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The Fundamental Issues with Financial Derivatives within the Framework of International Accounting Standard No. (39) and Their Relative Responsibility for the Current Global Financial Crisis

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Abstract
There are several factors that lead to the current and extremely dangerous financial and economic crisis, foremost amongst which is the way financial derivatives are dealt with and accounted for under international standards, especially International Accounting Standard No. (39), in addition to other factors that either complemented or were a natural extension of the aforementioned standards such as lack of oversight and poor transparency. The role other factors played in the financial crisis cannot be overlooked, however they were relatively smaller. This crisis might be curbed but the question remains how will it end and what are the consequences? More importantly, will it happen again? Is the pursuit of a stable financial system as announced by the leaders of the European Union during their summit with emerging economies in L'Aquila, Italy on 08/07/2009 a fact? Or simply claims and cosmetic remedies in order to show harmony as is often the case when some standards are modified to counteract the symptoms of a problem but not to actually fix the underlying issue. Continuing a trend that ignores values, commonalities and accepted professional ethics will have a lot of repercussions and lead to collapse; as such the alleged unification of systems will be nothing more than a ploy meant to conceal deliberate policies that use accounting and its standards as a means to further exploit and manipulate the wealth of nations besides complicating accounting practices and its concomitant burden and costs. Working towards the development of appropriate standards and sound accounting practices will result in a balanced, fair international financial system where accounting will then succeed where policy has failed; unfortunately reality points to the supremacy of the former trend where financial derivatives, its standards and accounting reflects the exploitative aspirations of economic policies. After reviewing these factors and analyzing the core issues and its impact on the current financial crisis, the Study reached a number of conclusions that formed a basis upon which appropriate recommendations have been proposed.

Key words: financial derivatives, International Accounting Standard, financial crisis.

Introduction

On 23/6/2012, the UN Secretary-General Mr. Ban-Ki Moon stated that the global economic crisis will continue for several years. It also represents a turning point in the global financial and economic system that will last ten years (Abu Ghazaleh 2008), with clear repercussions as evidenced by the financial scandals of Enron, Xerox and WorldCom as well as the bankruptcy and collapse of major financial institutions in the United States, Western Europe and the world. Unemployment soared affecting even wealthy countries such as Japan where it reached a level unprecedented since World War II. Furthermore, it had an impact on sovereign and national funds causing hundreds of billions of dollars in losses. At this point, the International Accounting Standards have come under fire for their purported role in causing, or at least facilitating the crisis, forcing the Chairman of the IAS Board to stand before the United States House Committee on Financial Services in an attempt to absolve the IAS of responsibility. The standards set by the IAS known as IAS 39, which deals with financial derivatives, its accounting and auditing, is the focus of said attention. This is due to financial derivatives instruments representing about 50% of the global financial economy, and was thus described by some as a weapon of mass destruction. For this reason, amongst others, it is important to examine the global financial crisis and shed some light on its root causes to better understand what had actually happened.

• Section one: The General Framework for The Study

This section deals with the core subject of the study, its most important questions, their importance and objectives, the applied methodology as well as previous relevant studies.

◦ First: The Core Subject of The Study

Economists are still unable to clearly define the focus of the problem, probably due to its uniquely complex nature. Therefore, by assuming the existence of numerous factors behind the crisis and its continuity including ethical, contractual and legal factors in addition to purely technical and accounting issues as well, we could formulate the questions as follows:

- What are the reasons for the crisis and its continuity? Are they limited to the standards set by the international accounting standard (IAS), its accounting and auditing? Or, is it in the level of disclosure, or in trading with derivatives, or is it something else?
- To what degree has each reason contributed to the crisis?
- What are the issues related to trading with financial derivatives within the framework set by IAS 39? What effect do the standards of financial derivatives have on the quality of the data in published financial statements?
- What is the extent of responsibility of financial derivatives in causing the crisis compared to other factors?

◦ Second: The Objectives of The Study

The objectives could be summarized as follows:

- Examine and analyze of the most important factors that could be behind the financial crisis.
- Examine and analyze the fundamental issues which accompany trading in financial derivatives and its accounting within the framework set by IAS 39, and showing the effects, role, and impact these issues had on the global financial crisis.

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• Demystifying, to the greatest extent possible, the subject of financial derivatives which is quite complex as acknowledged by the International Accounting Standards Board itself.
• Develop conclusions and recommendations that could lead to further targeted research with the goal of finding solutions to the fundamental factors behind this crisis.

◦ Third: The Importance of The Study

The importance of this study stems from the need for significant and substantial change at the level of international accounting standards and even the global financial system as a whole, due to the gravity of its effect and impact on world economies as a whole. As such the importance of this study could be summarized as follows:
• It discusses the most important factors believed to be behind the crisis,
• It deals with the analysis of the most important issues that accompany trading in financial derivatives, which are the most complex and controversial of IAS 39's standards,
• It tries to simplify the definitions of the most difficult concepts involved in IAS 39, and especially those pertaining to financial derivatives.
• This research strives to be a comprehensive study of the causes of the financial crisis and aims to evoke further research with the ultimate goal of producing usefully applicable recommendations for amendments to the currently applicable standards in the financial market especially since many countries are being called upon to adopt IAS voluntarily, or in response to regional and international policies.

◦ Fourth: The Methodology of The Study

This study is based on the descriptive analytical method, and relies on theoretical studies available from books, periodicals and the web. Also, it relies on actual data and indicators gleaned from the results of field studies achieved while examining issues pertinent to international accounting standards.

• Section two: The Theoretical Framework and Previous Studies

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Since the emergence of the current financial crisis many different factors that could have caused it have been discussed; therefore, it is necessary to define the most important aspects of the study with some brevity.

◦ First: Financial Derivatives and instruments within the framework of International Accounting Standards

IAS 39 is a large part of the substance of the international accounting standards and mostly pertains to financial derivatives and unlike other standards contains many exotic and difficult concepts. Since the start of the global financial crisis the bulk of accusations have been leveled at the IAS. The following are brief definitions:

1. International Accounting Standards

IAS are general guidelines for the accounting and auditing issued by the International Accounting Standards Board. *Accounting Standard* is a model or guide for what should be the application of accounting in terms of measuring financial operations and their disclosures fairly in financial statements in order to assist those who rely on published financial statements in decision making. Since the beginning of the twentieth century, through the first International Conference of Accountants and until the year 2001, Forty one standards have been issued.

Thereafter the International Accounting Standards Board took over the responsibility of setting international accounting standards, the IASB called the new standards the International Financial Reporting Standards (IFRS).

1.1. Stages of the evolution of international accounting standards

The international accounting standards went through five phases beginning with the phase of establishment 1973-1989 during which basic core standards were issued. Then came the development phase 1989-1995, which saw modifications to standards to reduce alternatives and established a comprehensive set of core standards. The third phase was between 1995-1999, during which the financial instruments standards were issued, and the establishment of a council for the interpretation of financial standards and financial reporting. The fourth phase 1999-2001 was the restructuring phase during which an advisory council was established, and finally the financial reporting phase which ended in 2002.

1.2. Reasons for the adoption of international accounting standards

Increased demand for the development of accounting by adopting international accounting standards due to the need to achieve convergence, which became apparent for several reasons chief among them the emergence of globalization, the growth and liberalization of international trade, direct international investments, changes to the international monetary systems, and the growing power of multinational corporations.

1.3. Advantages of adopting the international accounting standards

The adoption of international accounting standards in the preparation of financial statements was supposed to provide many advantages on a global level, the most important of which are the following:

• The standards provide credibility, and facilitate the understanding and comparison of financial data leading to the higher confidence in decision making.

• The adherence of accountants and auditors to these standards reduces the differences in measuring work results and financial position producing a fair, and equitable representation and leads to better stock price determinations.

• Provides consistency in measurement and disclosure, and therefore encourages participation in financial markets while also reducing the cost of preparing financial data and facilitates taxation.

• Aids in the design of integrated systems for multinational corporations, thus it both helps create and takes advantage of a consolidated system.

• Provides for ongoing and continuous review of applied and used standards, which then allows for it to keep pace with developments and changes to fit global market conditions, while also reducing the cost of these developments.

2. IAS 39

Its foremost concern is financial derivatives, the main topic of this study, and which were considered a revolutionary addition to the financial system when first issued. January 1st, 2001 saw the actual implementation of this standard, *Financial Instruments: Recognition and Measurement*. This standard applies to all financial instruments and derivatives, except for operations that fall within other international accounting standards i.e.: subsidiaries, subcontracts, etc.

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2.1. The importance of IAS 39

In addition to the aforementioned details, the following points as stated in IAS 39 further illustrate the importance of said standard in financial markets:

- It is the first comprehensive standard recognizing financial instrument data, its measurement and disclosure (complementary to IAS 32).
- Heavily depends on the use of *Fair Value* accounting for financial instruments, which is a substantial change from earlier accounting practices.
- It requires, and therefore enforces recognition of financial derivatives as assets or financial liabilities in financial position rather than it being considered incidental items independent of it.
- Allows the use of so-called *hedge accounting* methods in different ways to suit the type of financial instrument.

2.2. Amendments to IAS 39, and their importance

There have been many amendments to the standard since its adoption, the most important of which took place in 2005 and again in 2008 due to the financial crisis and in response to the credit crunch resulting from it. On 10/13/2008, the issued amendments addressed the issue of differences between local and international standards especially the differences in said standards in the United States compared to the International Accounting Standards. This is to ensure the provision of high quality financial information to investors in the global capital markets as well as transparency and to restore confidence in them. The most important of these amendments are as follows:

- Allows for the reclassification of financial investments that are not held for trading.
- In rare cases, allow the reclassification of loans (based on cost), if the intention and ability exist to retain it for the foreseeable future or until maturity.
- Does not allow for the reclassification of debt securities if the financial *Fair Value* option was previously adopted.

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2.3. Financial Instruments

They are real or virtual legal contracts between two parties involving some sort of monetary value. The financial instrument can be generally classified as equity based, representing ownership of the asset, or debt based, representing a loan made by an investor to the owner of the asset[1]. They are primary, or original instruments that require cash flow to own, and are amortized when sold or when due. Examples of financial instruments are financial investments (listed and unlisted debt securities, listed property rights, private property rights and any investments in unlisted ownership rights), purchased established loans, repurchase agreements, securities lending and loan operations, financial assets held for trading, financial derivatives (intended for trading or hedging), other trade receivables, cash and cash equivalents, liabilities held for trading, long term bank loans, bonds and unsecured bonds and paper currency.

3. Financial Derivatives

This is a subject that is complex and diverse making it difficult to examine; however, we will try to simplify key points to help facilitate its understanding. We will begin with its definition and continue through to accounting for derivatives.

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[1] http://www.investopedia.com/terms/f/financialinstrument.asp#axzz2KPeZxwpl

3.1. Definition of Financial Derivatives

A **derivative** is a term that refers to a contract between two parties relating to a security whose price is dependent upon or derived from one or more underlying assets. Its value is determined by fluctuations in the underlying asset[2]. The most common underlying assets include: commodities, stocks, bonds, interest rates and currencies and market indices. Unlike debt instruments there is no advance payment that can be recovered and no return on investment. Financial derivatives have different purposes including risk management and hedge investments, arbitrage and speculation. Examples of its types and their pricing variables (Standard 39, Implementation guidance, section B, B2, definitions: defining a derivative)

Type of Contract	***Pricing Variable\Principal payment (main variable)***
Interest rate swaps	Interest rates
Shares swap	Share prices (shares of another asset)
Credit swap	Credit rating\Credit index or credit rate

3.2. The use of financial derivatives

They are mainly used by banking and financial institutions in order to achieve two objectives:

- Risk Management: Financial derivatives is one of the most important Risk management (hedging) tools available, to reduce the risk of market volatility and its negative impact on the financials of the involved institution.
- Profit-making: Where products are sold in the derivatives market in order to enable the customers to enter a transaction to transfer, modify or reduce current and future market risks, and the formulation of financial position based on personal expectations of price movement, and risk exchange in different markets with the expectation of making a profit as a result of the positive changes in prices, rates or indices. Also balancing the exchange rates in order to benefit from the price difference between different markets for a variety of products in order to make a profit.

3.3. Traders in financial derivatives

Traders in financial derivatives can be classified into two categories.

Category 1: represents the end users for the purpose of hedging and speculation, and the formulation of financial position, such as banks, insurance companies, securities, investment and pension funds, and these can be further classified as:

- Hedgers: Those are interested in reducing risk through their trading with derivatives that improve the certainty factor.

[2] http://www.investopedia.com/terms/d/derivative.asp#ixzz2KPokCyA5

- Speculators: Those who speculate about the future price movements of financial derivatives in order to make a profit.
- Arbitrageurs: Those who benefit from price differences in order to turn a profit risk free, by buying from lower priced markets and immediately reselling them in higher priced ones.

Category 2: The intermediaries who meet the needs of the end users; their revenue takes the form of fees, commissions and margins on the purchase and sale of such derivatives.

3.4. Classification of financial derivatives

They are classified as follows:

Regular Derivatives (simply called Derivatives)

Are financial instruments, or other contracts within the scope of IAS 39, and could be stand-alone or attached to another financial instrument that can still be transferred independent of the attached instrument.

Embedded Derivatives

A host contract that is non-transferable independently of the embedded instrument. this provides some or all cash flow required under the original contract because of a specified interest rate, the price of a financial instrument, commodity, foreign exchange rate, index prices, rates or credit indices, or any other instrument.

If the original contract of a derivative is attached to a financial instrument provides for the independent transfer of the derivative apart from the attached instrument, or has parties independent of the parties to the original contract, then it is not considered an embedded derivative (Egyptian Accounting Standard 26)

3.5. Financial derivative instruments (types of derivatives)

Derivatives are broadly categorized by the relationship between the underlying asset and the derivative (such as future, option, swap) the type of underlying asset (such as equity derivatives, foreign exchange derivatives, interest rate derivatives, commodity derivatives, or credit derivatives); the market in which they trade (such as exchange-traded or over-the-counter);

a) Futures

A contractual agreement, generally made on the trading floor of a futures exchange, to buy or sell a particular commodity or financial instrument at a pre-determined price in the future. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange. The relationship between the contractors is an indirect one, involving mediators in clearing houses to guarantee the rights of all involved. Its most important types are:

<u>*Forward Contract'*</u>

These are future contracts traded between two parties outside of formal stock markets

It is a cash market transaction in which delivery of the commodity is deferred until after the contract has been made. Although the delivery is made in the future, the price is determined on the initial trade date.[3].

[3] http://www.investopedia.com/terms/f/forwardcontract.asp#ixzz2KEHohUwg

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'Option'

A financial derivative that represents a contract sold by one party (option writer) to another party (option holder). The contract offers the buyer the right, but not the obligation, to buy (call) or sell (put) a security or other financial asset at an agreed-upon price (the strike price) during a certain period of time or on a specific date (exercise date). This would hedge against the risk of asset prices changes with respect to the investor, and turn a profit with respect to the speculator.

b) Swaps

Are contracts between two parties for the exchange of one security for another to change the maturity (bonds), quality of issues (stocks or bonds), or because investment objectives have changed. Recently, swaps have grown to include currency swaps and interest rate swaps. The following are some types of swaps:

• ***Interest Rate Swap***: an agreement between two parties for the exchange of variable interest rates for fixed interest rates on a specified amount and in a specified currency without necessarily exchanging the actual underlying amount.

• ***Currency Swap***: an agreement between two parties to buy or sell particular currency against another currency on the basis of real time delivery at a predetermined exchange rate at or before a specified date.

• ***Optional Swap***: is the option to enter into a swap at a determined date in the future. An example would be the option to enter into an optional simple interest rate swap, which provides for swapping a fixed interest bond for a variable interest bond at a future date.

• ***Stock Swap***: an agreement between two parties to swap the rate of return on a stock (or any given number of stocks) for the rate of return on another stock at a future date.

• ***Commodity Swap***: it is the process of buying a certain amount of a commodity at the prevailing price at the time of purchase for which the purchase price is paid out immediately, and then selling the commodity to another party for a previously agreed upon price for which payment is made at a future date.

Also, there are tools used in derivatives trading. They are:

• ***Cap***: is a contract in which the seller, for a bonus, agrees to pay back the buyer any amount that exceeds the cost of interest previously agreed upon up to a limit that represents the highest amount for which the seller will go no higher.

• ***Floor***: is a contract in which the seller, for a bonus, agrees to compensate the buyer for the difference between the actual interest rate and those previously agreed upon if the interest rate falls up to an amount that represents a minimum.

• ***Cap and Floor***: if buying a *cap* coincided with the sale of a *floor*, then the bonus for the sale of the *floor* is compared to the cost of the *cap* if the latter is exactly equal to cash collections from the sale of the *floor*, then there is no bonus to be paid. The instrument is then called a *Cap Floor with Zero Cost*.

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3.6. Risks of trading in derivatives

While financial derivatives afforded financial institutions the opportunity to diversify their services and provide new instruments to increase profits, or reduce expected losses, there are many risks to trading in derivatives.

• ***Credit Risk***: arises from non-compliance with the contract. Traders seek to provide a number of regulatory tools to help estimate the risks and assess the credit worthiness of the other party and provide guarantees.

• ***Conversion Risk***: arises when restrictions and controls are placed on the conversion or transfer of currency from one country to another, which could result in preventing one party to the contract from executing it.

• ***Operational Risk***: these include non-payment on the due date, as well as payment to the wrong party.

• ***Exchange Rate Risk***: these result from unanticipated changes to the exchange rates when liabilities or assets are maintained in a foreign currency.

• ***Systemic Risk***: results from an "error" in the financial position of a banking or financial institutions trading in the derivatives market, which in turn leads to wider financial problems in other institutions within the financial and banking systems and all other markets related to the derivatives market.

• ***Interest Rate Risk***: results from there being maturity gaps between the assets and liabilities of a bank.

• ***Legal Risks***: result from illegalities of a given derivative or derivatives, or the inability to legally enforce a contract or an inability to carry out the terms of the contract(s). These include the inaccurate documentation of some transactions, or the ineligibility of one of the signing parties or a weak judiciary.

• ***Market Risks***: these result from market fluctuations such as the price of derivatives contracts, which result from the fluctuations of asset prices. Or, a lack of liquidity which leads to the deterioration of asset prices and difficulties in singing new contracts to the face the deterioration.

3.7.1 **Accounting for derivatives under IAS 39**

Scope: Considering that IAS 39 lays the basis for the documentation, measurement, disclosure and analysis of all financial instruments, including derivatives. It therefore follows that everything relating to derivatives applies to all transactions except those of subsidiaries, associations and joint ventures such as the rights and obligations in leases, assets and liabilities relating to workers benefits, plans and obligations under insurance contracts, financial security contracts in cases of failure to pay, and contracts based on natural variables.

a) Accounting treatment of derivatives

• ***Recognition of derivatives***: the application of IAS 39 requires the following:

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• Recognize all financial assets and liabilities including derivatives on the balance sheet, It's initial measurement is to be by cost which is the *fair value* of the asset or financial liability when an entity becomes a party to the contract for the purchase or sale of financial assets.
• Recognize the purchase or sale of financial assets in a systematic and consistent manner documenting either the trade or settlement dates.

b) Derecognition of financial derivatives: the derecognition of financial assets or part of it happens when an entity loses control over the contractual agreements of the financial asset through the sale, expiration or waiver of those rights. When derecognition occurs, then the difference between financial returns and recorded ledger values are listed under gains or losses for that financial period. Also, surplus or deficits resulting from the reevaluation of previous periods are to be recognized directly in their equity and are also to be listed under gains or losses for that period. When derecognizing a portion of the financial asset, the recorded ledger value is to be distributed proportionally specifying the portion sold using its *fair value* on the sale date and documenting the resulting gains or losses for the same period.

c) Measurement of derivatives: under standard 39, derivatives are to be measured by their *fair value*. It is the value estimated by a market mechanism by which an exchange of an asset or settlement between two knowledgeable and agreeing parties to a contract is concluded. Upon recognizing financial instruments and derivatives, the following must be observed

• Measuring financial assets at *fair value* except for loans and receivables not held for trading. Also, investment which an entity wishes to retain until maturity such as debt instruments, compulsory recoverable preferred stock, financial assets that could not be reliably measured at *fair value* but rather must be measured by the amortized cost and must be subject to an impairment valuation test.

• Measuring all financial liabilities and derivatives, except for those held for trading, by their amortized value.
• Report all recognized gains and losses resulting from a change in *fair value* of a financial asset(s), or liability that is not part of a hedge. The reporting is done either as part of the profits and losses for the period if the instrument or derivative is held for trading, or listing with profits and losses and recognizing it directly in ownership rights when the financial asset is sold or collected if the financial asset is available for sale.

• Recognition of gains or losses resulting from the reevaluation of financial assets or liabilities at *fair value*, measured at the amortized cost posted in the profit or loss period or when derecognized when its value drops.

• To include gains and losses resulting from the reevaluation of financial assets or liabilities at *fair value* in the net profit or loss for the period, excluding gains or losses resulting from the category of financial assets available for sale and must be recognized in ownership rights until they are sold or depreciate. Also, excluded are financial assets and liabilities (recorded at its amortized cost) that are covered by a hedge instrument at which point the rules for hedging are to be applied as set in the standard.

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• To include all impairment losses in the net profit or loss for the period, regardless of the category to which the financial asset belongs. In the case of impairment losses of financial assets available for sale where measurement is at *fair value* and recognition of differences are listed in equity, then they are to be transferred from equity to profits and losses for the period.

• Recognition of an increase in value in future periods not exceeding the amortized cost of the asset not measured at *fair value*, such as assets retained until maturity. This includes measurement of assets at *fair value* (in the budget) financial assets held for trading, derivatives and non-derivatives including those subject to *fair value* hedges using derivatives. In addition, all financial obligations subject to *fair value* hedges if all changes to the *fair value* are fully hedged.

d) Hedging and financial derivatives

The effectiveness of hedging is measured by the degree to which changes in *fair value* or cash flows of a hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

(1) ***The concept of hedging and its forms***: hedging basically means covering risks. It is the use of a derivative or a non-derivative financial instrument to cover risks and provide symmetrical compensation on net profit or loss resulting from changes to the *fair value* of the hedging instrument or its associated items. Hedging against risk has the following forms:

• ***Fair Value Hedge***: covers the risk to exposure to changes in *fair value* when recognizing an asset or liability. For example, changes in fair value for fixed rate bonds as a result of changes in market interest rates.

• ***Cash Flow Hedge***: covers the risk of losses in cash flows associated with the recognition of asset or liability, for example future interest payments on variable rate bonds.

• ***Hedge of a Net Investment in a Foreign Entity***: covers the risks resulting from changes in foreign exchange rates.

(2) ***Hedge accounting of derivatives***: in fact, hedging is usually done when trading in derivatives and rarely so for other financial instruments, which means determining the financial derivative (in certain cases a financial instrument) to cope with the changes in future cash flow of the hedged item. The hedging instrument is a derivatives portfolio containing vehicles equivalent to the risk of each of the individual hedges as well as those of the portfolio. All concerned hedges are measured by the *fair value* of the derivatives (standard 39: the basis of conclusions: conclusion 215), and the following must apply:

• The hedged item must be a firm commitment, asset or liability, or a highly probably forecast transaction, expected to be exposed to the risk of changes in *fair value* or cash flows, and recognizing the effects in net profit or loss.
• If the hedged item is a non-financial asset or non-financial liability, then it is considered a hedge item for either foreign currency risk, or for all risks because of the difficulty of isolating and measuring the appropriate portion of cash flows or changes in fair value attributable to specific risks other than foreign currency risk.

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• Recognition of gains or losses resulting from reevaluating the hedging instrument by the *fair value* of the net profit or loss if *fair value* hedges fulfills all the necessary requirements for hedge accounting.
• Allow hedge accounting only when the hedging instrument is a derivative (not a written option), or a written option designated as an offset to a purchased option including one that is embedded in another financial instrument to hedge against the risk of dealing in a foreign currency.

(3) ***Hedge accounting rules for derivatives***: Hedging becomes eligible for hedge accounting if the following criteria apply:
• If the institution formally documents the process of hedging from its inception.
• The effectiveness of the hedge can be reliably measured, with the expectation that the hedging process will be highly effective and if any differences are to be found, they should be minor. As such, risks are entirely covered and the results of the hedge are between 80% to 125%. The hedge is not considered highly effective if the results fall outside this range.
• In the case of forecast transaction, said transaction must be highly probable.
• The hedges were assessed to be highly effective throughout this period.

(4) ***Recognition of gains and losses of fair value hedging for derivatives***
This requires the following:
• The gains or losses from re-measuring the hedging instrument at fair value must be recognized in net profit or loss, also the gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and it to be recognized in profit or loss.
• With respect to cash flow hedges, the portion of the gain or loss on the hedging instrument determined to be an effective hedge shall be recognized in other comprehensive income whereas the ineffective portion of the gain or loss on the hedging instrument shall be recognized in profit or loss.
• Recognition of gains and losses of hedges of a net investment in a foreign operation. The effective portion of the hedging instrument is to be directly recognized in other comprehensive income while the ineffective portion is shall be recognized in net profit or loss.
• Remove gains or losses associated with the hedge (or forecast transaction that results in a financial asset or liability) previously recognized in equity, and included within the initial measurement of the cost of acquisition of the asset or liability.

e) Presentation and disclosure of derivatives: Under standards 39 and 32, disclosure shall include the following:
• The institutional accounting policies and methods of assessing the fair value of financial assets and liabilities which are carried by their *fair value* amount, and the gains and losses resulting from changes to the *fair value* of assets that are available for sale.
• Financial risk management policies of the project; describing hedging instruments, their *fair value* and the nature of the risks that are hedged, as well as the periods during which the predicted transactions are supposed to take place, what is NOT expected to take place and interest rate risks.
• Shall disclose the amount that was recognized in equity and the amount excluded from net profit or loss when recognizing the gains or losses of derived and non-derived assets and liabilities as direct cash flow hedging instruments in equity.

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• Directly recognize in equity the gains and losses resulting from the re-measurement of the fair value of financial instruments available for sale.
• Shall disclose separately from the total interest income and total interest expenditure, and gains and losses from the derecognition of financial liabilities included in the profit and loss for the period and adjustments to the fair list.
• Disclosure of securitization, repurchase agreements and related guarantees separately.
• The reclassification of financial assets by their amortized cost, and not by their *fair value* amount.
• The nature and amount of impairment loss in the value of a financial instrument.
• Financial assets pledged as collateral such as guarantees to certain obligations for the borrower.
• Additional guarantees for financial and non-financial assets that have been approved, sold or mortgaged at *fair value* to the lender.
• Reasons why the fair value cannot be effectively measured.

◦ Second: The Current Financial Crisis

This issue is no less complicated than what came before, due to the conflicting information from all concerned parties including professionals, academics and politicians about this crisis. As such, we will try to define the financial crisis by presenting its most important features and effects before analyzing its causes.

A. Defining the current financial crisis, its roots and characteristics

There does not yet exist any clear and concise definition of the current global financial crisis. Economists differ greatly in this matter, but certainly this crisis resulted from the abuse and misappropriation of available resources and numerous incorrect and possibly illegal decisions.

The roots of the financial crisis that took place on 13/9/2008 can be attributed to a number of factors and practices that were primarily based on capitalism and policies of US banks and financial institutions. The crisis deepened in many important financial sectors well before its manifestations were apparent due to the lax system which granted freedom of action and unprecedented market policies in the absence of effective supervision and oversight by state and national governments and institutions. To further substantiate that point, the G20 summit, whose members' economies represent 90% of the world economy (the West with a population of 1/5 that of the world owns 4/5 of its wealth) showed that the speculation of its major corporations in the financial market lead to a 60 fold increase of the financial block in comparison to that of the materials block (production), thus creating a huge money market for speculation.

Many experts and analysts believe that the current crisis resembles other financial crises such as the Great Depression of 1929, the oil crisis of 1947, and the mid-eighties crisis of 1983. However, it continues to have very unique characteristics chief among them is the magnitude of its effect on the global economy in its entirety, and the innovations of its financial instruments (Center of Middle East Studies seminar, main working paper, 2008)

B. Repercussions of the current financial crisis

The crisis has reached every part of the world, affecting global and local economies without exception albeit by varying degrees even affecting societies and politics. Many different factors coalesced to create and perpetuate the crisis, and this fact is what probably caused many economists to disagree as to what caused the crisis. Following is a summary of its most important repercussions:

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1. The bankruptcy and collapse of a large number of major global companies, whose assets are estimated to be in the billions of dollars. In a short few months following the start of the crisis, 100 banks declared bankruptcy in the USA alone. In the Gulf States banks lost an estimated at $3 Trillion, while their financial markets lost billions of dollars. The USA is expected to lose $100 Trillion.

2. The sharp decline in stock markets, which reached about 75% and more in some markets and a general recession that extended to oil prices worldwide.

3. A worldwide decline in economic investments, becoming virtually non-existent in some places.

4. Rising unemployment and declining living standards, even in developed nations. Suffice it to say that this is the first time in history the unemployment rate reaches these levels, in the Eurozone alone the rate is higher than the previous 10 years combined, and in Japan the unemployment rate is more than 5% the highest since WWII.

5. A significant decline and deterioration in grants and international aid to poor countries.

6. Contradiction and confusion in the processes and procedures of the so-called free economy, as evidenced by national governments especially the USA, European and Gulf governments, having to pump hundreds of billions of dollars into troubled companies and institutions that had lost their financial liquidity to secure the situation from further deterioration. In the Eurozone alone, more than $3 trillion dollars had to be pumped into the markets. In some cases, matters became so critical that governments had to nationalize some private institutions.

7. The prevalence of unethical behavior, including outright fraud, deceit, and abuse, in the actions of some who sought to abuse the financial system and markets using financial instruments and derivatives whose innovation and development is never ending.

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◦ Third: Previous studies

There are many studies in the field of international accounting standards, and especially fair value and disclosure, however there is limited research, both in number and depth, when it comes to financial derivatives. Following are the most important and directly relevant studies:

1. Helmi 2009: the study examined a brief history of the evolution of the global financial system, and the reasons behind the financial crisis that resulted from the improper practices of some financial institutions such as the policy of unsecured loans and the use of new methods known as financial derivatives to increase the volume of lending which triggered the mortgage crisis, and the rise in inflation. The study further examined the weak oversight over these institutions and mortgage brokers. The study emphasized the importance of the oversight role central banks play in facing the financial crisis, as they are considered the responsible body in charge of managing and executing monetary and credit policy in order to achieve monetary stability. Also, enabling oversight through capital, assets, management, earnings, liquidity and internal control.

2. Matar et al 2009: the study focused on trying to exonerate fair value standards of the accusation that they were the main culprit behind the financial crisis. The study arrived at, through polling the opinions of specialists in the fields of accounting and through accounting forums, as per the opinions of those polled that the fair value standards are not behind the crisis.

3. Al-Hassan 2009: is a field study that explored the views of financial, administrative and legal entities about the scores of probable reasons behind the collapse of major companies. The study concluded that the most important reason was an unjustifiable rush towards rapid gain and an absence of transparency, followed by the intention to circumvent laws.

4. Guy 2008: from a sample of 500 companies out of 6000 in the US, the study showed that their revenues did not represent real economic revenue; however, they were less volatile. As for accounting standards, they were found to be inadequate to allow for the proper accounting of profit or loss of a derivative.

5. Pete 2003: is a theoretical study of the relationship between the actual market value of equities, and the fair value of derivatives and their advantages. Its most important finding is that the fair value of derivatives is not appropriate for non-active markets, and provided alternative methods to measure financial instruments in cases where the fair value of one of the financial instrument is absent.

6. Global Forum for The Development of Accounting 2001: the study focused on the fundamental differences between national accounting requirements and international accounting standards, including those involving financial instruments and derivatives. The study examined 62 countries and more than 80 accounting and disclosure policies in financial statements. The study found significant differences between national and international standards in many countries, and that no effort was undertaken to address and minimize said differences.

7. Robert 2001: a field study on how to hedge against credit risk under national and international standards. It also shows how adjusting financial instruments at fair value leads to greater confusion to the user when compared to adjusting at historical cost. Also, the application of requirements in standard 39 leads to better results than those achieved by applying US standard 133.

8. Hussein 2001: an analytical theoretical study that dealt with the evolution of the concept of fair value, financial derivatives, their purposes and types and the role of IAS 39 in providing more accurate and useful data to users of financial statements of banks. The study came to the conclusion that the recognition of financial instruments and derivatives in the budget reflects a more accurate and useful financial position to users of financial data. On the other hand, it showed that accountants and auditors had two choices: either provide objective financial statements that are inappropriate, or provide subjective financial statements that are appropriate.

9. Unitani and Katsu 1998: the study aimed to determine the effect of using fair value to measure gains, dividends and capital of banks in Japan. The study found that bank earnings based on fair value are more volatile than those based historical cost.

• How this study differs from previous ones

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◦ It deals with various factors that could contribute to the crisis, while previous studies focused on one or a few factors.
◦ It focuses on the analysis of the issues of financial derivatives illustrating their substantial role in causing the crisis.

◦ Section 3: The Causes of the Current Financial Crisis

In this section, we will attempt to find and understand the different causes or factors that may have played a role in the current financial crisis, as there are those that consider international accounting standards, especially those relating to fair value, to be wholly responsible for this crisis as pointed out by the House Committee on Financial Services in the US congress, while others point to a lack of transparency, or the low level of moral responsibility, lax oversight, trading in derivatives etc. All that is going on without an appropriate and adequate analysis.

<u>First: International Accounting Standards and the current global financial crisis</u>

Today, there appears to be a more pronounced difference and disparity in opinions, because while there are those that defend international accounting and financial reporting standards, there are others that lay the whole blame for the current financial crisis squarely at its feet. Therefore the first and most important question is "Are those standards generally and inherently responsible? Or is it related to one or some of those standards? Or to specific standards such as those for financial derivatives? Or perhaps a more correct phrasing would be "Are international accounting standards suited to provide the required quality of financial data?" and as such, do these standards help achieve a consolidated global financial system or at least the unification of capital markets in such a manner as to ensure greater protection of the investor through the transparency, reliability and suitability of data? Will the linking together of the real value of a project and its market value will be a strong deterrent against financial crises? Or do facts reveal otherwise?

The declared strategy of adopting international accounting standards, and as we have mentioned in the theoretical section, indicates that they are general guidelines for what accounting procedures should apply in terms of fairly measuring, documenting, and disclosing transactions, and aims to reduce the differences and variations in the content and presentation of financial data between countries while maintaining independence and neutrality in their preparation. As such many regional and international actors and committees especially the IASB (International Accounting Standards Board), and the USA FASB (Financial Accounting Standards Board), and in collaboration with national centers and bodies and international organizations have absolved international accounting and financial reporting standards of responsibility for the financial crisis. Perhaps the most important event in this regard is the report submitted by the chairman of the IASB in response to a request from the House Committee on Financial Services in the US congress on 11/11/2008 concerning the role of accounting practices on the credit crisis, which stated that the IASB is an independent body committed to the development of international financial reporting standards that would create extremely transparent financial statements (TWEEDIE, 2008). However, the fact is that despite the passage of 40 years since the International Federation of Accountants Committee (IFAC) first sought to unify accounting standards, we are still far away from achieving that goal, and this could be illustrated by the two following dimensions:

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◦ ***First Dimension: The issues of content and comprehensiveness of international accounting and reporting standards***. It includes the following:
1. Establishment of an unreal economy. For decades the accepted accounting standards GAAP and IAS adopted the "*historical value*", which required that it show all the company's assets at cost or market, whichever is less, and considered to be a very conservative principle. Examples are equity investments where if its market price was higher than cost, then the difference does not appear as profit, another would be real estate investments that appeared at cost regardless of the market price; furthermore, intangible assets such as brand recognition, trademarks, patents and copyrights do not appear on the books except under very stringent conditions and at cost, not at fair value. Also, fixed assets were amortized on the basis of its useful life whatever its price. That was the advantage of historical cost, which was adhered to by everybody, as it facilitated comparisons between financial statements. Then, objections were raised that the standards in their then current form did not reflect a true picture of a company's assets and fair price. As such, there was a development in which standard 16 allowed for the revaluation of fixed assets. Standards 32 and 39 caused an accounting revolution by moving towards presenting financial instruments (stocks, bonds, loans, etc.) at fair value. Standard 41 allowed presenting real estate investments at fair value, too. However, it turned out that these standards were establishing unreal financial transactions. A field study conducted on a large number of US companies, and based upon dozens of other supporting studies, showed that there was indeed an increase in company revenues through the application of these developments; however, the investor posed the question of whether this represented a real economy. The answer was no, because the policies that these standards condoned allowed the shifting of revenue fluctuations from one company to another, and as such this does not represent a real economy (Guy: pg 2, 2008).

2. Allowing the adoption of various and different policies or options in accounting practices. This is not a benign policy, and may lead to significant differences between institutions where each would pick one accounting practice over another. This lack of comparability will have a negative impact on the ability of investors in making sound financial and economic decisions (Standard 39: Conclusions: Presented Opinions: Opinion 9 the objection of Mr Coop).

3. Complexity in the structure of international accounting standards. In October 2002, an IFAC committee, entrusted with the task of establishing investor confidence in international financial reporting standards, demonstrated the weaknesses the market system structure including difficulties understanding the complexity of the architecture of international accounting standards, which can be translated as their being an actual problem in the content of these standards.

4. The lack of a clear reference for some of the accounting treatments, which results in an improper application of the international accounting standards that leads to the preparation of faulty financial statements. Considering that personal judgments are involved when trading in derivatives; therefore, how could these standards cover all facets of emerging complexities of financial transactions especially the strange and exotic ones? Keeping in mind that there are no standards issued by the FASB that are free of personal judgment in their application. This is the result of many and varying objectives, principles, treatment or application (Dahmash: pg 4, 2003).

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◦ ***Second dimension: The issues of Disparity and Differences in adhering to The Application of IAS***

In addition to the problems in the substance of international accounting standards, there are variations in its application as well. The same IFAC committee has shown that although 100 countries adopted the international financial reporting standards, most continue to have gaps in their application. Following are the most important reasons behind this:

▪ *Non-Mandatory Application of Standards.* Since these standards are not issued by any government body, they are non-mandatory in their application in contrast to legislation and laws issued by governments. For example, the European Union demanded member states prepare consolidated accounts in line with IFRS, and as of 2005, left the option to member states to carry out their obligations in that regards.

▪ *The Large Gap Between Local Laws and Legislations, and the International Standards.* There is a pressing need to either repeal or amend local laws due to their incompatibility with some or all of the international standards. This is a time consuming process, and a difficult one to carry out. Significant differences exist, for example, in Europe and France standards 32 and 39 have yet to be applied. Thousands of major companies listed in markets including 7000 companies in the European Union alone, that were required to apply the standards by 2005, have not done so. The irony is that the finest financial and accounting expertise in these countries lead the process of preparing and developing international accounting standards for over 30 years. This is because international standards lends greater importance to financial reality than it does to legal aspect (Arab Accountants Forum, 2007).

▪ *A growing trend towards the development of local and regional standards.* In addition to the existing differences amongst standards, we are witnessing the development of new local and regional accounting and financial reporting standards either to address previously unaddressed financial instruments unique to the country or region, or developed as a reinterpretation of standards to fit local and regional laws. At the moment, there are international standards based on US standards, and there are European standards based on international standards. In 2005, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Bahrain issued 21 new standards based on Islamic jurisprudence and known as Sharia Standard (SS). The Saudi Arabian standards include an intellectual framework for financial accounting, and an Islamic based standard for the financial accounting for Zakat (alms giving); while Egyptian accounting standards are a reinterpretation of international standards that have been locally adapted. The Gulf Cooperation Council (GCC) issued Arabian standards (regional based on US standards) that include an intellectual framework for financial accounting devoid of any Islamic standards; Malaysia developed local and Islamic standards based on international standards (Tawfiq 2008). The varying application of standards by different countries around the world has a significantly negative impact on the ability of investors in making global financial comparisons; as illustrated by the aforementioned IFAC committee entrusted with restoring confidence in international financial reporting standards. To illustrate the extent of the dilemma, and after so many decades of hard, diligent and expensive work, the IASB had had to ask the chairman of the G20 summit held on 15/11/2008 to remind the heads of member states that the board is an independent body assigned the task of developing a unified international standard, and to inform them that accounting and accounting standards are not the cause of the financial crisis, and to request that member states adhere to said international standards. So what would it

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be like for the rest of the world, and how big is the problem? As such, and till now we are unable to discuss the presence of a unified global standard let alone achieving their desired goals. In spite of that we cannot explicitly say that these standards are the main and direct cause of the crisis, on the other hand we cannot completely absolve them of responsibility. Based on the set goals of these standards, and considering the existing disparity in adherence and application, the outcome is the provision of data that is not on a level that lives up to the requirements of suitability and reliability needed to make sound decisions, yet they are not misleading to the point that they can cause a crisis of this magnitude since the non-compliance or partial compliance with the application of these standards does not include the entire world. The reality is that this issue contributed and in no small measure to the crisis because of what these standards allowed in the first place; however, they are certainly not solely responsible for what had happened, nor are they the principal or direct cause of it. So what or who could it be?

◦ ***Second: The general issues with Accounting Practices in accordance with the IAS, and the current financial crisis***

Improper accounting practices, despite the presence of adequate standards, will produce faulty financial statements, leading to improper decision making thus contributing to the crisis. In this regard, we mention the following:

▪ *Variations in the degrees of adherence to the application of standards.* In some countries, international standards are not permitted for use by companies registered locally in the capital market, while they are compulsory in others. Or, compulsory for some companies, but not others. Due to these disparities, significant differences and variations in accounting practices between different countries arise, because of the differing basic and moral codes that are followed, and the resultant differing terms, concepts, and interpretations of laws and provisions, and by extension the basis for the evaluation, measurement and recognition of revenue and expenditures in the preparation of financial statements and data presentation.

▪ *Lack of clarity in application mechanisms.* The difficulty, complexity, contradictions and inconsistencies inherent in these standards led to complicating the accounting practice. This point was conceded by the chairman of the IASB in his report presented on 11/11/2008 to the House committee, in which he highlighted the necessity to provide the mechanisms and appropriate guidance for the proper application of the standards, the absence of which caused lapses or gaps in the adopted accounting practices or policies as per the international accounting standards. This in turn has been exploited to manipulate financial data. As such, many of the novel accounting treatments used by troubled companies may be in line with the text of the IAS, but they conflict with its intent and its general framework, such as the practice of granting stock options to company executives in the United States. As standards continue moving further towards the concepts of fair value and the economic environment, and while economic valuations remain stagnant, the path to further manipulations may be open. (Khoury, 2002).

▪ *The issues with having various choices in accounting practices.*

a- A variety of accounting treatments, the standards have given companies more than one different choice of accounting treatments, for example:

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1) A company has the choice, once in its lifetime, to record its real estate investments at cost or market, and may list a rise in the value of its investment portfolio as profits or to hide it in equity. This is dependent on the way it classifies these investments as either for trade, or for retention until maturity. This flexibility has resulted in large variations in the presentation or omission of some financial data, as well as in the results of company operations leading to difficulties in comparisons for investors.

2) Manipulations by management. The classification of financial instruments as either for trading, available for sale or retained until maturity is tied to the intention of management which gives it an opportunity to manipulate assets; for example, to classify assets as ones that are to be retained until maturity, list them at cost, while they intend to trade them. In this way, management manipulates profits through fair value. Standard 39 provides companies with the opportunity to recognize unrealized profits (before actual sale of assets) in income statements, this should not be used in order to increase profitability without considering proper investment decisions. It is unreasonable for a company to place the larger portion of its financial investments for trading, rather, some of these assets will be available for sale, and some are retained until maturity. As such, seeking to consider a large portion of the assets as set for trading, will lead to a significant increase in declared profits in gains and losses statements just by virtue of changing the value in the market, which is unreasonable. Such practices, which are illegal, can be used in profits management to falsely project stability and achieve financial objectives (Alsaafeen, 2002).

b- *Exploiting fluctuations in market prices*. Many companies declared profits in stock investments listed at last year's closing prices despite them being unsold, and were carried into the current year's profits, and the decision for their distribution was made accordingly. As such, the declared profits substantially contradicted that of the subsequent period.

c- *The lack of professional reviewers*. If the issue was considered simple in the case of shares because of the presence of market prices, the problem is further exacerbated when assessing investments in real estate, fixed assets and brand recognition because those are significantly impacted by personal judgment, and is susceptible to serious manipulations. While standards continue to move towards fair value, assessing remains stagnant which opens the doors to manipulation.

d- *The need for sophisticated information technology systems* to provide more innovative accounting tools in order to process all incoming information from many different sources, and not just financial ones. This is needed to meet the complex demands laid out in said standards, especially the requirements set by standard 39 (Arab Accountants Forum, 2007).

Due to the absence of even the minimum requirements of accounting practices as per the international accounting standards, a crisis of confidence in accounting emerged; and because that will negatively impact the provision of appropriate and reliable financial data which in turn

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affects decision making, thus it would not be reasonable to absolve accounting practices from culpability in the current financial crisis. However, it does not bear the full responsibility alone, either. Therefore, what are the other factors that lead or contributed to the crisis?

• ***Third: insufficient or a lack of transparency and current financial crisis***

How can insufficient transparency or a lack thereof be one of the reasons for the current global financial crisis? This is what we will attempt to illustrate in the following discussion:

1) *Not achieving consensus on the form or content of disclosure.* Despite a lot of effort, controversy still surrounds the content and method of the required disclosure. Disclosure of real, credible information of events inside and outside the budget facilitates market control. The US Federal Reserve played a big role in developing the joint report along with the Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO) in developing a framework for global reports. However, global consensus was not reached on a specific form and content to these disclosures (Phillips 1996). Audited financial reports published by public shareholding companies ranked first as one of the most important sources of reliable information for decision making when investing in stocks. While financial market bulletins came in second in terms of investor interest when making decisions with regards to companies' dividends policy (Alhussein 2007). The level of disclosure in balance sheets in accordance with IAS affects the market value of stocks where adherence accounted for a 30% variation in the market value of stock prices which is statistically significant, whereas supplementary notes for the budget and cash flow had no effect on the prices of stocks.

2) *Inadequate disclosure or transparency.* Through the daily monitoring of local, regional and international economies, one can observe that many companies in the current financial crisis resort to blocking a lot of important information believing they can save the situation. There is no doubt that this reflects narrow, shortsighted interests which inevitably leads to unrealistic data. This led to both internal and external panic, as the world economies are interconnected with each other and primarily with that of the US which helped propagate and worsen the financial crisis.

3) *Inequities in disclosure and transparency.* When most of the information contained within periodic reports have been leaked throughout the year thus reflecting on stock prices and its returns, then most of the effects that could be caused by the reports would have transpired by the time these reports have been published (Alhussein 2007).

4) *Continuing doubts of the quality of data.* One of the safeguards of market stability that shields it against violent and unexpected upheavals is not only transparency or the amount of information disclosed to decision makers, but also the quality and relevance of this information (Abu Haltam 2006). As a response to the credit crisis, the many modifications made to IAS 39 and financial reporting standard 7 on October 13 were meant to provide investors in global capital markets with high quality data, by ensuring transparency and restoring investor confidence in the financial markets. It can be surmised that inadequate transparency and disclosure exist; however, it should be pointed

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out that they were not 100% absent, as most companies are legally bound to prepare and publish important financial statements at the end of every financial period. Furthermore, inadequate disclosure has been a persistent problem for a long time, yet financial crises did not directly arise as a result, and while inadequate or bad financial data can lead to a few wrong decisions, it does not lead in itself to catastrophic consequences as has happened in the current crisis. As such, disclosure and transparency it is not entirely responsible for the crisis as a whole, but rather a contributor, and moreover may be a symptom of a disease, so to speak, but not the disease itself.

• *Fourth: Corporate Governance and the current financial crisis*

a- *Issues with corporate governance within the framework of laws and regulations:* Corporate governance is the method of directing, managing and controlling the company according to a set of basic principles one of which is preserving the rights of shareholders and ensuring equality amongst them. Also, to further ensure disclosure and transparency and to emphasize the role of the Board of Directors in protecting the company and the rights of its shareholders. It is an effective method for the rational management of financial institutions in general and companies in particular. Corporate governance came to the attention of many governments in light of the expansion of the (free) capitalist economic system by enacting a series of laws and regulations that aim to provide quality and excellence in performance through choosing effective and appropriate policies in order to achieve company goals. The pressing need for corporate governance emerged in the wake of the financial collapse and crises experienced by many Eastern European, South East Asian, Latin American, and Russian companies in 90's, and in the United States in 2002. Furthermore, governance became increasingly important as more world governments continued moving towards capitalism, with an increasing reliance on private enterprises to liberalize financial markets, the growing movement of capital and the separation of ownership from management. The most important problems caused by the lack of the required corporate governance are:

1- *The growing internal and external influences on companies.* Weak corporate governance worries investors in every part of the world, as their trust is vested in the pillars of corporate management. Strong corporate governance usually implies strong management which lends credibility to management as well as the financial statements issued by them. One has only to look today at the size of compensation packages and bonuses of CEOs and board members of some American companies, that were undisclosed during their tenure, and at the fortunes they amassed to understand the shock investors had regarding the accounting, management and legislative environment in the United States (Khoury: Unified International Accounting Standards, 2002). Corporate governance has an intangible effect on stock prices that reaches between 20-30% of the value of the stock according to a study conducted by Mackenzie & Company

2- *Non-compliance with the ethics of the profession in commerce, accounting and auditing:* Detecting a defect in a timely manner will prevent the accretion of mistakes that often lead to a sudden collapse. The real reason behind the collapse of companies, as shown by numerous investigations and studies, was not the result of a

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faltering business, but rather as the inevitable result of the mass accretion of faulty accounting practices that were not exposed early enough by the financial disclosure system. What transpired at Enron could not have happened were it not for the collusion of the company's auditors (Arthur Andersen) with company management to overlook irregularities and other improper practices (Rababah, 2003).

3- *The lack of independence of auditing committees and other important actors within a company:* Because of this and in light of the collapse of Enron, the board of directors of the New York stock exchange issued standard (SAS No. 99) which included important amendments to the listing requirements, and involved appointing independent members to the board of directors, and to provide for the full independence of company's audit committee that is responsible for monitoring the external auditor, and to disclose the criteria employed in judging the independence of these individuals.

b- *Issues with Earnings management policies:* Earnings management represents a part of the ongoing operations of a company. Amongst the basic tasks of managers is the management of profits in such a way as to benefit shareholders and other stakeholders, provided that reliability is maintained in the preparation of financial data and with high ethics as stipulated by accounting principles and standards. The fact of the matter is companies' management of their profits is inconsistent with this principle, and we will discuss the most important indicators of this issue

1. *Manipulation of profits by legal and illegal means, or methods that are contrary to accounting principles, or through the application of an inappropriate principle:* when this occurs, it is with the complicity of auditing bodies and away from market controls. This was perpetrated by one of the major American power companies, Enron, between 1997 and 2000, through fake swaps and hedges contrary to accepted accounting principles and procedures. Where in 2001 it had to restate its financial statements for the period because of the accounting violations reducing its earnings by $613 million, and increasing its liabilities by $628 million, and reducing its equity at the end of 2000 by $1.2 billion.

2. *An increased rate and succession of ethical scandals of global magnitude:* Starting with those of US companies Enron, WorldCom and Xerox, which shook the American financial markets in addition to the impact it had on the majority of global financial markets and the subsequent monetary losses that affected their shareholders, as well as the economic and social damage it as evidenced by the loss of hundreds of thousands of jobs, and even extended to include major accounting firms such as Arthur Andersen that was accused of concealing a lot of facts related to the bankruptcy of Enron.

3. *The Exploitation of accounting choices to manipulate profits:* Where international accounting standards, especially IAS 39 allowed the manipulation of when revenues

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are recognized, in addition to improper accounting practices regarding expenditure, mergers, and contingent liabilities, and in disclosure.

4. *Excessive use of power:* Many a company's management team overstretched their mandates by exploiting some accounting choices related to fair value when recognizing and measuring assets. Most banks realized asset and financial instrument profits in 2001 far exceeding that of 2000, in which IAS 39 played a major role in this increase especially considering that this standard has expanded the use of fair value for financial instruments (Ola Yassin, 2002). This new standard had provided companies with a significant opportunity to recognize on their income statements unrealized profits even though a sale had not yet taken place. This misled investors, and projected a distorted image of the financial position and performance of the company, this was done so as to achieve biased results desired by management through the misrepresentation of important facts related to the company's economic performance, such as the artificial inflation of their share value. These actions were often driven by internal factors such as conditions within the company and its environment, and external factors such as the fluctuation of stock prices in the stock market, which inevitably harmed investors and the national economy in general. Among the manipulative practices of companies that became common, was the raising of stock prices and then selling them at a profit, and then devaluing the same stocks to repurchase them at a lower cost. Thus such issues contribute to financial crises, and it seems that the main cause lies in the misleading policies that aimed to exploit and harm the market and were specifically aided by financial instruments and their derivatives.

Overall, it cannot be said for sure that providing all elements of governance will result in controlling behavior and preventing collapse. While governance measures assist in controlling the company's operations, any deficiency or defect in them cannot be a direct and explicit cause of the financial crisis. Any weaknesses in governance, in a worst case scenario, will lead to financial distress at the level of the economic unit. Even if all companies around the world commit to implementing sound institutional controls, that in itself will not prevent a financial crisis from happening which may be due to other factors. However, it cannot be denied that governance is a contributing factor in the evolution of the crisis, and there is no doubt that the manipulation of earnings management will lead to significant problems and may even lead to a company's demise. Yet, in the real economic sense, it does not carry a lot of weight for it to be a cause of a global financial crisis of this magnitude, which is unless the moral inadequacies had reached phenomenal dimensions, this will be discussed in detail in financial derivatives.

• *Fifth: Weak or absent oversight over corporations and the current financial crisis*

Monitoring of any administrative, financial, economic or other process means the verification of achieving objectives as planned. The importance of oversight/monitoring and its positive role in economics and safeguarding public funds against misuse cannot be questioned; provided that whichever entity chosen for its administration adopts recognized standards such as those set by the International Organization of Supreme Audit Institutions (INTOSAI), Companies Control Departments, and the Public Interest Oversight boards among others. It has

been shown that the oversight exercised by Capital Market Authorities over companies operating in the field of securities has had an important role in preserving the rights of shareholders and traders, and in clarifying the obligations of companies operating in that field along with encouraging corporate adherence to regulations and directives (Rashidi, 2007). So what are the most important issues regarding oversight in the financial crisis?

1- *Absent or inadequate corporate oversight by relevant bodies*: The lack of oversight over investment banks by central banks and the lack of oversight or the inadequate supervision of financial and intermediary institutions are among the most important reasons that stand behind the current financial crisis (Bilawi 2008). In the United States for instance it was found that the U.S Securities and Exchange commission only reviews the financial statements of a few companies, for example, it had not reviewed Enron's financial statement for the three previous years which prompted the chairman of the investigating committee in the US congress to describe this committee as a sleeping guard dog. Many violations have been committed and there has been much talk accusing governments of turning a blind eye that allowed matters to deteriorate for the last 5 – 6 years to this point; where real transactions only constitute a fraction of all financial transactions, not exceeding 30% while the rest are imaginary and unreal transactions. The new president of the U.S. Federal Reserve, who was reassigned to the post, has acknowledged that the bank has failed in the performance of its duties in safeguarding consumers and that oversight and supervisory bodies are encouraged to undertake sufficient and appropriate measures to limit the phenomena of deliberate manipulation in earnings management as well as identifying irregularities.

2- *Contrast between oversight policies and reality (disarray):* Perhaps one of the most significant negative aspects in this regards is the absent role of government oversight bodies. One might even find contradictions between policies and actions; where the activities of these oversight bodies were directed at institutions working in the public sector and partially on the mixed sector; whereas the private sector was excluded from oversight. When the financial crisis occurred, hundreds of billions of dollars were pumped into the private sector by the government (public sector) to bail them out; and while financial oversight over the private sector does not fall within the responsibility of these bodies; nonetheless, the bailout money did come from national wealth, in other words from public funds. Now, we observe European leaders attempting to clean house; they have decided to form three oversight committees one over banks, another over insurance companies and the third over financial markets as they had no option but to do so in order to confront the crisis. Perhaps even such a measure is an attempt to escape its current constraints under globalization and a return to the values and ethics accepted in different communities

3- *The growing burden of unethical behavior on oversight*. No monitoring system, regardless of how robust the system is, can accomplish its real objectives in the

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absence of disciplined ethical and moral behavior that is based on accepted values and standards. As such, financial, supervisory and oversight reports will become more of an embarrassment in active financial markets. Perhaps this embarrassment is primarily related to the prevalence of administrative and financial corruption in all its forms, even necessitating the need to monitor the monitors. Hence, the data will be as embarrassing to regulators as it is to all parties subject to such oversight. But, can the absence of oversight or its laxness be a primary cause of the crisis? The answer to this question is definitely no, because no matter how robust oversight is, it is of no benefit if the original players resort to what is not ethical. Therefore, weak oversight or its absence cannot be the primary or only reason behind the crisis. What can oversight do when administrative and financial corruption related to a lack of professional ethics, is so prevalent?

Now, and after all the previous discussion regarding the current problems and different factors that may have caused the crisis, we wonder which factor is the one that played the most significant role in causing the crisis. This is what will be discussed in the following section about financial derivatives. To the extent that the problems related to financial derivatives and their implications are basic and core problems with a social, political, financial and ideological framework, they are also problems from a technical accounting aspect. Therefore, they are far reaching and serious requiring their own research in order to shed some light on them.

Section Four: Standards for Financial derivatives, their accounting and the current financial crisis

Due to the sheer size of financial derivatives, we will be as brief as possible and will discuss the problems of financial derivatives according to familiar themes in accounting and its standards which are scope, recognition, measurement and disclosure. A lot has been said about financial and accounting corruption and the manipulation of data, until many financial and accounting scandals appeared worldwide. Where do financial derivatives stand from this, what are its fundamental problems, and how does it reflect on the current global financial crisis?

First: Issues with the scope of derivatives

These issues arise as a result of the nature and diversity of financial derivative transactions, and we will briefly discuss them as follows:

1- *The diversity of financial derivatives and their expanding use*: Financial derivatives are numerous and complex, so are their types, instruments, and traders. One can even find some derivatives tied to the climate, or the environment and even those that sell debts with debts (debt swaps) ….etc. Whatever applies to all transactions also applies to financial derivatives except what has been previously mentioned in the theory section, starting with subsidiaries, associates, and joint ventures, and ending with contracts based on natural variables. As far as the categorization and division of financial derivatives and their instruments, we discern the presence of regular and embedded derivatives. Financial derivatives have numerous and branching types, based on future contracts (such as future contracts and forward rate agreements), and options (such as purchase and sale options),

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swaps (interest rate, currency, shares, commodities, caps, base, options). As for users of financial derivatives, end users include hedgers, speculators, arbitrageurs, and mediators. Based on the above

a. The multiplicity and complexity of issues related to derivatives and their treatment; therefore, derivative transactions and their accounting require more procedures and innovation that is not necessarily standardized but to the contrary are rather exotic. We will not attempt to cover or review this variety in derivatives, just the resultant issues related to objectivity, reliability, suitability, transparency, cost, and benefit.

b. The difficulty of its processes and the complexity of its concepts and practice. The articles contained in international accounting standard (39), where derivatives get the lion's share, can cover most pages of all other standards combined. Not to mention the many paragraphs, details, methods, techniques, and overlap between them. this is not part of the targeted advantageous simplification of the accounting practice. This goes against the goal of simplifying accounting practices and the positive impact that would have had.

c. Because of the diversity and complexity of derivatives, and their varying methods and tactics, their transactions are exposed to numerous risks such as credit risks, legal risks, operational risks, market risks and many more.

d. The difficulty of controlling or monitoring their transactions in general because of their wide scope. This difficulty increases in the presence of the many morally, ideologically, or customarily undisciplined transactions that financial derivatives are known for.

e. The accounting of their transactions requires advanced computerized accounting systems to collect and follow up on complex transactions, something that is not available to many countries. The lack of sufficient expertise and the high cost of developing such accounting information systems will be a critical factor if the process of adopting international accounting standards is to succeed. This information system must be able to provide more efficient accounting tools that are able to handle complex standards such as standard (39).

f. It contributed to the expanding the scope of management earnings manipulation: This was a result of multiple client groups, conflicting interests, and weak oversight, in addition to the profit gathering methods allowed by financial derivatives, and in the process evading acceptable and standardized accounting principles. Conclusions reached by the Middle East Studies Center symposium suggests that the root causes of the international financial crisis that happened on

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13/09/2008 were capitalist procedures and policies that were unprecedented in the absence of government oversight.

g. The difficulties of harmonizing international accounting standards and their conflict with targeted strategy will inevitably be accompanied by greater difficulty in accounting practice standardization.

2- *Derivatives are not actual financial or real assets,* rather they are contracts similar to all other known contracts which confers a right on one party and a liability on another. The value is derived from a financial index average or price, such as the price of specific securities, interest rates, or foreign currency exchange rates. Contrary to debt instruments no advance payment is required to be reclaimed later. Contracts that are counted as derivatives are not considered as a regular sales or purchase (standard 39: Basis of conclusions: conclusion 24); therefore, its value depends on the price of the financial assets included in the contract which does not require a financial investment in said assets, hence there is no need to transfer the assets property rights or its cash flow as they are often linked to interest prices and/or currency exchange rates, and as such these transactions do not constitute real economic transactions.

3- *They can be utilized as tool to manipulate profits* through the buying and selling of financial risks in financial markets. Derivatives are used by banking and financial institutions in order to achieve two objectives, risk management and to reap profits. Earnings management via financial derivatives is not a management process in the real economic sense, rather it is a cash flow shifting process for a given institution by shifting revenues from one corporation to another. The issue of manipulation has no limits and cannot be eradicated and there will never be a scarcity of players; meaning that as long as derivatives continue to exist, and given its complex and difficult transactions and the harmonizing its treatment through standards, revenue manipulation will continue to exist. (2008Guy).

4- Changing its value in response to exotic and novel transactions. For example, in response to changing interest rates, price of securities, price of a commodity, foreign exchange rate, price index, credit index or any similar variable. Therefore; it represents imaginary operations that are difficult to hedge. Interest rates were reduced in the United States, Europe and Japan up until it had reached close to Zero, while other countries are calling for zeroing it. Isn't this a recognition, specifically in relation to financial derivatives, of the negative influence such instruments had on national and global economies and in the creation of international crises.

5- Zero investment: Unlike debt instruments, they do not require an initial investment or a very small one compared to other instruments that have a similar response to changes in market conditions. Therefore, they are known as zero investment. Unlike other assets or investments revenues cannot be calculated on investments in financial derivatives. This

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issue will be further addressed in the section regarding the analysis of financial statements.

6- Derivatives are dependent on a future date: as they are financial instruments tied to a date that follows the contract date. Its transactions depend primarily on probability, intention, diligence, practice, estimation, and assumption as stated by the international accounting standards board. Therefore, they are associated with unusual, unknown and exotic transactions much of which depended on the unknown; and as a result unusual outcomes were yielded which enabled the accretion of improper accounting practices that went against accepted accounting principles.

7- Seeking harmony at the cost of strategic objectives: A lot has been said about the importance of international accounting standard (39) as being the first comprehensive standard to recognize financial data related to financial instruments including their measurement and disclosure, that depends to a great extent on the use of fair value in the accounting of financial instruments, and allows the use of what is known as hedge accounting; and despite the many revisions and substantive amendments that mostly dealt with financial derivatives, starting in October 1989 and up until March 2009, that intended to simplify the standard, avoid complexity, and provide more transparency. The IASB did not undertake this task in order to reexamine the basic methodology of accounting for financial instruments as mentioned in the standard , but rather in order to strike a balance between different expressed views. This is a departure from the strategic principles of international accounting standards. . (Preface: reasons for amending International Accounting Standard 39 – reduce complexity and resolve inconsistencies).

8- Encouraging Illegal Practices: all that has been discussed above regarding financial derivatives is a matter of considerable debate, yet there is a general consensus regarding the presence of ethical, and even legal problems in derivatives market practices,. Examples of these include:

    a. Excessive trading transactions of debt instruments and usury: With the liberalization of the US and UK economies, and the declining role of governments in the economy and the movement of capital, and transmission of liquidity between nations; the Black-Scholes financial model emerged in 1973, It formed the basis for the valuation of derivatives, and resulting new innovations in financial instruments that helped lenders insure against lending risks at a small financial cost. As a result these instruments became very popular and a new market was created for them, even insurance companies started to use them. Because of human greed, and a rush towards wealth, profits of insurance companies and banks were 30% higher than the past 5 years. With that huge financial investment banks that relied on real estate investments as a major source of income grew, which in turn depended on their loans to insurance companies

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that also grew to become huge corporations. During Alan Greenspan's tenure as chairman of the Federal Reserve, he raised the interest rates to curb inflation, and then in 2000 they were excessively lowered in order to stimulate the economy by encouraging consumer borrowing (which increased by 4 folds) in order to purchase a house rather than rent one. The reason being that low interest rates resulted in lower mortgage payments, less than rent or lease payments. This enticed people to sign the contract ignoring other conditions set therein (if interest rates go up, the mortgage payment goes up) Therefore, if and when the U.S. Federal reserve raises the interest rate, the interest rate on the mortgage goes up, so does the monthly payment. If the borrower defaults, the bank takes possession of the mortgaged property. After signing the contract, the investment bank then liquidates the contract to facilitate lending to others by aggregating these loans into bonds that are sold to other institutions thus earning cash and raising liquidity to lend others. These bonds are then bought by other financial institutions, usually insurance companies, which either sell the contracts or insure them through some other instrument that valuates the contracts. This in turn is then sold to another company that assumes the debt and takes ownership of the original loan (mortgage). This company then sells the contract yet again to an even larger company. This practice grew to include more markets along with the US. However, as interest rates went up so did mortgage payments, which impacted borrowers abilities to pay their loans. As the number of foreclosures rose, the real estate market was impacted and property values dropped. The losses started a chain reaction, where losses moved from individuals to companies, to banks and to wherever the trail of traded contracts lead. The losses were in the hundreds of billions of dollars. This prompted some to argue that altering interest rates to levels that do not reflect actual market conditions (for use as a market stimulant), is what actually caused the global financial crisis. Furthermore, international ratings companies, which gave these bonds AAA ratings subjected themselves to skepticism and distrust through their actions which where blatantly politicized in favor of western policies (Dabyan 2008).

b. The pervasiveness of phantom transactions in many financial sectors, to the point they became the rule rather than exception, as well as basing the banking industry on a system built around interest, operating within the framework of debt trading, mediation and debt restructuring at higher interest rates; and the reliance of the global financial system on financial derivatives. The latter depends on phantom transactions, that are based on probabilities, and do not entail the exchange of actual goods and services, in other words they are nothing more than an adventure and bet based on luck and destiny. Also, the unchecked behavior of financial intermediary institutions, the excessive application of the unsecured credit card system and the magnitude of the interest paid (Shehata 2008).

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Second: The issues of recognition and derecognition in financial derivatives:

The most important problems in this area can be summarized as follows:

1- Failure of Financial Derivatives to meet the definition of Assets and Liabilities: it is thought that the result of that accounting is the recognition of assets, that fail to meet the requirements of the definition of assets and the carrying of liabilities that fail the definition of liabilities (Std 39: Basis of Conclusions: Dissenting Opinions: Opinion 3: Leisenring). Therefore, they are phantom (fake) operations. A study conducted in early 2009 on the offices Forex and margin trading showed that 90% of the offices are facing fraud investigations, 87% of them do not issue receipts and do not have any contra accounts, 82% of their transactions were phantom transactions and have no connections or links to financial markets (The Study of Excellence in Institutional Development 2009, Measuring The Financial Impact of Forex Trading Offices in Jordan). This shift from a real economy based on goods and services, to an economy based on financial instruments not linked to real assets threatens to plunge the world into financial depression and bankruptcy through an increase of global indebtedness, or what is known as Levarage (Albeilawy 2008).

2- Frequent Exceptions in the definition of financial derivatives and their recognition: an example of this is a futures contract for the purchase of a commodity at a specified future date and at a fixed price; This contract would qualify as a derivative if there is no initial net investment even if the price used is the commodity's forward price at the inception of the contract, because there is an underlying (price of the commodity) and the fair value will change (because the contract price is not the prevailing market price at the future transaction date); however, this same contract would not qualify as a derivative if the enterprise was required to prepay at inception (even if it prepaid at the current market price, and the contract was linked to its forward price) because a prepaid forward contract does not meet the initial net investment criteria of a derivative. (Std 39: Implementation Guidance: Section A: Scope. FASB: Statement 133 Implementation Guidance Issue No. A11).

3- The issue of separating between a Derivative and Debt Instrument: If an embedded non-option derivative is required to be separated from a host debt instrument, how are the terms of the host debt instrument and the embedded derivative identified? For example, would the host debt instrument be a fixed rate instrument, a variable rate instrument, or a zero coupon instrument? The terms of the host debt instrument reflect the stated or implied substantive terms of the hybrid instrument. In the absence of implied or stated terms, the enterprise makes its own judgment of the terms. However, an enterprise may not identify a component that is not specified or establish terms of the host debt instrument in a manner that would result in the separation of an embedded derivative that is not already clearly present in the hybrid instrument, that is, it cannot create a cash flow that does not exist. For instance, if a five-year debt instrument has fixed interest payments of 40,000 annually and a principal payment at maturity of 1,000,000 multiplied by the change in an equity price index, it would be inappropriate to identify a floating rate host contract and an embedded equity swap that has an offsetting floating rate leg in lieu of

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identifying a fixed rate host. In that example, the host contract is a fixed rate debt instrument that pays 40,000 annually because there are no floating interest rate cash flows in the hybrid instrument. In addition, the terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid instrument. If it was permitted to separate embedded non-option derivatives on other terms, a single hybrid instrument could be decomposed into an infinite variety of combinations of host debt instruments and embedded derivatives, for instance, by separating embedded derivatives with terms that create leverage, asymmetry, or some other risk exposure not already present in the hybrid instrument. Therefore, it is inappropriate to separate an embedded non-option derivative on terms that result in a fair value other than zero at the inception of the hybrid instrument. The determination of the terms of the embedded derivative is based on the conditions existing when the financial instrument was issued (Standard 39: Implementation Guidance: Embedded derivatives: 22-1)

4- The Impact of Intentions and Past Practices on Treatment Methods: if an enterprise owns property and entered into an agreement with an investor selling option in an amount greater than the current value of the property, and the right to the option expires within 5 years if not exercised, then the option could be repaid by either delivering the property or net cash payment depending on the enterprise. The question is how is the option considered, and how is it treated by the enterprise and investor? As for accounting for the project, it depends on its intention and past practices with respect to reimbursement (actual physical delivery, or payment in cash); and although the contract meets the requirements of the definition of a derivative, the enterprise cannot account for it as a derivative if it intends to pay the contract by delivering the property. As for the investor, because he cannot demand the actual delivery of the property he accounts for the contract as a derivative regardless of past practices (because his intention(s) has no bearing on whether repayment was made in cash or by delivering the property). However, if the contract required physical delivery and the reporting enterprise had no past practice of settling net in cash, the contract would not be accounted for as a derivative. Therefore, could all of this be based on intention, and does the intention not change? And, are past practices fixed and not change? This is a source of many, complex problems for recognition, and so it's difficult to acquire reliable, and consistent financial statements. (Standard 39: Implementation Guidance: Embedded derivatives: 14-3)

5- Accountants' preference for the use of Transaction Date to Settlement Date in accounting: depending on market conditions, and whether the institution used transaction date or settlement date accounting for the recognition and documentation of its purchases of financial instruments (at inception, or maturity); standard 39 permits the usage of either date (Std 39: Implementation Guidance: Section B: Definitions: B-2 Definition of Derivatives) accountants prefer the use of the transaction date in most cases because it reflects the date of transfer of returns and the risks of ownership (Groening, pg 324, 2006). Thus, we return to the question of consistency or stability in accounting practices. Also, the problems of receive-fixed, pay-variable interest rate swaps by which a fixed commitment is paid in advance during contract agreement and deducted using market interest rates usually on the basis of interest rates between banks for a 3 month period

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(Definitions B: 4 Interest Rates Swap: Fixed Payments, Variable Payments). Thus appears the size and extent of the problems that accompany the process of carrying the fiscal period on an accrual basis in interest rate swaps, and the extent of reliability and compatibility.

6- The issue of classifying deferred profits gained through Financial Derivatives: as they are an estimate of a part of their ongoing revenues, whereas it is beyond a corporation's ability to determine the amount of realized losses on hedged items.

7- Issues regarding the level of control: Not only is the issue of the loss of control to a certain degree, and that of derecognition based on some considerations a difficult one, it also illustrates the extent of the illusion as the institution loses its rights in light of it. Also, the difficulty in defining the non-fundamental value, which impacts the classification of financial assets as a result of an external or unexpected event.

<u>Third: The issues with accounting measurement of derivatives</u>

Fair value is one of the most complex and criticized subjects, and the one most reviewed in the framework of the international accounting standards. The U.S. accounting standards (GAAP) and International Financial Reporting Standards (IFRS) had, for decades, adopted the "historical cost" where all the company's assets must be carried at cost or market whichever is less. It is considered to be a conservative principle. Examples are fixed assets, which are consumed based on its useful life whatever the price of the asset is. Also, investments in shares or in subsidiaries and associates were shown at cost or market, whichever is less, even if their market value was much higher the differences did not appear as profit. Real estate investments appeared at cost regardless of market price. As for intangible assets such as trade secrets, trademarks, patents, brand recognition, and copyrights did not appear in the books except under very strict conditions and were even then shown at cost and not at fair value. However, there many objections were raised arguing that "historical cost" did not reflect an actual picture of company assets, or its fair value, which is true. On the other hand, the advantage of historical cost was that everyone abided by it, which then facilitated comparisons of financial statements from companies of the same sector. In response to the objections, there was a development that came in the form of standard 16 which allowed for the revaluation of fixed assets, and standards 32 and 39 followed. These two standards moved towards showing financial assets (stocks, bonds, receivables, loans, etc.) at fair value. In addition, standard 41 further allowed the listing of real estate investments at fair value, in addition to other standards (The financial Auditor, The evolution of accounting standards opens the doors to manipulation, Gulf Works TheGulfbis.com 10/3/2006).

The international accounting standards board concedes the fact that accounting for financial instruments is a difficult and controversial subject. Since 1988 hundreds of comments were made regarding the amendment of most articles in Standard 39, especially those concerning fair value and hedging which goes to the heart of the subject of financial derivatives. What took place was not a radical solution, rather an attempt to mitigate or illuminate the differences with other standards such as the U.S GAAP (IAS 39: Basis for conclusion, Financial Instruments: Recognition and Measurement, conclusions 5 & 13). As such, there is an urgent need to

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understand the many problems that faced implementation of this new concept in financial measurement, and to overcome these difficulties. Most important problems include:

1- ***The difficulty, complexity and ambiguity in the concept of fair value:*** and this is best illustrated by

  - The multiplicity of standards related to accounting and disclosure of fair value, which will lead to significant confusion and ambiguity in its practical application; moreover, more than one definition was given in international accounting standards.

  - The complexity of accounting treatments related to fair value and the difficulties in understanding them, in addition to the significant differences in the interpretation of many of its accounting treatment, as well as the lack of clarity of its disclosure requirements. This is further complicated when trading in financial derivatives, an example is the difficulty separating an embedded derivative from its host debt instrument; If an embedded derivative is to be separated (not an option, such as a futures contract or a swap), then the basic terms of the debt instrument shall reflect the stated or implied substantive terms of the hybrid instrument. If there are no implied or stated terms then the enterprise can exercise its own judgment. As such the terms of an embedded non-option derivative, such as a forward or swap, must be determined in such a way so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid instrument.[4] On the other hand an embedded option-based derivative (such as an embedded put, call, cap, floor, or swaption) is separated from its host contract on the basis of the stated terms of the option features. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.[5] Hence the embedded derivative will not necessarily have a real or fair value of zero at the time of recognition of the hybrid instrument, and the fair value of the option will only consist of the value it accrued over time and the possibility it goes up in the future. This is not consistent with the potential economic behavior of the combined instrument since adjusting the actual price of an option-based embedded derivative will change the nature of the combined instrument. As for the reliable determination of the fair value of an embedded derivative, in cases where an embedded derivative is required to be separated but cannot be reliably measured because it will be settled by an unquoted equity instrument whose fair value cannot be reliably measured, then it is not measured at cost, rather the entire combined contract is treated as a financial instrument held for trading. If the fair value of the combined instrument can be reliably measured, then the combined contract is measured at fair value. If however, the enterprise concludes that the

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[4] (Standard 39: Implementation Guidance: Embedded derivatives: Paragraph 22, Q 22-1)
[5] (IAS 39, Financial Instruments: Recognition and Measurement, AG 28, pp. 35)

equity component of the combined instrument may be sufficiently significant to preclude it from obtaining a reliable estimate of the entire instrument, in that case the combined instrument is measured at cost less impairment[6]. Therefore, theoretically there is no consensus between accountants, professionals, and researchers on a clear explanation of the concept of fair value, and that the current concept of fair value is inconsistent with long established accounting principles such as caution and historical cost.

2- ***Fair value measurement being affected by intentions and exceptions:*** Some of the complexities found in the existing requirements cannot be avoided in such a mixed measurement model that based in part on the management's intention of for holding financial instruments, and given the complexity finance concepts contained therein and issues of fair value estimation. Therefore, an entity's intent of whether to retain an asset for trading or not plays a large role in measuring the financial asset at fair value or amortized cost. In addition to intent, there are exceptions in the way profits and loss are accounted for, either in profit and loss or in equity; then when the value goes down (or up), regardless of which category is recognized, the difference between profits and loss shall be changed from equity to net profit or loss, i.e. contrary to the original treatment of the available for sale category (IAS 39: Basis for conclusion, Financial Instruments: Recognition and Measurement, conclusion 12). Therefore, we observe that consolidated financial statements at fair value lack objectivity and financial proof, and leaves a lot of room for manipulating the accounts (Sayyam, 2007).

3- ***The host of assumptions used in measuring fair value:*** For most financial derivatives, determining their fair value is purely based on assumptions, especially if these derivatives are not traded in the market. Most derivative instruments are basically contracts between a derivatives dealer and a user company. Determining the fair value of derivatives and the items to be hedged includes many assumptions, such as the perfect market, static or stable fluctuations, and prices that follow the natural distribution curve, and investors interested in maximizing wealth, as such this value is theoretical (Guy, 2008).

4- ***The use of multiple complex methods to measure fair value:*** Basically there is more than one way to measure fair value according to the standards; the major methods include replacement cost, market value, present value of cash flows and net realizable value. Whereas according to standard 39 (Fair value measurement considerations: valuation technique, paragraph 48, pp. 13-14) and (Implementation Guidance: Section B, B2, Definition of a derivative)

- On the measurement date: to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations

[6] (Standard 39: Implementation Guidance: Embedded derivatives: Paragraph 70, Q 70-3)

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- Valuation technique:

  a. incorporates all factors that market participants would consider

  b. Consistent with accepted economic methodologies for pricing financial instruments

- The entity shall make use of estimations and assumptions that is consistent with the available information used by market participants.

This illustrates the complexity of accounting treatments related to fair value, and the difficulty in understanding them. The fact that there are multiple methods for the estimation of the fair value of financial assets or liabilities makes financial data more volatile than it really is, especially in the absence of an active market. The main issue with estimating the fair value does not lie in its reliability (i.e. the extent of available proof) in such a manner as to aid its recognition, measurement, presentation or disclosure, but rather in the adoption of fair value in the accounting of a mixed measurement model where certain financial assets are measured by their fair value, while others along with most financial liabilities are measured by cost. This is incompatible with the principle of consistency in accounting, leading to inconsistencies in the accounting treatment.

5-The many risks trades in financial derivatives are exposed to as a result of fair value estimates: There are numerous risks involved with the use of fair value estimates in financial data, specifically consistency and reliability due to the use of the management's personal judgment in its valuation. The best fair value estimate of a financial instrument with an unquoted price in an active market is the transaction price, unless the fair value of the instrument can be demonstrated through other observable market transactions, or is based on a specific valuation technique whose variables include data only from markets that can be observed (Fair value measurement considerations: valuation technique, paragraph 48, pp. 13-14). As the estimation of fair value is left up to the discretion of accountants, and considering that there are options or financial derivative instruments that do not have a reference for fair value to begin with, this makes it all the more difficult to estimate its fair value objectively. In a study regarding the effects of price fluctuations on the pricing of financial derivatives from 1965-2004, it was found that 3 to 5 factors are needed for clarifying changes in swap rates, moreover it became apparent that there was a spike in risk when pricing was done on the basis of market price index, and their cost was too high compared to individual stock options (Dazhi, 2006)

6- The inability to arrive at a fair value for investments: either because there is no quoted market price or the market price does not reflect a fair price. Such metrics cannot be monitored in shallow markets in effect preventing the development of accounting information systems that can be adapted to deal with the fair value (Al Qishi and Karaja 2004).

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7- ***The difficulties in disclosing fair value information of financial derivatives, or the lack thereof:*** In addition to the difficulties in disclosing fair value data, especially financial data that has been settled according to inflation factors. There is a multiplicity and dispersion of disclosure articles related to financial instruments as stipulated by international financial standards.

8- ***The difficulties faced in providing qualified professionals:*** Those who are capable of understanding and applying the concepts contained within the international accounting standards appropriately.

9- ***Managements' abuse of treatments contained in fair value standards in earnings management:*** these treatments have been used as tools to manipulate profits, such as the ability to increase capital through unrealized dividends.

10- ***The high cost of preparing financial statements in comparison to other standards*** especially when external consultants or valuators are contracted to estimate the fair value. The issue becomes more complex when trading in and hedging financial derivatives as it requires advanced accounting systems capable of quickly controlling and dispensing information.

11- ***The doubts regulatory bodies have in its reliability:*** because at times the directives of governmental regulatory bodies are in consistent with the accounting treatments mentioned in the standards; as governmental regulatory bodies tend to have a conservative outlook to fair value standards.

12- ***The difficulty in striking a balance between reliability and appropriateness:*** This issue raises thorny accounting issues. When wondering about the possibility of finding an accounting model that balances reliability and appropriateness of financial data, the problem lies in the availability of actual improvement in accounting practices. Fair value is more appropriate than historical cost for users of financial statements but is less reliable. Therefore, accountants and auditors faced two choices when dealing with users of financial statement, either statements that are objective yet unsuitable or statements that are suitable but not objective. There is plenty of work to be done before fair value estimates become reliable, verifiable and auditable. Hence, a fair value measurement project was initiated by the international accounting standards board to review the measurement of fair value currently in use by international financial reporting standards since measurement guidelines of fair value are widely dispersed amongst a large number of these standards, furthermore they are inconsistent, incomplete and do not provide a clear goal or a solid framework for measurement. The board feels that that adds unnecessary complexities to standards and leads to differences in practice. The board has identified the objectives of this project as follows:

- Establish one source of guidance for all fair value measurements that are required or allowed under existing international financial reports standards to reduce complexities, and achieve greater consistency in its application

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- Clarify the definition of fair value and its associated guidelines to convey measurement objectives more clearly.
- Enhance fair value disclosures in such a way as to enable users of financial statement to estimate the extent fair value has been used in the measurement of assets and deductions, and to provide them with all information related to inputs used to arrive at that fair value.
- This project is intended to provide a definition (or definitions), and to better characterize market based valuations, but not intended to expand or narrow instances where existing market valuations are used.

Fourth: Trading risk and hedge accounting of derivatives:

Although financial derivatives gave financial institutions an opportunity to diversify their services and provide new instruments to reduce risks, trading in them can lead to large losses. Therefore, hedging was developed which is different than the caution principle known in accounting. As is stated in standard (39) a hedge instrument is a derivatives portfolio containing offsetting risk positions for both portfolio and individual hedges. All derivatives are measured at fair value[7]. The effectiveness of hedging is the degree by which a change in the fair value or cash flow of a hedged item is offset by the change in the fair value, or the cash flow of the hedging instrument. The main issues may be summarized as follows:

1. In terms of financial derivative standards and accounting practice guidelines needed to face the numerous and diverse risks of trading in financial derivatives, we are still at the beginning of the road.[8]

2. The unusual, complex and different methods of hedge accounting, and the unreliability of its rules. In a study on gas and oil companies, 1994 – 2005, it was found that hedge accounting is very difficult in application; therefore, companies should reduce hedging activities and reduce accounting activities of the effect of changes in the fair value of derivatives during short-term fluctuations in revenue (Suh, Julie, 2007). An expectation of high effectiveness can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument[9]. An entity may also choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge[10].

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[7] (IAS 39: Basis for conclusions, conclusion 215)
[8] (Drafts IAS 39, as amended, example (pp 54-55 IASB)
[9] (IAS 39, Financial Instruments: Recognition and Measurement, AG 105 (a), pp. 56)

[10] (IAS 39, Financial Instruments: Recognition and Measurement, AG 99 (c), pp. 54)

3. It results in the recognition of unreal gains: Which raises the question, do these transactions yield real gains that represent real economic transactions and add value to the economy? Or is it only a redistribution of gains and losses among economic units without added value to the economy. This represents a shift from a real economy based on goods and services to an economy based on financial instruments not tied to real assets. This threatens the world by slipping into depression and bankruptcy.

4. Doubts concerning the documentation process; after all that has been presented so far, one has to wonder to what level is the documentation of risk coverage adhered to, and how to trust the documentation process when the essence of the processes at best is based on assumptions, estimations and probabilities that are mostly fake as conceded by relevant standards.

Fifth: Issues with the presentation and disclosure of financial derivatives

All these issues were bound to accumulate starting with the setting of standards and ending with the preparation of financial reports, so that their combined effects show up when presenting, disclosing and analyzing final financial reports. Main issues that affect presentation and disclosure in particular are:

1- Lack of an international consensus on the nature of the required disclosures of financial derivatives.

Since the disclosure of credible information regarding events inside and outside the budget facilitates market control, the US Federal Reserve played a major role in the development of a joint report together with the Basel committee and The International Organization of Securities Commissions (IOSCO) in finding a framework for international supervision reports on financial derivatives. Despite immense efforts there is still a considerable debate as to how to provide reports containing quality information on risk management to shareholders[11].

2- Investors' ongoing doubts regarding corporate disclosures of financial derivative transactions:

There are still ongoing doubts as to whether corporate revenue reports had taken into account the gains and losses resulting from trades in derivatives, such as the mortgage bubble, which caused, and to a large extent, the massive corporate losses of 2007 of companies trading in these derivatives, and whether the disclosures were adequate in making sound decisions. In reality there was a lot of misinformation.

3- Absent or inadequate transparency in financial derivative transactions:

This is the main reason for amending IAS (39). Under the pretext of seeking more transparency, the most important amendments of this standards on 13 October 2008 were justified; where reclassification of financial instruments was allowed to facilitate solving the problems faced by financial institutions. The IASB focused on financial derivatives, which the board adopted as a response to the credit crisis. The total lack of transparency

[11] (Phillips, 1996)

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here was meant to help in the manipulation of interest rates in order to realize more profits. These interventions were expedited in response to appeal by EU leaders, which in itself is extraordinary. The International Federation of Accountants attempted to mask the effects of this decline and allowed conversion of investment categories to cosmetically improve accounting figures, but to no avail.

Facts show that many of the requirements of adequate and sufficient disclosure are not available and statements are not prepared in accordance with international accounting standards in general, or IAS (39) in particular, especially those standards pertaining to financial derivatives due to their complexity. Therefore, even assuming the presence of good accounting practices and effective monitoring of adherence to standard requirements, that still does not provide the adequate transparency needed for making sound financial and investment decisions, because financial derivatives in their entirety are built on methods and instruments that are inherently inconsistent with the mentioned requirements. In effect those who first laid the standards of transparency and disclosure became the same ones that are moving to end it as far as financial derivatives are concerned.

Sixth: Analysis and interpretation of financial derivatives statements

The issues here are no less important that the previously mentioned ones, in fact they are more important once we realize that they represent the evaluative stage of all that has been previously mentioned, most important of which are:

1- ***The inability to calculate the rate of return***: because derivatives require no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions.[12] Therefore, with the expanding use of these instruments the problem grew as this indicator is considered one of the most important indicators in the financial analysis of various economic activities, which in turn resulted in outputs that included information that lead to incorrect decisions that inevitably helped in the creation of the financial crisis. Within the same context margin trading is introduced, which is dealing and trading in the profit and loss margin of a traded commodity without having to pay its full value. Profit is added to the client's account while the loss margin is deduced, and for any transaction, in such a way that does not exceed the client’s account balance at the trading company. (Used margin = number of contracts *contract size/multiplier ratio.

2- ***Analysis requires the provision of a large amount of diverse data and information***. Despite what has been mentioned in paragraph (1) above, if information technology systems are not sufficiently complex to link financial instrument transactions with their derivatives, and specifically with accumulated gains and losses, then that will affect the value and importance of information (grionng 2006)

3- ***Analysis results vary with the varying managerial classification of asset categories:*** There are three categories of financial assets and their derivatives, they are held for trading, available for sale and held to maturity. If assets are held to maturity, unrealized gains and losses are carried over directly into equity (budget and not to the income statement). Those classified as available for sale are treated the same as those that are

[12] (Standard 39: Implementation Guidance: Embedded derivatives: Paragraph 10, Q 10-1)

held for trading and are carried by fair value; realized gains and losses (at actual sale) or the reclassification of investments are carried in income statement. As for unrealized gains and losses (unsold but changes in value due to changes in market prices or reclassification) will be presented as a separate component in shareholders' equity in the budget. Calculations as well as the continued accumulation of losses in equity.

4- ***Financial data's inaccurate reflection of reality:*** One of the main purposes of derivatives is the modification of future cash flows to mitigate and entity's exposure to risk, or for the purpose of deriving benefits and improve its allocation of capital to cope with changes in the business environment. As such these activities (transactions) that occurred or will potentially occur must be presented transparently to users of financial statements; because, and as an example, not reporting an interest rate or a foreign exchange transaction will be unsuitable for the consolidation of the financial statements of a subsidiary. As many derivative instruments have a statistically significant deviation from the expected mean, that will affect future cash flows, and unless these potential effects are transparently presented in disclosure and analyses, then budgetary representation of the fair value of financial instruments will be incomplete, and cannot be used to correctly evaluate the relationship between revenue, risk and analysis.

Conclusions and Recommendations

The major conclusions and recommendations of the study are: In light of the analysis done by the study of the various factors leading to the international financial crisis the following conclusions were reached:

1- The financial crisis and its repercussions will continue as stated by the Secretary-general of the United Nations and the heads of major powers and many economists around the world. It is characterized by financial corruption and serious business failures led to a disruption of regulatory and accounting systems the world over. This phenomenon of corruption first appeared in the United States and other major world powers then found its way to china, and caused the collapse of several major companies such as Enron, in early 2003, whose assets amounted to 60 billion dollars followed by huge corporations like WorldCom whose assets amounted to 100 billion dollars. it is evident that the crisis is still ongoing, in the United States for example, there are 350 banks that continue to have serious financial difficulties and are heading towards bankruptcy despite being given 100 billion dollars by the treasury department to address their difficulties. The crisis started in the United States and the ball is still rolling while the rest of the world is living a nightmare, especially because the United States' economy accounts for 25-40% of the world economy. It was estimated that 20 million people will lose their jobs by the end of 2009, bringing their number to more than 200 million worldwide. Suffice it to say that this is the first time in modern history that unemployment has reached such numbers. In Japan the unemployment rate is close to 6%, the highest since world war II. Negative inflation in the United Arab Emirates has reached up to %35 accompanied by growing unemployment, the laying off of expatriates and a decline in the value of real estate. The fallout from the financial crisis, that resulted from trading in financial derivatives will not

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end with this, as the G8 summit in L'Aquila, Italy has cautioned, it will also affect social stability. Until now through February of this year, 22 banks were closed in the United States. While Greece alone needed a 30 billion euro stimulus package from Western Europe to save it from financial collapse.

2- All of the aforementioned factors or issues complemented one another in contributing to the current financial crisis; perhaps the ripple effects of some amplified the effects of other factors contributing to the crisis.

3- The degree to which each factor contributed to the financial crisis varies. Standards are set by reaching a settlement between relevant parties; as such harm will inevitably come to the weaker one. While weak governance or lack thereof reflects partially or fully on a company or a group of companies, it does not reflect on the economy, or cause a crisis of this magnitude.

4- Financial derivative standards, which are one of most controversial standards, are considered the prime suspect behind the crisis. We may cite the following conclusions and proofs regarding their responsibility in the financial crisis: .

    a. The effect of derivatives in the financial crisis is larger and broader than others, where its value has been estimated at half a million trillion dollars, which is equal to half the size of the financial impact of the crisis on the world economy estimated at a thousand trillion dollars (Quadrillion).

    b. Economists are struggling to determine the main cause, and this is because of the prevalence of many large novel and exotic transactions. This is can be inferred from the statements made by the chairman of the international accounting standards board in his report to the House Committee on Financial Services on 11/11/2008 investigating the banking crisis, where he stated that the real reason behind the financial crisis are the bad practices and procedures followed in lending operations, and that the role of accounting was confined to reflecting those economic practices.

    c. Financial derivative transactions encouraged and allowed improper accounting practices; even despite the many amendments of IAS (39) in general and the parts dealing with derivatives in particular, the trend that it followed had a greater reliance on complex methods and which had its unintended consequences, which contributed to deepening the existing problems. As such, and based on our professional experience, we can infer that financial derivatives themselves represent the main source of the most fundamental issues that go to the core of all transactions, and other issues that arise as a result of it, and is reflected in the accounting of those derivatives and at every stage, from recognition, measurement, hedging, disclosure, even financial analysis processes.

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- They complicated accounting practices according to set international standards, especially with regards to fair value, where:
    - Allowing corporations to valuate derivatives, when said derivative does not have a market price, due to the lack of real or active markets for most if not all derivatives, thus providing an opportunity for manipulation which in turns lead to investor fear of financial statements prepared in accordance with that.
    - Inadequacy of laws or lack thereof to set the ethics of trading in derivatives.
    - Inappropriateness of its standards to the environment of many countries around the world
    - The high cost of its accounting because of the complexity of its transactions, its hedging requirements, and its need for appropriate electronic systems, in addition to the lack of qualified professionals.
- They have a fundamental impact on increasing the problems of transparency because of the illusionary nature of its transaction and its association with the future, hedging risks, and the lack of an initial investment.
- They play the largest role in creating the issues related to earnings management.
- Difficulty in controlling and regulating its transactions because of the complexity of its transactions and their various methods and treatments.
- They are the biggest contributor to the lack, lax or absent oversight.

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d. They open a door for creative accounting when using the fair value approach for trades in financial derivatives. A large number of asset components that appear in the budget, material or non-material, do not have a known market price. Assets may undergo significant changes in value that can accelerate the impact of the economic cycle by exaggerating the results of expanding enterprises, thus providing misleading data.

e. The market is not capable of regulating itself, external oversight and monitoring should always be implemented.

f. International credit ratings companies fail in their set estimates of financial derivative risks. The biggest global ratings companies, Moody, Fitch, S&P, who gave a high (AAA) rating subjected themselves to skepticism and distrust through

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their actions which where blatantly politicized in favor of western policies[13], and as such it can be said that these ratings cannot be relied upon to safeguard the world against such financial crises.

g. The political dimension of the crisis is taking shape more and more, and the existence of this dimension can be confirmed when, we ask ourselves about:

   i. The role and mechanism of early warning systems, and global rating methods. Could it not have been possible to adopt an early warning system for the largest economy in the world? Could it not have been possible with advanced communication, advanced information systems and econometric methods to install a crises forecasting system? One has to wonder about preventive treatment before the crisis, and one has to also wonder about where credit ratings stand in relation to this crisis, and about the ability of these institutions to provide alerts prior to the occurrence of crises.

   ii. Ongoing practice of unprecedented policies and procedures. The roots of the financial crisis that took place on 13/9/2008 can be attributed to a number of factors and practices that were primarily based on capitalism and policies of US banks and financial institutions. The crisis deepened in many important financial sectors well before its manifestations were apparent due to the lax system which granted freedom of action and unprecedented market policies in the absence of effective supervision and oversight by state and national governments and institutions, which encouraged an unjustifiable rush to make rapid gains, and the absence of transparency. They are as Warren Buffet has described them, weapons of mass destruction given their destructive role that brought down giant institutions.

5. International accounting standards, especially IAS (39) and in particular those relating to financial derivatives are constantly being amended. These amendments were aimed at achieving harmonized policies, and perhaps they were exaggerated interventionist policies not meant to improve the quality of data.

6. Catastrophic expansion in financial derivatives innovation (especially swaps) .

7. Incompatibility or unsuitability of some accounting standards requirements, especially in non-active markets since their prices are unavailable, even in first world countries.

[13] Dabyan, 2008

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8. Inadequacy of information systems, and the internal and external oversight of financial and banking institutions, especially those that guarantee suitability and reliability of the data contained in financial statements.

9. There are those that defend financial derivatives despite the aforementioned issues and their attendant repercussions, with the claim that in spite of the bad press, derivatives remain a meaningful force in today's economy and what has been experienced in a year and a half passed was a result of unusual pressure on capital markets (Oakely, December 2008). In 18/8/2009 the international monetary fund announced that the global economy is recovering despite large enterprises declaring bankruptcy, rising unemployment, prices inflation worldwide; then a few months later the same institution gave conflicting remarks that suggest the crisis is going to go on for some time.

Recommendations:

In lieu of the importance of the results and conclusions obtained it is imperative to arrive at worthy solutions to confront the obstacles posed by financial derivatives which are listed based on priorities as follows:
First: cooperate and seek all venues in order to fix the global economic, commercial, financial and monetary system through:

1- Ending the era of giving free markets a free hand, thinking it can regulate itself, and develop a free system that is controlled, monitored and responsible which provides reliable supporting documents and maintains economic freedom. A return to a system based on gold and silver reserves, which is the most evenhanded financial system, and rescind all forms of debt selling. Discard commercial papers and deferred checks and reschedule debt collection at higher interest rates. Prevent speculators from manipulating prices in financial markets as long as they participate in phantom transactions. The objectivity principle requires that the measurement of the value of a particular market contract not be assessed according to a different market in which the transaction did not take place, neither does it recognize gains and losses on the basis of a transactions that may take place in another market. (International Accounting Standard 39: the basis of conclusions: dissenting opinions: opinion 6: Lesnirng).

2- Refrain from investing in immoral venues, since all that is based on falsehood is false; this is even being promoted by major powers. This paper does not object to the use of any instrument or even fair value; however, what is needed are appropriate mechanisms and appropriate standards which facilitate and regulate accounting for such instruments and values both morally and legally. What is required is the assurance of providing a system of values, ideals, credibility, transparency, cooperation, solidarity and facilitation for borrowers. Finding a basis for participation in profit and loss and the actual trading of funds and assets as well as prohibiting financial derivatives based on risk or debt trading, and all phantom transactions governed by ambiguity, ignorance and usury. If these measures are committed to, then they will spare us the efforts and money that is spent today in order to rescue deteriorating positions and limit the series of financial and

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economic meltdowns. Provide the requirements needed to adopt mechanisms suited to contemporary developments and ethical values. most important of which is the use of money and not hoarding it, fair distribution of wealth in accordance to private and public ownership. The legalization of commerce and prohibition of financial speculations based on guessing and risk taking and promote effective financial market oversight to prevent fraud, artificial inflation, and prejudice. Therefore, it is important to search for alternatives and a different mechanism in derivatives. The Islamic portal could be one such alternative addressing many details related to usury, debt selling and others. It is then required to devise instruments or maintain instruments that entail ethics and moral values needed by the market and accounting practice such as credibility, integrity and ideals stemming from religious ideals.

3- Depend on commonalities that are based on ethical and moral principles while developing international accounting standards, otherwise all would collapse once we realize the redundancy and ineffectiveness of available standards, accountancy, oversight and transparency. Therefore, we can say that we cannot harmonize standards in the presence of disagreement but common ground acceptable to all should be found. Investor confidence stems from prescribing accounting standards common to all yet not imposed by a single entity

4- Developing general global standards that are sufficient and appropriate together with providing suitable guidance for its application in order to prepare financial statements to be disclosed appropriately and reliably

5- Refrain from attempting to equate accounting to standard science in the inevitability and conciseness of its measurements, data and estimates.

6- If necessary local standards must be compatible with international standards whenever possible, because life in isolation from the rest of the world is not possible. Furthermore, and without neglecting global consistency and globalization, alternative local requirements or standards should be provided whenever needed. In other words, guarantee an acceptable level of consistency that is commensurate with economic openness in the provision of more reliable and appropriate data for the making of relevant decisions, while emphasizing the development of local standards needed to address the weakness of international standards in areas where it is inconsistent with local requirements, without allowing infractions at a level to that sustained in the west. Simultaneously it is important to develop local financial information systems in such a manner as to ensure the best application of international financial standards whether related to the core of the information or its oversight mechanism.

7- Not to politicize standards and instruments, and not regard comments and statements as a sufficiently reliable source for a definitive acquittal or bearing of responsibility for the financial crisis no matter the source of these comments or statements, but should investigate what is behind them without prior doubt or diminution but in search of truth, reliability and credibility since the subject matter can gravely reflect on social life. Rich populations can potentially be impoverished in the near future if the financial crisis continues to exist

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8- Pay more attention to the quality of service provided to the client and not just the financial dimension only. With increased competition and enterprises shifting from an era of industrial competition to an era of information technology competition, an enterprise must consider the importance of other than the financial dimension in its performance so that it can link the multiple objectives that must be met in order to compete, for example, the reflect on the needs of clients and the extent to which the product can meet their needs. Customer retention and satisfaction as opposed to depending on the financial dimension as a measuring tool used to assess the performance of an enterprise like net income, which is a widely used tool

Second: Pay more attention to consolidating and regulating attitudes and behaviors of enterprises management (Institutional governance) in their performance of their respective duties and in executing different resolutions. Attention should be focused on the following:

1. Create a unit or a department in every institution specialized in managing risks and limit work to clean technology.

2. Provide an advanced and appropriate technological system that can handle the treatment of different transactions and their settlement, irrespective of their difficulty or complexity.

3. Hold workshops on an ongoing basis, locally and internationally for preparers of financial statements and those involved in implementing international standards, in order to provide the human resources required to keep up with the significant advances in this field.

Third-Consolidate and increase the role of internal oversight/auditing to participate effectively and efficiently in guaranteeing the appropriate application of international accounting standards.

Fourth- Enabling and empowering the role of regulatory bodies specifically the supreme financial regulatory bodies such as audit bureaus overall economic enterprises as opposed to limiting their jurisdiction to government related units to ensure the proper application of the requirements of accepted standards with honesty and credibility. The formation of three regulatory bodies by the big ten and what is practiced by Arab states as per the recommendation of the General Secretariat of the council of Arab interior ministers by taking appropriate action to combat patterns of financial fraud and strengthening of auditing and oversight standards is a step in the right direction.

Fifth: Seek to harmonize the methods of measurement and disclosure of financial statements with all honesty and transparency by economic and financial institutions to assist in making the right decisions as this would stimulate healthy competition and reduce time, effort and cost. Serious consideration must be given to appropriate principals and mechanisms needed to accommodate the Islamic approach in this matter since it includes a moral and dogmatic system that fits a model to be followed and eventually polarize internationally accepted standards based on the fact that Islam does not oppose a market based economy

Sixth: Changes to international accounting standards particularly standard (39) should not come as a response only, but rather an opportunity to provide the best, and on an ongoing basis, stemming from the known and declared objectives of accounting principles in providing financial data of high quality to its users

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Seventh-Direct scientific research towards many of the sensitive issues in financial derivatives that were raised in this study along with the formation of specialized committees to achieve a more productive and constructive development or application of international accounting standards or what is related particularly to international accounting standard (39) which is in need of greater efforts to understand and articulate in terms of its compatibility with canonical ethical and social standards. Also research should be conducted into the motives behind the divergence in views between an accountant and an auditor regarding the requirements of the standards in question. It is important to search for methods and tools needed for the sustainable development of the skills of those concerned with applying this standard. Let us keep in mind that field surveys are not the reference that provides a concise diagnosis since the result depends on the existence of a number of conditions and considerations, and seldom do we find the required neutrality to all details of the research and studies. If the above recommendations for accounting services were to be achieved, we can certainly say that accounting has succeeded where politics has failed.

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