How did Financial Reporting Contribute to the Financial Crisis?

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Abstract

Purpose – The current paper constitutes a thorough research and analysis on the way that the banking circumstances and the audits affect the current economic crisis on the banking industry. We examine to what extent the current situation could have been predicted and dealt with from a different perspective. We analyze the contribution of the internal and external audits, which ensure the stability and the accuracy of financial statements, based on the principles of transparency, efficiency, impartiality and of objectivity.

Design / methodology / approach - The approach based on the examination of forty three (43) large banks based in four (4) countries of the European Union (EU) and particularly of the South Europe. Twelve (12) of them are based in Hellas (Greece), eighteen (18) in Italy, nine (9) in Spain and finally, four (4) are based in Portugal. The influence of financial reporting and audits on banking sector, studied by analysing the financial data of these banks through the logistic regression models presented by J.Y. Jin et al. (2011) with the use of specialized econometric software.

Research limitations / implications. We use two sets of samples: a) a sample of troubled banks including banks that failed from 2007 and onwards. They were classified as troubled based on profitability, quality of loans and their capital adequacy (Tier 1), and b) a sample of banks that are troubled or not. For the first sample six reliable predictors of bankruptcy they have identified: the type of auditor, the specialized auditor, the capital ratio (Tier 1), the percentage of securitized loans, the growth in loans and total loans. For the second sample of banks, we define the following points to predict the failure of the Bank: the type of auditor, the specialized auditor, the capital ratio (Tier 1), the percentage of securitized loans, the growth of loans, the kind of bank (public or not), as well as the growth in non-performing loans.

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commercial loans, real estate loans, provision for loans, other types of loans and total loans.

Originality / value. The application of the methodology described by J.Y. Jin et al. (2011) in a sample of European banks in financial crisis and the use of current literature, allow us to present the real causes of the crisis, as well as the weakness of the countries concerned.

Keywords: Bank, audit, financial crisis, audit quality, financial reporting, bankruptcy

Paper type Research paper

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