

Role of Accounting in Recent Banking Scandals, UK

Introduction

The essay had been conducted in order to study the causes and the consequences of the scandals that involve the banking industry of UK. In this essay the discussion on the scandals of major banks of UK has been conducted that mainly includes: JP Morgan, Barclays and HSBC. In this essay the issues regarding the accountability, representation and control have also been highlighted that have resulted in the scandals highlighted in this essay. The objective of writing this essay was mainly to understand the concept and purpose behind ARC. Moreover, the essay also helps to understand the core principles of accounting and its importance in order to maintain the global financial system.

Role of Accounting in Recent Banking Scandals

➤ Issues of Accountability in JP Morgan

As per the study of Bernau (2014), the issues of Accountability arise when the application of accounting principles and the practices were not appropriate. These issues can either take place in the corporations or in the banks, moreover, if the case of JP Morgan Chase has been highlighted than it is obvious that it has also gone through the accountability issues. These issues faced by the bank were mainly due to the misrepresentation of its financial statements and also due to its falsification of its assets. As per The Washing times (2013) due to the “London Whale” Scandal JP Morgan had to pay 1 billion dollars in fine. The reason of the fine was the bank’s failure to rein-in loses some of the trading practices which have resulted in a loss of 6 billion dollars. In addition to this, the author furthermore stated that this failure of the bank has again revived the chances of the worldwide financial crises that took place in the year 2007-2008. The accounting issue on behalf of the bank was conducted by one of the trader of the bank known as Bruno Iksil commonly known as “London Whale”.

In the light of the study of O'Brien and Dixon (2013), another issue of accounting faced by JP Morgan was the Madoff investment scandal. For this scandal the bank had been penalized for 2 billion dollars. The scandal took place mainly because of the Ponzi scheme. Moreover, the author also states that Ponzi scheme conducted on behalf of the bank was a sort of fraudulent investment in which the trader appointed by the bank had paid the returns to the investors from

the capital investment of other investors. As a result, according to Fox Business (2014), the bank has been able to fraudulently attract a large pool of investors towards its particular portfolio than any other investment for the short term returns. To carry out this scheme, the bank had to frequently attract large number of new investors and the capital raised from such investors cannot be disclosed on in the financial statements as Ponzi scheme was an illegal act. Not disclosing off the accurate financial information of the bank was one of the issues of the accountability of the bank that have taken place by the ponzi scheme of JP Morgan. If the studies of New York Times (2014) are highlighted than it has been observed that the lack of forensic accounting within the bank has given the opportunity to JP Morgan to conduct the act of fraud.

➤ **Issues of Accountability in Barclays**

Another good example stated by Monticini and Thornton (2013), highlights the issues of accountability of Barclays bank of UK. At the bank the financial information that is necessary to decide upon the Libor rate has been manipulated which gives rise to the Libor fixing scandal. The author furthermore states that the rate of labor also represents the credibility of the bank; hence in order to portray as a profitable bank Barclays has manipulated various interest rates that were used to calculate Libor rate. The studies of BBC News Business (2013) have concluded that the manipulation in the labor rate was not only conducted by Barclays only; however, the bank of Scotland, Rabobank and UBS bank has also been involved in it. This manipulation in the Libor rate clearly highlights the weakness of the accounting principles and policies within these entire banks. The intentions of all these banks mainly Barclays were to earn more of the profits mainly for two reasons (The Fiscal Times, 2012): the first reason was to portray that the financial crises of 2007-2008 had not affected the profitability of the bank and the second reason was to earn huge amount of profits by making borrowings more expensive than expected and to earn more on the derivatives.

➤ **Issues of Accountability in HSBC**

As per Forbes (2012), HSBC has been considered as one of the largest multinational bank of UK and like Barclays, RBS and JP Morgan. This bank has also been facing the issues of accountability within its departments. The major issues of accountability arise when the bank

had taken the advantages of liberty provided by the FASB in the GAAP principles. Due to the flexibility in these principles the bank had attempted to inflate the funds through wrong means into the financial system of the country without giving anyone the sense of doubt. Moreover, the studies of Salon (2012) have stated that the weak accounting and financial system have also permit the bank to easily portray these funds as legal by conducting a series of complex transaction that cross multiple jurisdiction. In this way the bank had been become successful in hiding its actual sources of raising funds and enjoys by showing healthy financial position of the bank.

In accordance with the study of The Telegraph (2012), blowing up of funds through wrong means into the bank and then showing it as legal have made the bank to stuck into the trap of money laundering scandal. This scandal of the bank had not only affected its profitability in the vicinity of UK but it has also adversely affected the brand image of the bank worldwide. To settle out this scandal and to gain the confidence of its clients again the bank had agreed to pay an amount of 1.9 million dollars. This was the highest penalty that has ever charged to someone for the money laundering crime. As per Bloomberg (2013) the bank had been accused for transferring the funds from United States into its bank accounts with the help of a Mexican drug alliance. The author furthermore states that the reason for transferring funds through a drug cartel was either to avoid the huge amount of charges and duties entailed in the process of transferring funds or the bank wants to hide the actual illegal sources through which this fund has been raised.

➤ **Issues of Representation in JP Morgan**

Another accounting issue of this bank as stated by Yahoo News (2013) was the fraud or lack of representation in the dealing of the derivatives. It was concluded upon the investigation that the bank had lost 6 billion dollars while dealing in the derivatives, however the regulators at JP Morgan had underestimated their loss in their financial statement for the month of April and May 2012. Furthermore, due to the bank's rigid policies of not disclosing the financial data have also raised accounting issues for the bank. As per this policy, the regulatory trade examiners could not able to intervene and investigate the financial transactions conducted by the bank.

In the light of the study of Forbes (2014), the scandal of Madoff taken place on behalf of JP Morgan mainly because of the issues of representation of the financial records within the bank. It has also been stated by the author that the reporting principles and policies related to financial record had not been effectively implemented in the bank. Due to this, the bank has been found successful in not presenting its true value of assets and equity to the investors and the regulatory firms. As per Davis and Wilson (2011), the reward and compensation of the upper management at JP Morgan has been observed as directly tied to the financial performance of the bank. This was also a crucial reason that has given rise to the Madoff scandal in the year 2008. Through this scandal the bank has tried to project a sort of blushing picture of the bank in the minds of the potential as well as existing investors; however it was a scam on behalf of the bank through its traders. As a result, the bank for a time being had become popular for offering the highest returns to the investors.

➤ **Issues of Representation in Barclays**

In the light of the study of Leading British Conversation (2013), in order to make the investors and other corporate clients believe that the bank has not been affected by the global financial crises the management at the bank decided to manipulate their financial statements. For this, the bank had exaggerated the current period earnings thereby arousing the interest of the corporate clients towards the bank. According to Council on Foreign Relations (2013), the bank had been successful in falsely exaggerating its current period earnings by manipulating the labor rate. However if the studies of The Economist (2012) are highlighted then it has been observed that the bank had been enjoying a freedom in the accounting provisions that have been set by the FASB more commonly known as the financial accounting standards board. As a result it has become very feasible for the bank to misrepresent its financial facts and figures. Furthermore, the elasticity provided to these banks by the FASB in the GAAP principles has also encouraged Barclays and other banks such as royal bank of Scotland to manipulate their financial records. Liberty in the manipulation of the financial records then further gave rise to the labor rigging scandal.

➤ **Issues of Representation in HSBC**

As per Banks (2013), HSBC has been found as recording its revenues ahead of time. Due to this, the bank before the cash has been arrived into the bank, overstated its income account in the income statement. This according to the author was not the ethical and legal way to present its financial accounts and therefore the bank had faced the issues of representations of its financial statements. Moreover, it has also been stated by the author that the accounting information communicated at the bank is also not very useful in making either the financial decisions of the company or to make the economic decisions of the company. In accordance with the study of Haldane, Brennan and Madouros (2010), the reporting and the accounting standards that the bank executes in its financial statements are also not very rigid. As a result it becomes difficult for the investors to judge the actual and real financial position and performance of the bank.

In accordance with the study of Wainwright (2009), HSBC by not accurately flowing the accounting principles have somewhat attempted to manipulate its accounts. For successful manipulation of the accounts the bank in its financial statements have either overestimated its profit or underestimated its loss for the particular year. Due to this, the issues of representations have been raised which was the prime cause that have let the bank into the scandal of money laundering.

➤ **Issues of Control in JP Morgan**

In accordance with the study of Bloomberg Quick Take (2012), London Whale scandal also raised on account of JP Morgan due to the lack of control of the bank over its dealers. It has been examined that the bank was unable to keep an eye over its traders, and the traders got successful in overvaluation of one of the very complex portfolio. The reason for this overvaluation was to hide the loss of 6 billion dollars in the dealings of derivatives. In the light of the study of Reuters (2013), another issue of control faced by the bank, when it was busy in deciding upon how to amend the breakdown of its internal control system, was the ruining of one of the fundamental principle of the bank by the senior management at the bank. The rule that was broken by the senior management was related to the corporate governance. As a result the bank had faced a huge difficulty in gathering critical information that is required by the bank in order to review that timely, reliable and authentic facts and figures had been revealed to the investors as well as to the regulators of the bank. Langley (2012) stated that because of the out of order of the control

policies within the bank, JP Morgan has also encountered the challenges in the identification of the bank's internal problems and issues.

In the light of the study of Sale (2014), JP Morgan due to not clearly disclosing off its confidential financial information with the regulatory department has given a blow to the issues of control in the bank. Consequently the bank had been trapped into the scandals one of which was the madoff scandal. Moreover, it has also been stated by the author that the risk management department at the bank was also not performing their duties and responsibilities of monitoring the limits of the traders effectively. The department has also not taken any serious actions against the breach of the limits assigned to the dealers and traders. In accordance with the study of Pontell and Geis (2014) the risk management department at the bank has also not given any report to the regulatory department of the bank about the breach of the limits of the dealers. This fact also played a crucial role in the Madoff scandal that has tremendously affected the brand image of the bank. Furthermore, the lack of control in maintaining the minimum capital requirement of the bank had resulted in the slight decrease in its CAR ratio. To maintain this ratio the bank has find to run Ponzi scheme which in reality was the scam and it further erodes the reputation of JP Morgan.

➤ **Issues of Control in Barclays**

In accordance with the study of Bainbridge, S. M. (2013), the ineffective control system within Barclays was also one of the reasons that results in the Barclays Libor rigging scandal. According to the author, the regulatory requirements stated by the central bank of UK related to Libor rate were not appropriately followed by Barclays. Moreover, middle office of the treasury at the bank also failed to monitor the activities of the dealers when they conduct any transaction related to derivatives. As a result the middle office of treasury was unaware of the Libor rate that these dealers have charged to their clients. In the light of the study of Decker (2005), the policies of the corporate governance had also very rarely followed within the bank highlighting that the control system of the bank has also not workable and the chances that the bank will conduct any fraud has also been very high.

If the studies of Billings and Capie (2004) are highlighted than it has been examined that the internal control department at Barclays does not successfully monitors the financial position and performance of the bank. This department is also liable to organize and articulate the reliable financial information to both the management as well as to the investors. This department of the bank has been observed as ineffective in its duties and responsibilities which also encourages bank to engage it in the crime of Libor rigging scandals. However, the studies of Martin (2012) have concluded that the policy of upper management at the bank to not disclose the confidential financial related information to any of the department and regulators have resulted in the incompetence of the internal control department of the bank. Their incompetence had affected the overall control and management of the bank. In accordance with Issahaku (2013), the middle department of treasury particularly the market risk wing that monitors and controls the limits of the dealers and traders have assigned the limits to the dealers that are not in accordance with the regulations of the central bank. This information of allocation of the limits was also kept confidential from the compliance department and also from the central bank. Due to this the bank was unable to prevent its treasury department to undertake any illegal transaction. Consequently the bank stepped up onto the scandal of Libor rigging case.

➤ **Issues of Control in HSBC**

As per Davies, Richardson, Katinaite and Manning (2010), lack of legislation by the central bank has been a major factor that has encouraged HSBC for money laundering. Another issue related to the control system of HSBC was the smoothness in the anti money laundering policies at the bank. The author had also stated that the compliance department at the bank was also not very efficient in its duties of making sure that the laws and regulation in the bank had been followed accurately. It has also been concluded on the basis of the studies Yan, Hall and Turner (2014), that the compliance department of the bank act as a protecting shield for the bank that also helps the bank to maintain its reputation and image in the minds of its clients. However, the compliance department at HSBC was found to be futile and vain in terms of not preventing the conflicts of interest, not have rigid control over the trading activities of the dealers. The department also found as unproductive to make certain that the bank had not been involved into the transaction of money laundering and also the evasion of taxes imposed by the government. Moreover, Shiwakoti, Keasey and Hudson (2008) stated that this department also fails to sustain

the reliability across different departments of the bank. Subsequently, the issues of internal control of HSBC have given an extreme liberty to the bank to fearlessly conduct money laundering.

Conclusion

In a nut shell, it has been concluded throughout this essay that implementation of accurate and authentic accounting principles is very crucial in order to prevent the global financial system from the frauds and misconduct. In addition to this, it has also been concluded that these principles are not only vital for the global financial system but it also facilitates the investors to judge the true picture of the organization in which they intends to make investments. The essay also concludes that the implementation of appropriate and rigid accounting standards within the banks also facilitates in ensuring the proper functioning of the banks. It also prevents the banks from many major issues such as money laundering or manipulation of interest rates.

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