

OVERCOMING CREATIVE ACCOUNTING: A Study

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ABSTRACT

The term creative accounting means the manipulations made in books of accounts by adopting number of ways with the help of various professionals. Through creative accounting we can show the opaque image of the company in the eyes of law and its stakeholders. Creative accounting questions on the ethical practices which are to be followed in the company. Creative accounting is also depicting the grey image of the code of conduct followed by the company as it gives the encouragement of the unethical practices. Creative accounting is been practiced by the individuals to earn the undisclosed profits in the company. It is shows the bad corporate governance practice followed in the company. There are also various reasons through which director's of the company are involved in creative accounting. The overall purpose of this study is to explore more about the overcomings of the creative accounting , and to how it is been falsely used by the organizations to increase their profits. Through this research we can came to know the different aspects of creative accounting and how it is affecting the ethics of the organization.

INTRODUCTION

What is creative accounting? Creative Accounting is the principle in which rules and standards (may or may not) be followed. The term creative accounting is the process whereby the accountants use their knowledge in the negative way, so that they can manipulate the accounts easily. It is also the process of moulding the rules and standards of accounts according to the needs for the benefit of the company. A corporation is a “congregation” of various stakeholders.

In the corporate-sector, the principal-agent relationship between the shareholders (as owners) and managers (as agent) is explained by the “agency theory,” which assumes that the ordering party and the agent “want to earn more benefits for themselves.” Thus, creative accounting is the practice which is followed by the CAs and other tax consultants to show the willful image of the company to its stakeholders. Alternatively, creative accounting is the manipulation or transformation of the financial accounting of the company form “what they actually are what they are to be made by finding certain loopholes in the rules and standards”. Naturally very often one question arises “whether creative accounting is good or bad”. The answer is quite simple it is purpose which decides that creative accounting is good or bad. But, creative accounting is generally used for the malafide intentions for showing the grey image to its stakeholders.

REVIEW OF LITERATURE

A lot of empirical study papers has been written on Creative accounting.

- However it is publicly known that the Anglo-Saxons were noted to be the first, to write about creative accounting in their literature in **1970s**.

- Hussey & Ong (1996) stated that creative accounting first became very prevalent in the **1980**. Due to loopholes of accounting regulations, companies could produce accounts which shows their fine financial performance. It tells about type of creative accounting like interest capitalization, brand accounting, depreciation calculation techniques, stock valuation, and accounting standards which prevent the major and strong abuses.
- Watts and Zimmerman (1990) wrote in their literature about accounting practices and provided, guideline about positive creative accounting.
- Beneish, M. (1997). Detecting violation of GAAP: Incrimination for assessing earnings management among firms with utmost financial performance. *Journal of Accounting and Public Policy*:
 - The study suggested in the paper that, there was a high probability of accounting insincere behaviour in Enron's financial statements for over the years preceding its bankruptcy.
- Oriol Amat, John Blake and Jack Dowds (1999), *Journal of Economic Literature classification*:
 - Creative accounting is important for auditors or management to understand that, it gives an opportunity to companies to manipulate things in desired manner but morally the practice is not acceptable.
- Luca Enriques (2000), "The Law on Company Directors' self-dealing: A Comparative analysis":
 - Self-dealing transactions should not be treated as negative always, the intentions behind the transaction and its impact on long-term sustainability and profitability of the firm should be considered.
- Herve & Gaetan (2004), "Accounting Manipulations: A Literature Review and Proposed Conceptual Framework":
 - This paper highlighted the issue of deceting and defines accounting manipulations in different way and stated that dishonesty depends upon the objective of getting into it. There is no apposite way to remove such unlawful malpractices from the system, but through promoting ethical mindset and decorum among the corporate world, the chances of such execution could be minimized.
- Frank Partnoy (2006), "How and why Credit rating agencies are not alike other ositary":
 - Credit rating agencies act as a supportive hand for stakeholders in investment decisions. Since full expert team work on the analysis of financial statements, and parties engaged are independent one, investors feel that the data or information provided is reliable and trustworthy.
- Naomi S. Soderstrom (2007), "IFRS Adoption and Accounting Quality: A Review" *University of Colorado at Boulder*, Accepted paper series extracted from Journal SSRN, which stipulated that Accounting manipulations and creatively managing the accounts is becoming most common practice these days and thus it has becomes very important for the regulatory bodies to take an prompt actions.
- Vladu and Matiş (2010) explain the relationship of corporate governance and creative accounting, according to them they have a strong relationship with agency theory.
- .As Gherai and Balaciu (2011) asserted in their literature, they submitted that, enterprise stake is at risk when it indulges in practices of creative accounting.

- Kassem (2012) contended that the ethical practices of creative accounting in existence, are there basically to support the external auditors and to increase their efficiency and accuracy in finding any swindling act.
- Yadav (2013) finds that involvement of outside directors, could reduce the practices of creative accounting. And the more, the outside users, the less creative accounting practices.

RESEARCH OBJECTIVE

- To study the history behind the introduction of creative accounting.
- To study the methods to overcome its affects and loopholes to exate the creative accounting.
- To study the relationship between corporate governance and creative accounting.
- To study the methods to overcome the creative accounting.

RESEARCH METHODOLOGY

Creative accounting is one of the key aspect of accounting techniques around the world, and also one of the best method to play with accounting numbers. In this empirical study the research approach which is been used is “qualitative approach”. It is so because qualitative approach as it used to gain the underlying reasons, motivation, and opinions. As a field of study, qualitative approaches include research concepts and methods from multiple established academic fields. In contrast, a qualitative approach might argue that understanding of a phenomenon or situation or event, comes from exploring the totality of the situation. The qualitative research often reject natural science models and are oriented towards the investigation. Qualitative research is mainly used by educational researchers, political science, and social researchers.

RESEARCH PERUSAL

CONCEPTUAL ANALYSIS

Creative accounting concept just become more vibrant from the just past two decades ago. As there is more boost in the economy and countries are on the growing pace than the more accounting principles and standard are updated according to the need of the era, but there are some loopholes has been left which emerges the concept of creative accounting. Through these loopholes the consultants of the company earn the undisclosed profits from the company by molding the certain rules/standards which gives them the benefit. Manipulating certain numbers is the practice which is to be followed to do the creative accounting. Consequently, creative accounting becomes popular as a term among the financial and economics journalists in the media of United Kingdom. The concept of doing this research is explore the various ways through which we can overcome creative accounting. Doing creative accounting is the easy task but to get rid of from it is might be a difficult one, as it

stops the certain undisclosed incomes and can also be harmful for doing the unethical practices.

HOW IT IS BEING EXECUTED?

- ✓ **Conceding fictitious and under matured reserve:** Creative accounting primarily deals with recognizing the fictitious reserves of the company. With the help of these creative accounting can be done very promptly and easily without any biasness. It is the revenue recognition through which generally accepted accounting principles (GAAP) can be manipulated easily at the company's own will.
- ✓ **"Big Bath" accounting:** The term big bath accounting signifies that "to reduce the current cost, so that the future looks more better". This also helps in doing creative accounting.
- ✓ **Reducing Candy/Cookie jar reserve:** It is the technique through which company's reserves are over provisioned when revenues are high, so that high profits can be shown in near future to the stakeholders with help of this reserve.
- ✓ **Shape the inventory:** Company's sometime manipulate their inventories by showing the closing inventory less and opening inventory of previous year so that inventory can be managed and it can depict the profits to the company. It can also be done by hanging the methods of recording inventory year to year.
- ✓ **Manipulating cash flows:** It is one of the easiest technique to do creative accounting to manipulate the creative accounting, by showing operating expenditure as and investing and financing. Or by changing certain other figures.
- ✓ **Creativity with the income statement:** It means the practice of communicating the other power of recording rather than recording in the actual way. For example-showing the non recurring revenue under the other revenue, this change will not affect the net income in total.
- ✓ **Being liberal with bad-debts:** Companies which are involved in direct sales have more debtors. They might be bad-debt or doubtful debts, company make more provisions for the doubtful debts than the bad debts, so that their profits can be increased.
- ✓ **Choice of writing transactions:** Companies are free to record sales and revenue at any time, whenever they want to which helps them to show more profit.
- ✓ **Transfer pricing methods:** Tax differentiation and tax advantage between the countries gives the benefit to the companies, where they are have to pay less tax they can show more profit there.

RELATION BETWEEN CORPORATE GOVERNANCE AND CREATIVE ACCOUNTING

Corporate governance shows all factors which guarantees the managing the assets of the firm in an efficient way which are involved in the interest of finances providers , and mitigating

the inappropriate use of resources. Corporate governance also deals with how the outside and inside management of the firm are doing work in an ethical way with following the proper rules , regulations and laws in the corporate world , whereas creative accounting deals with the ways of how to do the work in an unethical way by analyzing the various loopholes in the accounting. The importance of corporate governance is to analyze the facts of creative accounting where they are being used to do the unethical practice in the organization. By examining the various theories given by the other scholars we can get to know the other loopholes.

OVERCOMING CREATIVE ACCOUNTING

- ◇ **One accounting and booking keeping system:** The company must follow only one accounting system and one book keeping system throughout the period. This prevent the manipulations, creativity, frauds in the books of accounts.
- ◇ **Finding fraudulent finances:** The accountant has to keep an eye check on the fraudulent finances which are been shown in the books of accounts, so that creative accounting can be prevented. The main task is to look at the unusual transactions which are been occurred. Segregating functions can also be helpful for finding the fraudulent finances.
- ◇ **Foster ethical atmosphere:** The company show create a ethical atmosphere at the workplace , so that no person can able to do creative accounting and proper rules and regulations are to be followed. The employees should be aware of laws , ethics , companies code of conduct and proper procedure to do accounting and book keeping.
- ◇ **Formal policies and penalties:** The company should create the tighten policies and penalties on the employees who are involve in creative accounting practices and other malafide intentions which gives losses to the company.
- ◇ **Hiring an auditor:** The auditor should be hired to keep an check on the other employees , the auditor's work is to find the fraudulent transactions which are occurring in the books of accounts.

LOOPHOLES OF CREATIVE ACCOUNTING

One of the major loophole of creative accounting is dual methods of accounting system as it leads to more manipulations, creativity, and frauds in the books of accounts. Also dual techniques are used for stock valuation and depreciation calculations. Cashflow statements often shows the fuzzy and fake transactions and also data entries is transferred from one account to another. Accounting numbers can be easily manipulated to show the future better and more profitable. Transfer pricing is also the loophole as it has tax differentiations which is been used to promote the tax evasion. Generally

Accepted Accounting Principles(GAAP) has many faults in them which also give birth to creative accounting.

Attributes

It is quite good to creative in any profession, but for accounting the term creative accounting can be coined as deceptive accounting. Creative accounting is that practice of accounts in which various pre determined standards and laws are molded in that way , that they are looking as same as which they are before but certain loopholes are found. The term creative accounting has also embezzle the accounting scenario by giving the opaque image. Creative accounting are can also be seen as the sins of others which borne others. It may be quoted that creative accounting is born because of greed, corruption and deception. It rightly said that creative accounting are the methods which are adopted by those who want gain the personal incentives. Creative accounting is done for attaining the self-satisfaction and also undisclosed incomes. Job security is also been provided to the employees who are promoting creative accounting. Financial reports are prepared to show the true and fair view of the company to its stakeholders, but creative accounting is involved to fabricate those financial reports. In fact creativity is not bad its good, but creative accounting is bad. Creativity in the accounting profession is not bad, just like other professions but with the proper rules are to be followed. Accountant should find out the better ways to boost and improve their knowledge and skill set which is beneficial for the company as well as the society. This will help them to have the automated work rather than the manual intervention.

Presence of creative accounting in India

India is a developing economy where every sector but mainly the corporate sector plays a vital role. As almost all the Indian companies are entering into the global market, so there are more scope of doing the creative accounting. As the rules of accounting indifferent countries are different also the taxation policies too so that where there are less taxability and more profitability creative accounting is adopted in that country by the corporates. In almost every company of India creative accounting is to be practiced. It is because of the loosen criminal and corporate laws which gives the umbrella protection to the persons who are doing it and also the various loopholes in the principles and standards which are present. In fact the company management may use the various techniques to dress up the financial statements to show the positive or improved performance. The main reasons for creative accounting in India are global economy, competitive environment ,increasing competition etc. There are certain corporate scams which are taken in between 1996-2008:

Year of scandal	Name of the company	Accounting scam
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1996	Wipro	Wipro Ltd had converted fixed assets into stock; the excess amount was credited to reserves, which improved their net worth per share and current ratio and neutralized the effect on profit on reduction of land value. A Wipro employee is believed to have embezzled about \$4 million by stealing a password and transferring money from Wipro's account to his bank account.
1999	Larsen & Toubro Ltd.	Income recognition through transfer of liabilities of loan at a lower cost.
2003	Bombay Dyeing and Manufacturing Company	Creating provision for possible loss on firm purchase contract and subsequent write-back of such provision thereby converting operating losses into operating profit.
2003	Hindustan Zinc Ltd.	Recalibrate investments into tangible assets to mold the need of valuation of investments.
2004	ONGC Ltd.	Capitalization of interest as well as other intangible assets to show fixed assets appraised value and deficit revenue expenses.
2008	Satyam scam	Mr. Ramalinga Raju, founder and promoter of Satyam computers, fraudulently overstated assets on Satyam's balance sheet by \$1.47 billion. Nearly \$1.04 billion in bank loans and cash that the company claimed to own was nonexistent. Satyam also underreported liabilities on its balance sheet.

Source: Global Data Services of India Ltd., Accounting and Analysis: The Indian Experience, 2006

FINDINGS

- This study reveals that creative accounting as immensely affecting the corporate in the real world.
- The result of study clearly signifies the unethical behaviour between corporate governance and creative accounting.
- This study also shows what are the different techniques used by the professionals to do the creative accounting.
- The various loopholes in the rules and regulations framed by the law.
- The various ways to overcome the creative accounting from the system.
- The history of the creative accounting from where it has been borne.
- The various methods to overcome the affects of creative accounting.
- It also shows how the accounts can be manipulated by changing various numbers and also by molding various other principles and standards.

- The data of various corporates which are engaged in creative accounting and do the scams.

RECOMMENDATIONS

- From this study it is to be recommended that the ethical practices in the corporate arena should have been more tighten.
- The corporate governance policies should more enhanced, so that the corporate culture should be more flourish.
- Adopting of global financial standards known as International Financial Reporting Standards (IFRS) should be more rapidly adopted to provide the more transparency in the accounting.
- Proper code of conduct of accounting regulations and government ethical regulations should be more focused to avoid the unethical practice of creative accounting.
- The regulatory agencies in drafting the rules minimizes the concept judgement estimation and prediction , rather than be more focused on the actual figures.
- Auditors should play a key role in identifying the dishonest and fuzzy transactions, and relevant actions should be taken against the doers , so that the creative accounting can be minimized.

CONCLUSION

The conclusion is made on the basis of the various findings which are made: Creative accounting is the drastic challenge of the accounting profession which is spreaded widely. To overcome these challenges the corporate has provide the various ethical policies and ways which are to be followed by the company and also focuses on the corporate governance policies of the company. As creative accounting brings the negativity in the accounting professionals and is also creating the bad impact on the society too. The study also describes the various other financial scandals which has its deepen roots in financial reporting as it in multi-dimensional nature. We can also say that creative accounting is the burden on the financial reporting.

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