The Impact of the Financial Crisis in the Activation of Corporate Governance

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Abstract- The global financial crisis has led to the collapse of many financial organizations, banks and companies, which negatively affected the economic achievements that it have been achieved by many of global economies. It necessitates investigating the causes of the crisis, and taking all necessary actions and possible measures to deal with these issues and to avoid unpredictable consequences. here appeared the necessary to apply the principles and mechanisms of corporate governance, and activated it and to remedy shortcomings, as one of the tools and the main pillars to solve the financial crisis and avoiding the negative impacts, especially after some studies have proved that the wrong application to principles and mechanisms of corporate governance was the main cause of the crisis.

The aim of this paper is to study the crisis reasons through reviewing previous studies, and the impact of this crisis on activation of corporate governance, despite of all the effects that have been caused by the financial crisis. However, it has had a positive role in showing deficiencies in accounting standards, principles and mechanisms of corporate governance. Besides deficiencies in the methods and application procedures which made many of political actors, bankers, financial organizations and auditors are calling to activating the role of corporate governance through their properly practices, to avoid some of the negative effects which is resulted from the financial crisis worldwide.

Keywords: Global financial crisis, Crisis impact, Banking, Economies, Corporate Governance.

1- Introduction

Since the beginning of the second half of 2007 the world has seen a severe financial crisis has swept many global economies. It resulted in the collapse of many banks, companies and global financial institutions in the United States of America in particular and in worldwide, which made economists and politicians trying to develop detailed explanations about the causes of the current financial crisis, beginning of fraud and financial failure and even the absence of regulations, and not to apply the principles of corporate governance in companies, as pointed out by Rainer Geiger, (YESR) that "the global financial crisis has provided an opportunity for change in corporate governance, perhaps one of the main reasons for this crisis is the lack of transparency and clarity in the financial institutions, it was prevalent before the recent crisis, it has increased criticism of corporate performance, and its executive management of boards of managements of companies, especially the contribution companies that have made many of stakeholders demanding that accounting procedures be tightened, the application of more stringent control laws, they are claiming to apply of requirements of corporate governance".

It was considered as special cases, there was no significant attention to collapses that occurred to companies, especially whose believed that these collapses will leave its reflection on some of the contributors, but it has exceeded far beyond that in 1998, where it has appeared Bankruptcies to major of companies that have left its impact on economy of entire state, it can be said that it has exceeded the negative impact on the economies of the world countries, until these repercussions turned into a global crisis, It began in the Southeast Asian Nations, then it turned to affect the global economy as a whole. However, despite global attention to this crisis, the global economy has suffered since mid-2007 to financial crisis was more severe, its repercussions are still continuing up to the present. Which has led to the attention of the issues of huge companies again,and extent of the role of imbalances and corruption in the emergence of such crises.

It has led to the current crises of which caused by the administrative and financial corruption, and mismanagement, the gap between the executive and administrative salaries of these companies, to that characterized the process of attracting of sufficient levels of capital is very difficult, many shareholders suffered from financial losses that led them to clearly declare that they are not willing to stand against the consequences of corruption and mismanagement, so that investors are demanding before investing on evidence that companies are run in accordance with business practices right.

Recently they have paid attention to the application of the principles of corporate governance in companies and banks, as a result of rapid developments in the financial markets, the globalization of financial flows and technological progress, which led to an increasingly competitive pressure between banks and companies. With the global financial crisis that has swept most of the global economies, it has started activating a corporative governance which is of importance, to adjust performance of companies, and what the consequent on accuracy of the results and avoiding companies to financial crisis, which leads to failure and financial collapse. The study evolved to explain the reasons beyond this crisis, referring to the weakness management or there is no corporate governance in practice?.

2- The global financial crisis, its concept and its reasons:

The financial crises are considered the most economic issues that it has deliberated due to their nature and its relation to economic business. So we will discuss the concept and types of crisis, we will be discussing examples of financial crises.

What is the financial crisis?

The financial crisis has defined as "The collapse of the financial system as a whole accompanied by the failure of a large number of financial institutions, and non-financial with sharp contraction in macroeconomic activity"[1]. The financial crisis is "Sudden collapse in the stock market, or in the currency of a State, or in the real estate market, or a group of financial institutions, to extend to the rest of the economy, it occurs such a sudden collapse in asset prices as a result of price explosion or speculation as sometimes called purchase and sale of huge quantities of one or more financial assets or materiality such as stocks, or properties with price that exceeds their real state value".[2]

Of the previous definition we conclude that it is profound changes which affect wholly or partly on all financial variables, on size of issuing and stock prices, and total loans and bank deposits, exchange rate, and refers to the collapse of a comprehensive in the financial and monetary system.

The main characteristics of the financial crisis are highlighted in the following points:

- Lack of sufficient information about them.
- Complexity, and tangles, and overlap in their factors and its causes.
- They have occurred violently and suddenly.
- To face the crisis requires a high degree of control in the capabilities and energies.

Types of financial crises

On the difference and diverse of types of financial crises and economic issues, it can be classified to several types:

*** Banking crisis**

Banking crises appear when the bank faces significantly increased and a suddenly in request to withdrawal of deposits. Thus, occurs "liquidity crisis" for the bank, if extended to other banks occur in that case "systematic banking crisis" when deposits are available to bank refuses to grant loans for fear of failure to meet withdrawal requests occurs of a lending crisis. For example Overend & Gurney Bank in UK and Bank of United States in USA.[3]

**** Currency Crisis**

The crisis occurs when a currency is expose to a country to attack of speculative is very strong leads to a decline of its value significantly reduced, which is imposed on the monetary authorities to reduce its value thus, occurs crisis of collapse of exchange rate.

***** The crisis of financial markets**

The crises occur in the financial markets as a result of what is known as an economic phenomenon "bubble", which occur when rising price of the asset to exceed its value of fair as a result of the severity of speculation.[4]

3- Comparative analysis of the effects of the crisis on Corporate governance

A study of Talal (2009) has indicated that reasons of collapse of some companies was due to the lack of good practice by their governing boards to control and lack of experience and skills, and random drainage imbalance of funding structure and the inability to achieve cash flows sufficient to meet its financial obligations, which has led to financial collapse for companies or financial institutions.

The study also confirmed that financial collapse of companies was due to either the wrong application or not to apply the principles of corporate governance which are based on accounting principles disclosure and presentation of real accounting information on the financial position of the companies.[5]

Amerta (2005) also, has indicated that reasons of collapse of some American companies recently was resulted in meeting the commitment of the principles of corporate governance correctly. According to the study that was conducted on an Enron company, the study has reached to many of results of which; It was not disclosed on activities that have been manipulated by the management of company, it turned out that what was done by Enron of conversion operations was not efficient, but it was intended to hide of losses and achieving gain from it and management of company did not provide any information to shareholders regarding the problems or crises that had emerged to the company, during the financial crisis period, even not expectedby the complete collapse.

According to the study of Erkens (2009) the main reasons to crisis areas following:

- The weakness of the supervisory role of ownership structure of the companies.
- The independence of the audit committee.
- The independence of the board of directors, the number of external non-executive members.

The study has found that companies are more powerful in terms of corporate governance to be more able to cope with financial crises, and finding appropriate solutions.[6]

It has explained by a study of Pomerantz & Mohr (2009) that the shortcomings that occurred in risk management owing to the global financial crisis was the issue of weakness in structure of corporate governance due to the lack of effectiveness of internal controls and incentive systems in reducing financial problems, this was confirmed by another study,[7]Hopkins & Posner(2009) has reported that the process of risk assessment in the companies have become very bad, as a result of the lack of the ability of accountants to provide appropriate information that they can rely on it to face those risks, the study has suggested that an increase of the effectiveness of corporate governance mechanisms should be considered by activating the role of the external auditor, manipulation experts, and anti - manipulation programs, in order to limit of any improper practices which may be associated with financial crises.[8]

As study has indicated (Abadi,2007) that the collapse of many of companies global due to several of reasons: Weak professional practice correct, following the management to practices profit management, besides spread of financial and administrative corruption, which led to increased attention of governments and scientific and professional bodies to corporate governance, to treat causes of bankruptcy collapses and financial crises and ensure that they are not exposed in the future.[9]

Analysis of previous studies the researcher can conclude the following important notes:

❖ That the lack of application or the wrong application for the principles of corporate consider of the reasons that helped in emergence of the financial crisis, this what make of many of accounting bodies are requesting for reconsider of the principles of governance, and that taking of actions that commit companies to apply these principles.

❖ Several studies have dealt with some of the procedures and the means on which it depends in activating the principles of corporate governance of which; activate role of legal auditor, manipulation experts and programs of anti-manipulation to reduce improper practices that accompany financial crises.

❖ Despite all the disadvantages that caused by the current financial crisis, but it was the primary motivation and tool of pressure of effective on all responsible authorities on design development of the principles of corporate governance to ensure the proper application of those standards and principles, so that ensures the reduction of the negative effects of the crisis.

The researcher finds that weak control side and ethical, also the lack of commitment to the basic principles of corporate governance is one of the main reasons behind the prevailing financial crisis, collapse of many banks and international companies.

4- Corporate governance and the effects of its activation on increase confidence and protecting shareholders' rights.

The term corporate governance has associated with the idea of globalization and financial crises, and during the short period has become this the term interesting to many of professional bodies, scientific and the Academy, Interest has increased corporate governance significantly in both developed and developing economies alike in the wake of economic collapses and financial crises which passed it many of global economies during the last decade of the twentieth century and the first decade of the twenty-first century. Also interest has increased principles, standards and mechanisms for implementing corporate governance in most of the world. Given for the importance of the subject of corporate governance, especially in light of the financial crisis, the researcher will deal with this section in corporate governance in terms of concept, principles and mechanisms of application, and its role in increasing confidence and credibility of accounting information in reports and financial statements, besides its role in protecting shareholders' rights and all of relevant parties to the company.

Concept of corporate governance.

Corporate governance definition indicates that it a set of strategies that adopted by the organization is seeking through it to achieve its basic objectives, in an ethical framework in the light of the systems, internal regulations and the administrative structure, so that ensure its achievement of objectives according to their own potential without detriment on the interests of the rest of the other parties associated with the organization.(Arsanius, 2002).

Ahmad, (2003) defined it" system to control and administration adopted by business organizations with a view to the distribution of responsibilities and rights among all parties involved in the organization, and setting the foundations and procedures for the affairs of the organization, in order to improve performance and keeping of the organization's economic reputation, rationalization of decision-making which serve all relevant categories."[10]

Abdul Samad (2010)defined corporate governance “is the practice of a good administration through set of laws, rules and standards that control of relationship between the company's management and its board of directors, shareholders, and other parties have Interests with company, in order to maintain on the shareholders' rights to achieve their wealth equitably, with the support of different levels of the Board of Directors”.[11]

Through previous definitions of the concept of corporate governance, the researcher can that defines the basic pillars which corporate governance is based;

- It is a set of foundations, principles and Financial administrative and regulatory practices, it is applied in order to increase benefits of resources and possibilities.

- corporate governance is a means to achieve goals that achieve through the company's interest and the interest of its shareholders, and providing effective control and using of efficient to resources of the company.
- Corporate governance system must be an integrated system for control in business organizations, and that is characterized by continuity, so include monitoring all processes and various activities.
- Corporate governance must that include sub-system for risk management which aims to avoid risks and crises, or reduce its various negative effects, or liquidity risk, or credit risk and the extent of continuity, or any kind of risks that may face the organization.
- Corporate governance means commitment to proper application of the laws the systems and the regulations different which govern performance is necessary, leads to the satisfaction of shareholders and achieve their interests, in addition to other parties have interests with company.
- Corporate governance means the disclosure of the activities of the organization, transparency and increase confidence in the necessary accounting information to rationalize management decisions and shareholders.

The importance of corporate governance;

Based on previous definitions of corporate governance, it can be determine with the importance of corporate governance in the following basic points:

- Ensure commitment with laws and issued regulations with regard to the application of corporate governance.
- Benefit from accounting and internal control systems significantly, and work to develop it and improve its performance, to achieve the efficiency of the organization's performance, in addition to improvement accounting practices, financial and administrative.
- Elimination of financial, administrative and accounting corruption and to develop the necessary measures which ensures that it will be avoided again.

The basic principles of corporate governance in business organizations;

The principles of corporate governance can be summarized below.[12]

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- The need for a basis for an effective corporate governance: The corporate governance framework should include on a set of foundations. which helps to achieve transparency and ensure its efficiency and effectiveness, to ensure the achievement of positive results to economic performance of the organization.

- Maintain shareholder rights; Through the implementation of the group of mechanisms that ensure getting all shareholders on the company's information in a timely manner.

- Fair treatment and equal to all shareholders: Equality and justice among shareholders within each category, especially small shareholders or foreign shareholders.

- The role of stakeholders in the exercise of management responsibilities: It should include a corporate governance framework recognition of the rights of the Company's stakeholders as guaranteed by law, and include what motivates on create a spirit of cooperation between the companies represented in their governing bodies and stakeholders.

- Disclosure and transparency: The governance framework must ensure sufficient disclosure, about methods of exercise of authorities, ownership structure, performance evaluation.

- Responsibilities of the board of directors to company: It should contain a governance framework on criteria for selection of members of the board of directors, their basic functions and guarantees necessary for effective follow-up for executive management by the board of directors.

Based on the above the researcher finds that make efforts of all responsible parties on the principles of governance and develop them according to developments and economic variables, it became necessary to ensure the effectiveness of those principles and safety of its application, this is confirmed by the global financial crisis, especially in light of the collapse and bankruptcy of many companies, banks and financial institutions, which was supposed to it apply the principles of corporate governance, however it proved in fact after occurrence of the crisis that application of the principles of governance was formality away from reality.[13]

5- The repercussions of the global financial crisis and its role in activating corporate governance.

Although that some of studies pointed out that the global financial crisis started since the beginning of the second half of 2008, however there are other studies confirmed that the real beginning for the financial crisis was in 2002 (Halaika, Al-Wazzani, 2010), where has collapsed at that the time Enron company and company of World-Com, then followed a breakdown and the bankruptcy of many companies, banks and financial institutions, which raised many of the questions about how effectiveness of principles of governance and safety of mechanisms of its application, and its effect upon quality of financial information and accounting in the financial statements.[14]Despite of the financial scandals which accompanied the financial crisis, however the researcher sees that it of positives these scandals, it has showed lack of substantive rules for corporate governance, and that the principles and governance mechanisms that applied only a formality, and it needs to real reform, helps protect companies of financial collapse, so that ensure this reform achievement of effective control and the credibility of accounting information, veracity of financial statements, also include effectiveness of accounting systems.

So the researcher notes that emergence of the financial crisis, it has imposed on the responsible authorities on the application of principles and mechanisms governance a new challenge, to ensure the proper application of its, lack of complicity of external auditors with some of the parties which have relations and the interests in the company, as members of the board of directors and executives, considering that existence of a good system for corporate governance means more of supervision, intervention and control by shareholders and some of stakeholders.

It has mentioned (Fatah and Ben Aichi,2011) that the global financial crisis made some of countries are doing several procedures to avoid such crises these include:[15]

- Repair of systems and accounting standards to achieve greater accuracy, credibility and transparency for accounting measurement in companies.
- Application of effective systems for corporate governance, and that obliges of companies to applying these systems through the issuance of legislation and laws which regulated in different countries, to eliminate negative practices in companies.

The occurrence of the global financial crisis since the beginning of the second half of 2008, and what happened of financial collapses for many international companies was major cause to pay researchers, organizations and scientific bodies responsible for improving and development of corporate governance to make attempts, which ensure activation principles of Corporate Governance and the integrity of the application of its mechanisms.

The researcher can to confirm this through display for some efforts that made by some Governments, scientific and professional bodies to activate the principles and mechanisms of governance, and ensure integrity of its application in companies, banks and financial institutions, the researcher has mentioned previously that corporate governance mechanisms including internal mechanisms as internal audit and audit committee, and external mechanisms as external audit. It helped the financial crisis focus on weaknesses in those mechanisms which caused an increase in the severity of the crisis, what it has made many of governments, scientific and professional bodies to develop and improve effectiveness of performance those mechanisms, which will be presented by the researcher in the following points of this paper.

6-Some of international efforts to activate the principles and mechanisms of corporate governance.

Some of countries have done and governments Following the repercussions of financial crisis many efforts in order to develop of accounting standards and activation of principles and mechanisms governance, the researcher will deal with it from the beginning of 2002, where the beginning of the collapse of some of companies and large economic institutions, of these efforts, for example the following;

Amendments of the International federation of accountants;

The International federation of accountants has done set of amendments on international auditing standards during 2009, as a result of the global financial crisis and its impact on the global economy, as a means of defense on accusations which it has directed for the profession as one of the causes of the financial crisis, the most important of these amendments are the following;

- It was confirmed through the international auditing standard No (260) special of contact with those charged with governance(ISA 260, 2010),on the need to auditor commitment of ethical requirements and special independence requirements to review of the financial statements preparation and connection a report to responsible for governance, refers to that members of audit team and staff of audit office, they have obliged of ethical standards concerning of independence.[16]
- International Accounting Standard No.(250), and the special to observance of laws and systems when auditing of financial statements (ISA 250, 2010), modifications have been made to this standard in order to increasing the effectiveness of corporate governance and increasing the role of auditors where amendments were confirmed on that the responsibility ensure of run of company operations consistent with the laws and the systems have located on the company's management and under the supervision of the responsible bodies on governance, the standard has pointed out that the process of communication between the external auditor and

responsible on governance has become communication of two directions , it is not in one direction as was before modification, which leads to the reduction of errors and the fundamental distortions in financial statements.[17]

❖ International Accounting Standard No.(265), (ISA 250, 2010), special to reporting on shortcomings in internal control for responsible on governance and management, which was issued recently to help auditor in identify deficiencies in the internal control system and connected it to those responsible for governance, at the end of 2008 in the wake of the financial crisis, financial report board has issued special constitution to corporate governance, in order to activate role of the audit committees, on that be written to include a follow-up to the integrity of the financial statements and internal control systems, and how effective of internal audit function and audit process.

In light of the amendments to previous international audit standards, it is clear to the researcher that these amendments aim to emphasize of importance of role that play it by the responsible authorities on corporate governance, it aims also to activate the mechanisms of governance, to treat weaknesses resulting of non the application of governance mechanisms properly. Therefore will help improve and develop corporate governance principles and mechanisms.[18]

❖ organization for economic cooperation and development; It has worked with governments of nationalism and some international institutions to develop a set of criteria and instructions for corporate governance. In order to activate the mechanisms more coherent with regard to disclosure standards and transparency, the organization has announced in November 2002, it is being developing and updating principles of governance which it issued in 1999, to suit with crises and economic variables imposed by financial markets at the level of the global economy.

It has been issued of revised corporate governance principles in 2004, but it was not mandatory to apply in companies, thus it did not well implemented by many companies, which threw on governments responsible for develop an effective framework imposes sufficient flexibility allow for markets to work effectively. From the point of view of the researcher that the most important of the main reasons for the financial crisis, and what followed it of financial collapses for many companies, banks and financial institutions, therefore it was necessary on governments to determine how the mandatory application for principles of governance, through the development of laws and legislation that ensure the proper application of those principles, according to cost considerations and the benefits of each company.

❖ Publications of the Basel Committee for Strengthening Governance; it has dealt with one of the studies (Wahiba, 2011) where it was issued Basel committee of report on strengthening governance 1999, after of occurrence the of the Asian crisis in 1997, that it has occurred in 1997, then released a modified version in 2005, in February 2006 it has been updated following the collapse of many of companies and US banks, It included on basic principles for corporate governance in banks.[19]

❖ American institute of Certified Public Accountants(AICPA); Audit committees are considered of the basic mechanisms that are used in activating the principles of governance, in 2004 (AICPA) has Issued instructions help Audit Committees in its role towards the external auditor, audit committee is responsible about everything related to the external auditor In terms of employment, determine the fees and isolation, and evaluate the performance of auditor, consequently the audit committee should be knowledgeable all things which have a relationship with external auditor, so that can performance of its responsibilities with a high degree of effectiveness and efficiency.

❖ Financial Reporting Council(FRC); It has issued several of issues including guidelines for audit committee helping in performance of its responsibilities effectively, as one of the most important mechanisms which are reliable in activating the principles of governance, the most important of these publications was that has issued following the financial crisis in 2008, in which the responsibilities of the Audit Committee were determined.[20]

❖ American Institute of Certified Public Accountants(AICPA); Where the Institute was established center to follow of financial crisis in terms of its consequences and implications, and what it requires from the reactions and procedures to be taken by accountants and auditors, the center has done several of efforts with regard to the most important repercussions of the financial crisis on the profession of accounting and auditing, and a result of what caused the financial crisis of risks, institute has issued alert (AICPA , 2009 , A) including considerations that have to receive attention by accountants and auditors in light of the financial crisis, and taking in them consideration when performing their works, alert has indicated that the most important repercussions of the crisis is the loss of confidence in the published financial statements.[21]

❖ International Auditing and Assurance Standard Board(IAASB); The council issued has issued following the repercussions of the financial crisis several of alerts to try to reduce of the effects, of which;

- alert related to imposition of continuity in light of the financial crisis(IAASB, 2009, A) to assess the company's ability to continue as a basic premise of assumptions of preparation of the financial statements, it was emphasized in this alert on the need that do of the auditor in each audit process to study the imposition of continuity, and it is disclosed in the auditor's report thereon, it also confirmed on the need to reconsider in the International Standard No. 570 according to the new indicators which was developed in light of the financial crisis.[22]

- Alert of special to audit of accounting estimates for fair value In the current economic environment and financial crisis (IAASB, 2009, B) which was released in October 2008, to guided by auditors to it in case of audit of companies that have investments in instruments of the new financial recently.[23]

Of the previous presentation it is clear to the researcher that the financial crisis was the main reason behind all these previous efforts, as attempts by the responsible authorities for accounting and auditing profession, to reduce the repercussions of that crisis, and to avoid the negative effects of the resulting. This is what seeks to this paper that the emergence of the financial crisis, it achieved a positive role in the doing scientific and professional bodies to take actions needed to improve and activating the role of corporate governance.

7- conclusion and recommendations

Findings from this study indicated that the major reason to the financial crisis is the wrong application of corporate governance mechanisms, therefore it has to reformulate those principles and mechanisms so that there will not be chance for wrong application because of misunderstanding by those who responsible for this implementation. Global economies need desperately to take the necessary measures to apply the principles and the existing mechanisms to minimise the risk of any financial collapse for companies and banks. Due to the financial crisis, corporate governance has become a concept of ethical and great interest by a number of governments and decision makers.

Therefore, companies should have takenall actions and means that would increase confidence, transparency and credibility in accounting information in financial statements, and finding comprehensive solutions to the current financial crisis, both through the development of current principles commensurate with the economic changes developed, or by proposing new principles and practices. to counter of the current financial crisis, and to avoid financial crises in future should on authorities that take the necessary actions to reform and activate financial control systems, principles and mechanisms of corporate governance, by improving systems of accountability, integrity, transparency and efficiency of companies and global financial organizations.

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