financial reporting approach in which companies are required or permitted to measure and report on an ongoing basis certain assets and liabilities (generally financial instruments) at estimates of the prices they would receive if they were to sell the assets or would pay if they were to be relieved of the liabilities. Moreover, "financial globalization and the constraints it imposes on the international accounting harmonization and national normalization indirectly increases the importance of fair value and gives extra complexity" (Deaconu, 2009: 339). Thus, it is undoubtedly that fair value accounting has raised serious concerns during the global financial crisis that started in 2008.

Academic debates with respect to fair value accounting

The global economic crisis, from 2008, stemmed from a bank panic in the United States. Gorton (2009, 2010) argues that the recent crisis is similar to banking panics of the late 19th and early 20th centuries. The recent crisis started in a *shadow banking* system that had grown up around securitized loans and the demand for collateral in markets involving the sale and repurchase of securitized assets. These security markets were highly sensitive to changes in the fundamental value of real-estate assets underlying securitized loans. The shock that led to the crisis was the bursting of a real estate price bubble that was caused by low-interest-rate monetary policies and government subsidization of sub-prime homebuyers (Rajan, 2010).

Moreover, declines in real economic activity during a crisis can spill over to other economies through trade and capital flows. In response, governments often undertake monetary and fiscal stimulus as well as regulatory reform, and according to Reinhart and Rogoff, this has been the case with the most recent crisis (Reinhart & Rogoff, 2009: 210). Fair value measurement is controversial and was strongly debated prior to the financial crisis commencing in 2007 (ICAEW, 2006) and subsequently has been discussed as a possible cause of the crisis (Laux & Leuz, 2009). Thus, this study aims to conduct a quantification of academics opinions related to fair value accounting and its role in the recent crisis; also this study aims to find answers of the abovementioned questions. Since 2007, when the global financial crisis has started, researchers and academics in the area of accounting and other areas have published a significant amount of articles analyzing the relation between crisis and fair value model. Consequently, quantifying all the information provided in these articles is not an easy task; thus we choose to split them in four directions, because challenges to fair value accounting have generally centred on four main concerns, as it is emphasized in the figure below.

Figure 4. Main concerns related to Fair Value Accounting during the global financial crisis



(Author's projection)

The global financial crisis has led to a vigorous debate about the pros and cons of fair value accounting. Even though fair value accounting did not cause the crisis, it is right to reflect on its role; particularly, to understand whether it accelerated the crisis and if is now continuing to aggravate it. We do believe that the main problem during the recent crisis was IASB's lack of flexibility, to adapt or react rapidly, and this would have led to fewer concerns on fair value regime amongst academics, business community and the general public.

Furthermore, concerns regarding comparability are often raised in the context of fair value accounting in the absence of quoted prices. But we strongly believe that the use of historical cost accounting, instead of FVA, may result in the potential for an even greater lack of comparability, as assets are valued based upon differing purchase prices, resulting in identical individual assets with different assigned values.

Some academics have shown a strong support to FVA (Barth & Taylor, 2010; Barth & Landsman, 2010; Laux & Leuz, 2009 and 2010; Plantin *et al.*, 2008) others have viewed FVA as a main factor in accelerating the crisis (Hitz, 2007; Ryan, 2008; Mishkin, 2008) and considered that FVA should be replaced with HCA (Boyer, 2007; Allen & Carletti, 2008). Moreover, academics considered that FVA has played a catalytic role in the financial crisis (Yujing & Gaichune, 2009) as it led to pro-cyclicality (Waymire & Basu, 2011; Persaud, 2008; Fu, 2008), but in the same other researchers considered that FVA is just a convenient scapegoat (Veron, 2008; Matis *et al.*, 2010; Badertscher *et al.*, 2012).

To sum up, the fair-value debate is far from being over and much remains to be done. Among academics this debate still continues, and each of them have their own views that are developed based on different theories, models (Franklin & Cartelli, 2008; Plantin *et al.*, 2008), empirical analysis or simulations (Sapra, 2008).

Study on the Comment Letters Submitted to the IASB Exposure Draft for Fair Value Measurement

Academics and researchers, in the area of accounting or other areas, are publishing articles or research papers in academic journals or other types of journals, so they could made accessible to the large public researches, theories, ideas and even their thoughts. But what about the general public, like businessmen, bankers, managers, accountants or different organizations, how could they make their opinions related to a certain subject or issue known to the large public? They could definitely start publishing articles, as academics do, in related journals or newspapers; yet this is not their main objective, as they have to deal with many daily issues at their work, and it is also important to acknowledge that everything that is published in journals or newspapers must first need to pass through a certain filter.

Consequently, the business community is using other types of channels to make their views known, and we do believe that they do not miss any opportunity in doing so. For instance, the global financial crisis, from 2008, has raised many concerns, among the academic and business community, related to the accounting system and standards, and more specifically related to mark-to-market accounting regime. Certainly the academics started to publish papers related to this subject, but the business community has used another tool to share their views to the general public.

On May 2009, the IASB has published for public comment an Exposure Draft (ED) on guidance on Fair Value Measurement (FVM). And this was one opportunity that the business community and even the large public, has used in order to express their thoughts regarding the fair value accounting and its implication in the current financial crisis. We do consider that this opportunity was a great opportunity for the business community, because they not only did make their views known, but they could also give advices to IASB on how to improve the standards, in terms of fair value.

Another opportunity, coming once again from IASB, was on June 2010, when the IASB published for public comment further enhancements to a disclosure proposal on Level 3 Fair Value Measurements that formed part of the IASB's Exposure Draft Fair Value Measurement published in May 2009. And this opportunity and the previous one was indeed used by the business community and the regulatory bodies, in order to express their concerns and ideas, as there were many comment letters (CLs) received by IASB, on those periods over which the CLs can be submitted.

Therefore, we attempt to conduct an analysis on the CLs, received by IASB, on the ED on FVM, in 2009, and on the ED on *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements - Limited re-exposure of proposed disclosure,* in 2010. The purpose of this study, the analysis of the CLs, is to identify the main issues discussed by the business community and the regulatory bodies and their views regarding the relation between the fair value accounting regime and the global financial crisis.

We do believe that by analyzing the CLs we will be able to find out whether the general public (such as business community and the regulatory bodies) consider that fair value accounting was a factor in triggering the current crisis. Furthermore, this study will help us understand why fair value is blamed by some and applaused by others; who are those who blame/applause it and what reasons do they have in doing so.

The premises of our study are that the respondents of the IASB exposure drafts (those who submitted the CLs) have used this opportunity to express their thoughts, not only to the fair value measurement as it is presented in the proposed ED, but also to the fair value accounting and its role in current financial crisis. Moreover, we assume that the recent financial crisis has played a major role in the development of the fair value measurement EDs, and the respondents of the EDs have acknowledged this in their comment letters.

Thus, we have developed the following two hypotheses:

- *Hypothesis 1: Respondents of the EDs on FVM have used this opportunity to express their thoughts related to FVA and the global financial crisis*
- *Hypothesis 2: The recent financial crisis has played a major role in the development of the FVM EDs*

The qualitative analysis has enabled us to elaborate a deep examination of the CLs submitted to the IASB ED for fair value measurement, on 2009 and 2010. Consequently we were able to obtain a more profound knowledge of the respondents' opinion toward the highly debated issue in the recent years, the fair value accounting and its role in triggering the global financial crisis.

A summary of the qualitative analysis have been elaborated by developing two questions which we consider to match our research purpose. Answers to these questions were made based on the analysis of the CLs of the respondents listed on the below table. The first question is: 'Was FVA an issue during the recent crisis?'; and the conclusion which can be drawn by analyzing the CLs, is that all respondents from this examination has considered that FVA was an issue in the recent financial crisis. And this was not just because this subject was highly debated in the recent years, but because the fair value accounting, as developed in the IFRS, was not properly regulated in situations in which markets are under stressed conditions, like in the current crisis. Moreover the majority of respondents, 15 out of 23, do believe that IASB has not learnt a lesson from the current financial crisis, in terms of FVA, and they did ask IASB to improve the existing guidance on fair value measurement (see Table 3).

Table 3. Summary of the qualitative analysis of the Comment Letters Submitted to the IASB Exposure Draft for FVM on 2009 and 2010

No	Respondent	Did IASB learn a lesson from the current financial crisis, in terms of FVA?
1	United Kingdom Accounting Standards Board	Yes
2	Australian Accounting Standards Board	Yes
3	European Financial Reporting Advisory Group	No
4	Ernst & Young Global Limited	No
5	Institute of Management Accountants	Yes
6	Hong Kong Institute of Certified Public Accountants	No
7	Joint Accounting Bodies in Australia	Yes
8	Singapore Accounting Standards Council	No
9	Association of Chartered Certified Accountants	No
10	Association for Participation in the Development of Accounting Regulations for Family-owned Entities	No
11	Basel Committee on Banking Supervision	No
12	European Banking Federation	No
13	Federation Bancaire Francaise	No
14	Confederation National du Credit Mutuel	No
15	Adriana Sarmiento	No
16	Ministry of Finance from China	No
17	Institute of Chartered Accountants of India	No
18	International Actuarial Association Canada	No
19	Royal Dutch Shell	No
20	World Council of Credit Unions	Yes

21	Confederation of Swedish Enterprise	Yes
22	Association GEDEON-DFCE	Yes
23	Autorite Des Normes Comptables	Yes

(Author's projection)

Moreover this qualitative analysis helped us to understand why certain respondents were not in favouring the EDs on fair value management issued by IASB. For instance, as stated above, bankers were those who truly saw fair value accounting as the crisis' scapegoat and they also were very reluctant to the content of the fair value measurement EDs, by asking the IASB to make improvements on the accounting standards. Additionally, European organizations (especially the French ones), have expressed similar concerns related to the role that mark-to-market accounting has play in the recent financial crisis.

While collecting the data, from the CLs, for the qualitative analysis we were considering gathering information for a small qualitative study. The following steps were made in order to collect the information for the qualitative analysis. First we have created an Excel Spreadsheet in which we gathered information from the CLs regarding: the name of respondents, country, activity sector and their answer to the twelve questions from the FVM ED. Second, the authors of all letters were examined to determine to what type of constituent they belonged (e.g. preparers, standards setters or users; and individuals, companies or organizations).

Besides the qualitative analysis of CLs, it is mandatory to elaborate a ***quantitative analysis*** of responses for shaping relevant conclusions towards respondents' opinion related to the FVM ED. The objective of the quantitative analysis is to strengthen the conclusions of the qualitative analysis. Particularly to emphasis the fact the majority of those who submitted the CLs have not supported the ED on fair value measurement; and as mentioned above they considered the IASB still needs to improve the existing guidance on fair value.

A content analysis of the comment letters was undertaken in order to determine whether the respondents opposed or supported the ED on fair value measurement. Further positions were classified in the categories: *support, oppose* and *neutral*. In the statistical analysis, the values *1, 0,* and *-1* were assigned to the categories *support, oppose* and *neutral* respectively. This type of categorization and approach is based on the previous research of Buckmaster *et al.* (1994), Rahman *et al.* (1994), Ryan *et al.* (1999) and Georgiou and Roberts (2004). An issue of major importance consisted in recording and coding the responses, as not all respondents were stating clearly their support/oppose to all the questions from the FVM ED. Thus, we conducted a detailed content analysis of text responses and the categorization was made based on that. Appendix 3 presents the questions of the ED on fair value measurement from 2009, which have been used for this detailed content analysis.

We have also developed the following hypotheses for this quantitative analysis:

- *Hypothesis 3: Respondents of the ED on FVM were reluctant to the content of the ED.*
- *Hypothesis 4: European respondents rejected the content of the FVM ED at a larger scale than those from other countries.*
- *Hypothesis 5: Bankers rejected the content of the FVM ED at a larger scale than other respondents from other activity sector.*

Table 4 shows the average position for preparers, standard setters and users on the twelve questions of discussion from the IASB's invitation to comment and the last columns represents the combined average of those twelve questions. All these three types of respondents are generally in favour of the elements proposed in the ED, but it is extremely important to highlight that their support is very weak. This means that all preparers, standard setters and users were not opposing to the content of the ED and their support was pretty *shy*. Further, Table 5 presents the average position for all the respondents which were split in three groups: companies, individuals and organizations. By analyzing the table we can confirm that individuals and organizations were reluctant to the content of the ED and only companies were showing a bit of support. Moreover, Table 6 presents the average position of respondents towards the content of the FVM ED, classified by regions. Remarkably is the fact that the results that are shown in this table validates hypothesis 4 which states that respondents from Europe were reluctant to the content of the FVM ED than those from other countries. American respondents shares the same views as their European counterparts, they are also more reluctant to the content of the ED than supportive. The opposite are respondents from continents such as Asia, Australia and other regions, who did express their support towards the ED, although their support is not that strong.

Tabel 4. Average position for preparers, standard setters and users

	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	AVG
Preparers	0	0.25	0.0277	0.2963	0.0092	-0.1759	0.0463	-0.1759	0.1111	0.1666	-0.1389	-0.1852	0.0192
Standard setters	0.0833	0.2083	-0.0417	0	0.1666	-0.1667	-0.0417	-0.3333	-0.0833	0.4583	0.25	-0.2917	0.0173
Users	0.0833	0.2083	-0.0416	0	0.1666	-0.1666	-0.0416	-0.3333	-0.0833	0.4583	0.25	-0.2916	0.0174

(Author's projection)

Tabel 5. Average position for companies, individuals and organizations

	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	AVG
Companies	0.1458	0.3541	0.0208	0.3958	0.0416	-0.125	0.1041	-0.2083	0.2083	0.3541	-0.2083	-0.3333	0.0625
Individuals	-0.3636	-0.1818	-0.0909	-0.0909	-0.1818	-0.2727	-0.0909	-0.1818	-0.3636	-0.0909	-0.0909	-0.0909	**-0.1742**
Organizations	0.0104	0.2395	0.0312	0.1562	0.0208	-0.2395	-0.0416	-0.2708	0.0208	0.0625	0.0208	-0.1041	-0.0078

(Author's projection)

Tabel 6. Average position of respondents classified by regions

Regions/ Continents	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	AVG
Asia	0.3684	0.2631	-0.2105	0.1578	0.1578	-0.1053	0.0526	-0.2105	-0.0526	0.1052	0.0526	0.1578	0.0614
Australia	0	0.5789	0.3684	0.5789	0.5263	-0.3684	-0.1579	-0.3684	0	-0.1053	-0.1579	0	0.0745
Europe	-0.2222	0.2222	-0.0138	0.1527	-0.1388	-0.3194	0.0555	-0.3194	0.1111	0.2222	-0.1111	-0.2083	**-0.0474**
North America	0.2647	0.0588	-0.0294	0.1176	-0.1176	0.0294	-0.2058	-0.1470	-0.0294	0.1764	0.0588	-0.4117	**-0.0196**
Other regions	0.3636	0.3636	0.1818	0.3636	0.2727	-0.0909	0.4545	0.0909	0.1818	0	-0.0909	-0.0909	0.1666

(Author's projection)

This quantitative analysis was made only on the comment letters of the IASB ED for Fair Value Measurement, from 2009. We could not conduct a similar quantitative analysis on the comment letters of the IASB ED for Measurement Uncertainty Analysis Disclosure for Fair Value Measurements - Limited re-exposure of proposed disclosure, from 2010, because the questions that were addressed in the ED were open and informative questions; they were just seeking for examples of certain circumstances or alternative disclosures of fair value measurement on illiquid markets.

The purpose of this chapter is to summarize the evidence collected and give a short and clear answer to our research question: What is the opinion of the business community and the regulatory bodies on the issue of fair value accounting and its role in the recent crisis, and what arguments are presented pro/con?

We do believe that is very important to highlight the fact that this analysis of the CLs is an extremely valuable asset for this thesis and one important reason is that the analyzed population from this study (those who submitted the CLs) is a population which has a clear view of the global financial crisis phenomenon and moreover on the role of fair value accounting in this crisis. For instance, if we take a look on Appendix 1 and Appendix 2 we will figure it out that the majority of respondents are organizations, regulators and companies that play a very important role in this world and for our society (e.g. World Bank, European Financial Reporting Advisory Group, International Organization of Securities Commissions, Basel Committee on Banking Supervision, Deloitte Touche Tohmatsu, Ernst & Young, KPMG, PricewaterhouseCoopers).

In a nutshell, we can claim that respondents of the ED on fair value, issued by IASB in 2009 and 2010, did considered mark-to-market accounting an issue in the recent financial crisis. Furthermore all our hypotheses were validated and this led us strongly confirmed that:

- Respondents of the EDs on FVM have used this opportunity to express their thoughts related to FVA and the global financial crisis (H1);
- The recent financial crisis has played a major role in the development of the FVM EDs (H2);
- Respondents of the ED on FVM were reluctant to the content of the ED (H3);

- European respondents rejected the content of the FVM ED at a larger scale than those from other countries (H4);
- Bankers rejected the content of the FVM ED at a larger scale than other respondents from other activity sector (H5);

Thus bankers and Europeans were in general the ones which have criticized fair value accounting and consider it an important issue in the recent crisis. Moreover they were also more reluctant to the content of the IASB's ED on fair value measurement and they have claim that IASB must consider further improvements on fair value measurement before publishing the financial reporting standard.

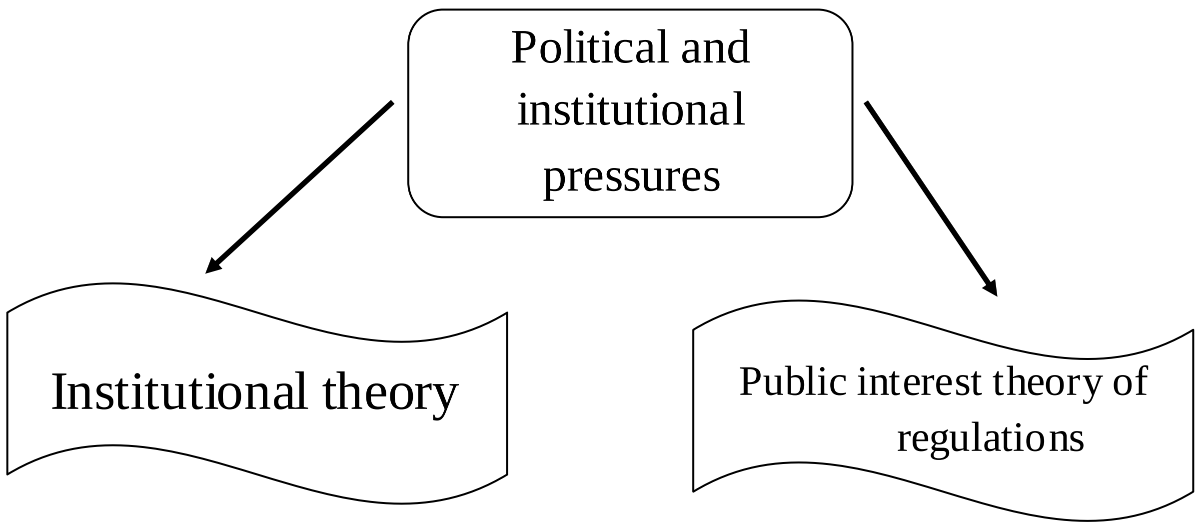
Chapter 6

Political and institutional pressures – factors that led to accounting changes during the global financial crisis

This study attempts to explain the ways power operates in order to influence the accounting change during periods of economic crisis. In order to determine these types of pressures or influences, we need to consider the institutional system in which power struggles and political processes take place. But such systems of norms, values, beliefs are typically ignored in accounting research based on political economy (Mattli & Büthe, 2003).

In this research, power does not only refers to economic power or formal sanctioning powers, but also to informal sanctions that follow from being regard as legitimate by other powerful stakeholders. This is contingent on organization's objectives and actions being congruent with the system of norms, values, and beliefs in which they act (Jepperson, 1991). Institutional theory was often used in researches on accounting standard setting to complement the explanatory frameworks of rational theory and political economy (Judge *et al.*, 2010; Touron, 2005; Carpenter & Feroz, 2001). But their mainly focus was on how normative pressures influence adoption of accounting standards, and not on how the playing field of political power struggles is formed and influenced by normative or cognitive traits. In this chapter, we demonstrate that political and institutional pressures are factors that determine the accounting standards-setters to change accounting regulations during periods of economic instability, such as an economic crisis, through the lens of institutional theory and public interest theory of regulations.

Figure 5. Theories used to identify and understand the political and institutional pressures



(Author's projection)

Institutional theory is complementary to economic theory and provides another lens through which to view economic resource dependency incentives for accounting regulation choice. Also from the institutional theory perspective, the organizations are operating within a social framework of norms, values and taken-for granted assumptions about what constitutes appropriate economic behaviour (Oliver, 1997). *Public interest theory of regulations* is an economic theory that was first developed by Arthur Cecil Pigou, and states that regulation is supplied in response to the demand of the public for the correction of inefficient or inequitable market practices (Pigou, 1932). More generally, according to Hertog the public interest theories may be applied to "identify possible causes of market failures and to summarize possible regulatory solutions" (Hertog, 2003: 15). Furthermore, the standard public interest theory of regulation is based on two assumptions: (1) first, unhindered markets often fail because of the problems of monopoly or externalities; and (2) second, governments are benign and capable of correcting these market failures through regulation (Posner, 1974). This theory of regulation has been used both as a prescription of what governments should do, and as a description of what they actually do, especially in democratic countries.

At the international level, the first steps towards fair value accounting lobbying were taken by International Organization of Securities Commissions (IOSCO) and the Financial Stability Forum (FSF). IOSCO has prepared a report which highlighted a number of problems regarding the existing accounting principles. On the other hand, FSF's report contained a number of recommendations that IASB should take into account in order to improve the accounting standards. However, at the European level, the first initiative, regarding all the concerns on fair value accounting, was taken by France and it took by surprise the IASB; as at that time the IASB was searching for response to the Group of 7 (G7) and FSF's report. Since the global financial crisis had burst out, the IAS 39 requirement to measure certain financial assets using the fair value approach caused major concern among bankers and politicians. Fair value accounting, particularly mark-to-market valuation, was perceived to create a negative spiral, in which banks' sales pushed market prices down, forcing additional fire sales and further declines in asset prices (Appelbaum, 2009; Jones, 2009). But it took a couple of months from the first signs of financial instability in summer 2007 before IASB's stakeholders, formally voiced its concerns.

The French President, Nicolas Sarkozy, has asked the former president of the International Federation of Accountants, Rene Ricol, to make an investigation in order to find out whether the European banks were being disadvantaged by IFRS in comparison with the American banks, which were reporting under US General Accepted Accounting Principles (US GAAP). Ricol took into account the European banks' complains, that under IFRSs, debt securities could not be reclassified from trading to hold to maturity, and thus they were disadvantaged as compared with their American counterparts. In his report, Ricol has argued that SFAS 86 - *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed,* did not require property mortgages to be held at fair value; and SFAS 133 - *Accounting for Derivative Instruments and Hedging Activities*, the substantive fair value standard, allowed available for sale financial instruments to be re-classified under 'rare' circumstances (Ricol, 2008: 51). Hence, he concluded that European banks were being disadvantaged by IFRS in comparison with the American banks.

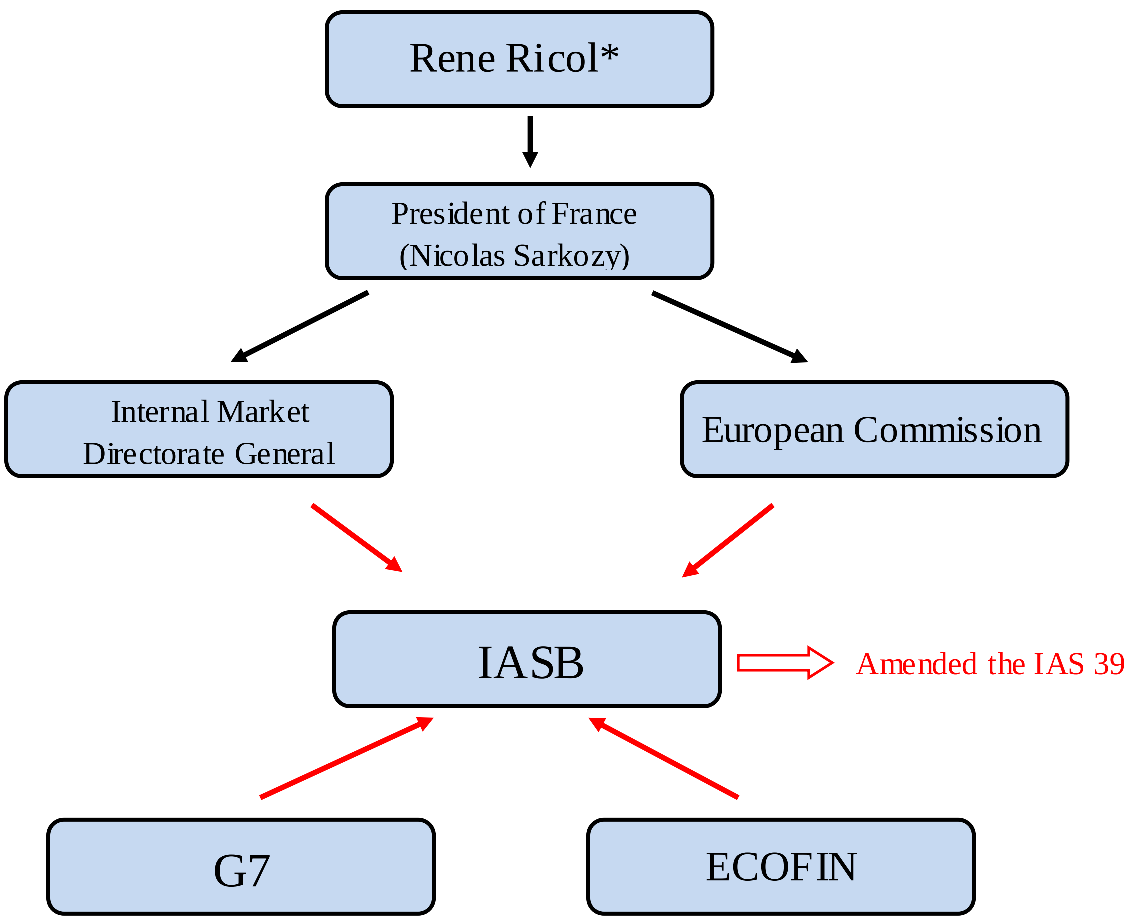
Ricol's report was made public and it generated intense lobbying among European political institutions. The institution which took a step forward in this respect was the Internal Market Directorate General (DGXV) which is responsible for capital markets in the European Union. The DGXV together with the European Commission (EC), have issued a 'carve-out', notifying the IASB that it must amend the IAS 39 *Financial Instruments: Recognition and Measurement* immediately, without due process, otherwise the EC would take some unspecified action, which might lead to the IASB's losing its franchise to set accounting standards in the EU (European Commission, 2008a). From their point of view this issue was urgent, because the banks were within days of releasing their third quarter earnings reports.

In addition, the European Commissioner for Internal Market and Services, Charlie McCreevy has reported to the European Parliament's Committee on Economic and Monetary Affairs: "there is a growing debate on whether fair value and mark to market measurements may have aggravated the crisis by bringing pro-cyclicality in financial statements. I want to make it clear that I believe that there are some real accounting issues and anomalies to examine" (McCreevy, 2008: 2).

Taking a look back to the European Union Regulation (EC) No. 2002/1606, which required that all European listed companies must follow IFRS from 2005 and also included a requirement stating that IFRSs endorsed by the European Union must not disadvantage European companies as compared to those in other major markets. But the recent crisis has prooved that this requirement does not apply during periods of financial instability. Furthermore, immediately after the collapse of Lehman Brothers, in September 2008, the Heads of State of France, Britain, Germany and Italy together with the head of the European Central Bank and the President of the European Commission agreed on a plan that addresses the global financial crisis issues. Moreover, during the G7 meeting, on October 4, 2008, has been agreed that the IASB should be asked to amend IAS 39 to bring it in to line with US GAAP by the end of October; and a few days later, during the meeting of the EU Council of Finance Ministers (ECOFIN), the same decision has been approved.

Consequently the IASB, being under pressure, has amended the standard on October 13, retroactively, as the Commission has demanded, to July 1, 2008, when the market values of their debt holdings may not have been lower than their carrying amounts. The IASB has stipulated a disclosure requirement that obliged the banks to reclassify their debt holdings and reveal what their profits would have been in the absence of the reclassification. And the EC has endorsed the standard two days later. Deutsche Bank was one of the first that took advantage of this accounting rule and was obliged to disclose that its pretax profit of €93 million for the third quarter would have been a pretax loss of €732 million without the reclassification (Stice & Stice, 2010).

Figure 6. Illustration of EU's political pressure on the IASB' standards setting process, during the global economic crisis



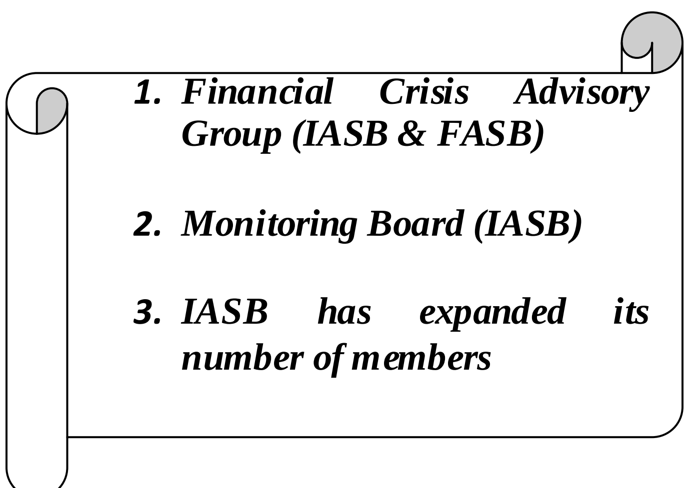
(Author's projection)

But the US Securities and Exchange Commission (SEC) were not pleased by the EU 'carve out' and by the actions took by IASB; and this turned into a bizarre episode for the IASB. Sir David Tweedie, the president of the IASB during that time said he came close to resigning (Tweedie, 2008) and it believe the European carve out could have lead "to the demise of the worldwide globalization project. The credibility of IFRS and the IASB would be fatally damaged if it became inescapably clear that Europe did not accept its authority" (Andre *et al.*, 2009: 14).

As Sir David Tweedie has highlighted, the European Commission's intervention in the standard-setting process led to a loss of credibility of the Board, in from of other stakeholders, especially those from US. In addition the US SEC's critics seized on this episode as constituting evidence that the IASB cannot be relied upon in the face of political pressure, especially from within Europe (Deans & Mott, 2008; Selling, 2008; Ciesielski, 2009).

Even though the IASB has made many concessions, during the global financial crisis, towards fair value measurement, its standard due process and delaying the rethink over accounting for liabilities, the IASB did not just passively adapt to the political pressures and it developed several strategies to resist or to minimize political influence (see Figure 7).

Figure 7. Steps taken by IASB to minimize the political influence



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The global financial crisis has altered the beliefs of the IASB's credibility and independence, as they have been compromised by the European Commission, which force the IASB to allow re-classification. Hence, it was extremely tough for IASB to not take into account the EC's demands; and some argued that if the "Commission abandoned IFRS, it was probable that Japan would follow suit, and potentially all the countries planning to adopt in 2011 might withdraw" (Andre *et al.*, 2009: 20).

Furthermore, the Commission intervention was not very well regarded in the US, especially by the SEC. Thus, the chairman of the SEC, Mary Schapiro, has confirmed in front of the US Senate that she does believe that a single set of global standards would be a very beneficial thing but she expressed concerns about the independence of the IASB and said she would not necessarily be bound by the proposed roadmap (World Accounting Report, February 2009: 7). Consequently all these facts have led to the delay of the US in adopting the IFRSs.

The IASB's accounting standard setting has been for long controversial in the area of financial instruments (Perry & Nölke, 2005), even at the establishment of IAS 39, IASB was under political pressure. Moreover the adjustment of the standard in the face of political influence from the EU is a clear example of an institutional strategy in response to institutional pressure. As the global financial crisis broke out, the general turbulence on financial markets and difficulties of banking systems in Europe altered the institutional system surrounding accounting standard setting. Prevailing norms of capital market logic and standard setter independence were challenged and institutional heterogeneity arose. As illustrated by the above described events, one such area of institutional heterogeneity concerned the purpose of accounting standards.

European dissatisfaction with fair value was fuelled by concerns that European financial services industries were suffering from regulatory disadvantage vis-à-vis their US counterparts. Also certain European banking systems were particularly hard hit under fair valuation rules. In this institutional environment, the EU took a range of actions to pursue change, through reports, letters and speeches and also via other actors, such as G20 and BCBS. Also, the EU threatened to limit mark-to-market valuation and strict deadlines were set for which important changes to IAS 39 should be made by the IASB.

CONCLUSIONS

If there is anything good about the global economic crisis and its consequences, it is an opportunity to refresh our thinking. This crisis challenges us, the academics, to re-evaluate our research agendas - and perhaps also the institutional incentives and unexamined assumptions that drive them - so that the economic and accounting research can contribute - to a broader social and political analysis of the recent economic crisis.

As the current crisis has shown, accounting standards can have huge implications for the outside world, so the outside world should have the opportunity to have a say in it. This is especially the case now, when public authorities have become so important in the worldwide acceptance of standard. Furthermore, stakeholders are the one being considerable affected by crises and any changes in accounting regulations will influence their welfare. Also, the desire for certainty seems to have been one of the characteristics of the "crisis mentality", during the past century, and accountants could not give legislators all the assurance they demanded. But the recent events have emphasized and also made clear to most regulators, practitioners and stakeholders that there is not such a thing as "simple rules" in accounting.

Research studies on the evolution of accounting have a long tradition, although only few of them studied the relation between economic crises and accounting. Researchers believe that accounting standards are deeply implicated in the economic crises, at the same time they consider that crises shaped the evolution of accounting. Therefore, we do believe that our research, which studies the interplay between economic crises, particularly with an emphasis on how crises drive changes in accounting regulations, brings novelty in the accounting and economic crises area and contributes to the body knowledge of accounting literature.

In the *first chapter* of the thesis, we have presented the conceptual framework and theoretical grounding position in the sphere of knowledge, of economic crises. We have clarified the notions of 'crisis' and 'economic crisis', particularly we emphasized what we mean when we use the term of 'economic crisis' in this thesis; we described the typology of economic crisis and we have made a brief overview of the history of economic crises. Moreover, we have conducted an analysis, using Google Trends, which has emphasized that Google users (which can considered of being the general public) did made an association between ‘accounting’ and ‘crisis’, during the recent economic crisis and this can be interpreted as follows: the general public either saw accounting as a factor or as a solution of the current crisis. Although - we would like to highlight once again - Google data may contain inaccuracies, but this may be regarded as a starting point on understanding the link between crisis and accounting on people’s mind.

In the *second chapter* of the thesis, we have elaborated a review of the literature in order to find out whether we could talk about progress in accounting and if changes in accounting are evolutionary. Our conclusion is that it is not legitimate to say that accounting is progressive and accounting changes are evolutionary, as long as many researchers recognize that what is progress for some may be degeneration for others, and what appears progressive at one point in time may not seem so with the benefit of hindsight.

Moving forward, the main goal of the *third chapter* was to prove that economic crises drove changes in accounting thought and practice, and we can conclude that this goal was achieved. Also, all these changes in accounting and accounting regulations were presented through the lens of punctuated equilibrium theory. Therefore, our analysis has started with England’s commercial crises that occurred during the nineteenth century, crises which led to bankruptcy laws which improved the books of accounts of those days. Then, the Great Depression (1929 – 1933) has marked the beginning of a new era of accounting thought and practice in the US. The end of the twentieth century and the beginning of the twenty-first century is characterized by depression periods which led to economic crises in different parts of the world, such as Mexico (1994), Asian countries (1997), Russia (1998) and the US corporate crisis (2001-2002) and we have emphasized that all these crises led to changes in accounting regulations, of the aforementioned countries, bringing them into line with the International Accounting Standards (Bhimani, 2008; Lin, Chen, 2000; Mooskooki, 2002; Rahman, 1998). Moreover, our assumptions were validates, so we can state that the economic crises, from the end of twentieth century, from Mexico, Asia and Russia, are one of the rationales used by IASB to gain global dominance, with the IMF and World Bank as messengers. Finally, the global economic crisis (2008) continues this trend, as several changes have been made to the international accounting regulations (IAS and IFRS) during the crisis, and these changes were briefly pointed out in the last part of the third chapter.

Subsequently, this thesis continues with an analysis of the indigenous and exogenous factors of economic crises that led to changes of the accounting regulations. By indigenous factors we have referred to accounting itself, particularly accounting regimes. Thus, we have analyzed two of the worst economic crises from the history, namely the Great Depression from 1930s (in Chapter 4) and the Global Financial Crisis from 2008 (in Chapter 5), in order to determine whether the two accounting regimes, Historical Cost Accounting and Fair Value Accounting, were one of the factors which triggered or accelerated the crises and this led regulators to modify accounting regulations.

In the *fourth chapter*, our analysis focused on the discussions arising amongst academics, during the Great Depression, regarding the Historical Cost Accounting and the so-called *deviations* or *departures* from Historical Cost Accounting. Moreover we have presented two cases of corporation (Dodge Brothers and Ivar Krueger), which were misleading their financial statements, but during those times accounting was not regulated, and consequently, all those strange transactions recorded in accounting were legal. Furthermore, in this chapter we presented an illustration of the events that occurred more than 80 years ago, and we have emphasized that people had similar concerns, as today, related to accounting regulations and accounting regimes and their role in a crisis. This confirmed that history repeats itself, but also that the lesson is still not well learned, and we do believe that only by learning from the past, we will be able to avoid future crashes and crises. The main conclusion to be drawn from this chapter is that we do not consider that American accounting was the factor triggering the Great Depression of 1930s, but we believe that the greed of some businessmen from those times, whom determined their accountants to book the fraudulent transactions, might had an influence in triggering the crisis of 1929 and fuelling it.

The *fifth chapter* presents the debate which occurred, during the global economic crisis, amongst academics, regulators and the business community, regarding Fair Value Accounting, as regulated by the IASB. Our attempt is to identify whether this accounting regime was a factor that triggered or accelerated the recent economic crisis. Firstly, we have focused on the debate that arose amongst academics regarding Fair Value Accounting and we have presented their main concerns. During the global economic crisis, from 2008, there were many criticisms addressed to Fair Value Accounting, and therefore we choose to split these criticisms in four directions, as follows: lack of comparability and reliability of financial statements; volatility; inconsistency on measuring and pro-cyclicality. The conclusion that can be drawn by analysing these criticisms is that nowadays the research community is split in two main categories: those supporting fair value and considering that it was just a convenient scapegoat during the recent crisis; and those opposing fair value and considering that it played a catalytic role in the current crisis and that it even accelerated it.

Then, we have elaborated a qualitative and quantitative study on the Comment Letters, received by the IASB, on the Exposure Draft on Fair Value Measurement, in 2009 and 2010. Our goal was to identify what was stakeholders' opinion on this highly debated topic of Fair Value Accounting and its implications in the recent crisis. We would like to emphasize that, in this part of the thesis, we have referred to stakeholders of the international accounting regulations, such as the business community, standard-setters, accounting practitioners and investors. We have concluded that the respondents of both Exposure Drafts on Fair Value Measurement have used this opportunity to express their thoughts related to Fair Value Accounting and the global financial crisis and they did considered that the recent economic crisis had played a major role in the development of the Fair Value Measurements' Exposure Drafts.

Moreover, we do believe that IASB elaborated proper accounting standards since its inception, and although many have argued that the recent crisis has emphasized that the accounting standards, issued by IASB, were weak, we do believe that the crisis was a 'great opportunity' for IASB to review all the accounting standards and reconsider their content. Also, we strongly believe that this crisis has determined the IASB to take a further step in the development of the financial reporting standards and moreover on improving them. Hence, this led us to a better understanding of the fact that only through suffering one can become stronger and so was the case of the IASB, as it had to support all the criticisms that arose during the crisis, in order to become stronger and globally accepted, by improving the financial reporting standards.

The main conclusion that can be drawn, as referred to the indigenous factors, is that Historical Cost Accounting was not a factor to trigger the Great Depression, in the 1930s and Fair Value Accounting was not a factor to trigger the global economic crisis, in 2008. Nevertheless, we believe that both accounting regimes have played a significant role in fuelling or accelerating these crises. This is the author's perspective on this highly debated subject and it is based on the empirical findings of this study.

Standard setters or regulators of accounting have decided to modify the accounting regulations, as a response to the concerns that have been raised during the economic crises. For instance, in the 1930s the Securities Exchange Commission has regulated the American accounting and Historical Cost Accounting has become the predominant accounting regime, since the Great Crash until 1970s. Also, the IASB has issued in May 2011, IFRS 13 *Fair Value Measurement* to provide guidance on Fair Value Accounting. And our empirical findings, based on the examinations of the IASB's comment letters, have emphasized that the aforementioned IFRS has been developed by taking into account all the concerns of the events surrounding the global economic crisis.

The historical data of accounting evolution emphasizes that the majority of changes in accounting regulations have added complexity to financial reporting. From our point of view the complexities of accounting treatments, especially those associated with fair value accounting, give rise to consequential risks of ineffective or inconsistent implementation by corporations and potential for misunderstanding by users of critical components of financial statements. But, we do believe that the accounting regimes debate and their role in triggering or accelerating economic crises is far from over and much remains to be done, by standard-setters, business community and other regulatory bodies, to improve the content of financial reporting.

The *last chapter* of the thesis (Chapter 6), referred to the exogenous factors which led to changes of the accounting regulations, during periods of economic crises. In this chapter we refer to political and institutional pressures as being the exogenous factors, which determined accounting standards-setters to modify the accounting regulations, during periods of economic crises. Our analysis focused on the events surrounding the global financial crisis, from 2008, and we have emphasized how the political and institutional forces changed the international accounting standards-setting process.

In our view, 2008 was the most boisterous year for the international accounting standard-setting organization (IASB). As the political actors, especially the EU, have increased their influence, by starting to comment on accounting draft proposals late in the process (Botzem, 2008) and trying to change the international accounting standards-setting process. Also, they managed to alter both the IASB's standards-setting process and its governance structure. In this last chapter, we have presented all these attempts of political and institutional pressures on the IASB, through the lens of institutional theory and public interest theory of regulations. These theories helped us understand how institutional and political forces operate in a system characterized by power struggles.

The criticisms of many researchers who called for a substantial reform of fair value accounting, because it was perceived to have contributed to the severity of the 2008 economic crisis, and the ensuing of political and institutional interference by the European Commission and the US Congress, have put considerable pressure on the accounting standard setters (IASB and FASB) to relax the rules.

During the recent economic crisis, the European Union was the first to be concerned of the systemic risk and pro-cyclicality of valuation and demanded changes in the international accounting standards. Apparently, at the beginning, the IASB could not resist to these pressures and they immediately amended the accounting standards, as requested by the European Union. But the US Securities Exchange Commission has criticised the IASB for not been able to develop strategies to resist to these types of political pressures, especially from within Europe. All these events and criticisms were dramatic for the IASB, as these could have led to the demise of the world wide project and the loss of credibility of the Board.

Furthermore, it is obvious that the IASB could not take the political support that is necessary for its survival, as it repeatedly warned that this may undermine the confidence of capital markets in accounting standards. Also, further dissemination of international accounting standards may be restrain by the IASB's succumbing to political pressure from the EU. Additionally, we have argued that the EU faces a similar struggle as the IASB. The political independence of the IASB was a precondition of the EU's adoption of IFRS (Van Hulle, 2004) but when pressing needs, relating to financial stability and its consequences of certain banking systems, this independence was sacrificed.

Many researches analyze the influences from the corporate sector (Hopwood, 1994; Martinez-Diaz, 2005; Perry & Nölke, 2005) or the accounting profession (Botzem & Quack, 2006, 2009; Brown, 2004; Cooper & Robson, 2006) throughout the history of the international accounting standard setter, but less attention has been devoted to outright the political interference. Thus, our study endeavors to provide a better understanding of the institutional and political influence in the accounting standards-setting process.

Moreover, the limited research on this topic has emphasized that EU largely remained outside the direct sphere of influence and has shown little interest in challenging the standard setting of the IASB. But our study has shown that this changes dramatically during periods of financial instability, like the recent economic crises. Also, we do believe that our research contributes to the accounting literature, by demonstrating how institutional and political actors have reclaimed their role in the accounting standards-setting process.

However, we do believe that is early to draw a final conclusion on the long term effects of the global financial crisis on the balance of power and institutional system in which the international accounting standards are developed. The events surrounding the recent financial crisis represent an opportunity of studying the institutional developments and politics of accounting standard setting.

Finally, our study has emphasized that accounting regulations and changes in them are shaped by political processes (like any other regulations), especially during periods of economic crises. Also, we do believe that the role of the political forces further complicates the analysis. For instance, it might be possible that changing the accounting rules in a crisis as a result of political pressures leads to worse outcomes than sticking to a particular regime (Brunnermeier *et al.*, 2009). In this respect, we do believe that the current crisis provides a fertile ground for further study.

If they are truly to serve the needs of stakeholders, accounting regulations can never be frozen in time. Any action that is taken in this area must be done with the prime purpose of strengthening financial reporting for the future and to enhance financial stability. Thus, let us have an open-ended discussion but also realize that, ultimately, what we all want is for an independent standard setter to come up with the best technical solutions for the stakeholders, to help us recover in time and to better equip us for the future.

Taking into account the fact that the main goal of any doctoral thesis is to create added value in the studied area, we present below a summary of our ***main contributions***, as follows:

- Our research is the first study, in the accounting literature, that provides a chronological overview of the impact of all the major economic crises in history, on the accounting thought and practice, starting with the England's commercial crises, from the nineteenth century, and ending with the global economic crises, from 2008;
- We have demonstrated that all the studied economic crises brought changes on the accounting and accounting regulations, of those countries affected by the crisis;
- There has been emphasized that during the recent economic crisis, people (meaning the general public and not only the researchers) did associate accounting with the crisis;
- A novelty found in our thesis is the study on the role that accounting regimes (Historical Cost Accounting and Fair Value Accounting) have played in triggering or accelerating the economic crises (the Great Depression and the Global Financial Crisis). This study is unique as it emphasizes how similar is the recent crisis with the crisis from the 1930s, in terms of the debate on accounting which arose immediately after the burst out of the crises;
- Another novelty that is brought up in our research is the fact that, it is the first study in accounting literature, which demonstrated that the economic crises from the end of the twentieth century (from Mexico, Asia and Russia) brought changes in the accounting of those countries affected by crises, bringing the into line with the international accounting

standards. And our believe is that these economic crises were one of the rationales used by IASB to gain global dominance, with the IMF and World Bank as messengers;

- In this thesis we have also demonstrated that economic crises are external factors, that might identify potential weaknesses of accounting regimes and accounting regulations;
- Our research has proved that changes in accounting and accounting regulations, during periods of economic crises, are often driven by political and institutional pressures. We have also emphasized the way political power operates in an institutional system.

There are ***limitations*** that need to be acknowledged and addressed regarding this research. But we believe that limitations are mainly linked to the ***future research perspectives*** of this scientific endeavor, and therefore we do attempt to present them together.

The first limitation concerns the fact that there are few research studies and articles related to the economic crises, from the end of the twentieth century (from Mexico, Asia and Russia), written in English. But the author of this study welcomes any collaboration with other researchers that show interest in this topic, from those countries affected by crises in the 1990s.

Moreover, our research is limited to the analysis of only seven economic crises (England's commercial crises, Great Depression, Mexican crisis, Asian crisis, Russian crisis, US corporate crisis and the Global financial crisis). Therefore, our conclusions were drawn based only on the analysis of the aforementioned crises. But, we would like to engage ourselves in further studies that will take into account, other economic crises which took place in other jurisdictions (for example the Japanese crisis from 1980, the Scandinavian crisis of 1990-1991, the Argentina crisis of 2001-2002).

Another limitation of our research is the fact that we have identified as exogenous factors that led to changes in the accounting regulations, during periods of economic crises, only the political and institutional pressures. Hence, a further study might attempt to identify and analyze other exogenous and even indigenous factors having an impact on the accounting changes during economic crises.

Our thesis is an international research study, as it analysis the interplay between accounting and economic crises, particularly with an emphasis on how crises drive changes in the accounting regulations of those countries affected by the crisis. Also, we believe that this subject is very complex and is far from being exhausted; thereupon it represents a fertile ground for further study. For instance, a further research in which we would like to engage is an analysis of the impact of all these seven economic crises studied in this thesis on the Romanian accounting and the Romanian accounting regulations. We believe that this further research could be a very interesting one, as it will emphasize how the development of our national accounting norms was influenced by such major external factors as the economic crises.

In the end we consider that this thesis has reached its main goal, both from the theoretical and practical point of view. We hope the outcome and the contributions we brought will be helpful for researchers and accounting professionals, giving them directions and hints to overcome any possible boundaries, creating a fundament for their future scientific steps.

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