

# CREATIVE ACCOUNTING: AN EXHIBITION OF CORPORATE ART

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**Abstract:** *Creative accounting has become very interesting topic recently due to the increase of scandal that involves large companies worldwide like Satyam, Ricoh etc. Despite the wide spread of creative accounting practices, the academic studies are still few. The purpose of this study is to examine the effect of creative accounting practices on financial reporting system, techniques, reasons and the probable ways to preventing and curbing the creative accounting practices. In this study a questionnaire-based survey methodology was used. The sample constituted of respondents including 38 professional chartered accountants, and 27 Research scholars. The findings reveal that companies use the practices of creative accounting to reduce tax payments, to increase market value of shares and to establish the ground for loan accessibility companies. The results also indicate that by implementing forensic accounting techniques, external audits, strict accounting measures and establishing ethical atmosphere are the probable way to prevent creative accounting practices in corporate financial reporting system.*

**Index Terms-** *creative accounting, financial reporting, forensic & fraud detection accounting*

## 1. INTRODUCTION

As we know that accounting figures are the languages of business. This refers that the performance of an organization is being reflected in the accounting figures or financial statements. The information provided by these statements is being used by various interested parties like investors, bankers, government, creditors, debtors, researchers etc. So, the authenticity and reliability of these financial statements are important. However, most of the times the accounting information provided by these corporates is not true. Here, the role of creative accounting through window dressing comes in to the picture. The best examples of creative accounting practices are Satyam (2009, Forged accounts to show higher revenue to the tune of \$1.5 billion.), Ricoh (2018, Falsification of Accounts) Scams, in India. Creative accounting is also known as income smoothing, earnings management, earnings smoothing, financial engineering and cosmetic accounting.

### Definition and Concept of Creative Accounting

Creative accounting is an accounting which presenting an academic view: creative accounting is the transformation of financial accounting figures from what they actually are to what preparers' desire by taking advantage of the existing rules and/or ignoring some or all of them' (Kamal Naser, 1993).

'Creative accounting is the process whereby accountants use their knowledge of accounting rules to manipulate the figures reported in the accounts of a business' (Amat, O. et al., 1999).

Creative accounting is an accounting practice that falls outside the regulation and policies of the organization and give benefit to certain people. These practices can be described as a practice with a clear aim to interrupt the financial reporting process which affects reported income to make it looked normal. Briefly, creative accounting practices are the transformation of financial accounting figures from what they actually are to what users' desire by taking advantage of the accounting policies which is permitted by accounting standards.

## REVIEW OF LITERATURE: -

Patnaik, Satpathy and Das, (2014) indicate that window dressing practices are prevalent in majority of corporates but it also depends upon the knowledge of experts of the accounting department. It is also found that the external auditors to some extent encourage these practices for their own interest.

Mirdala et al., (2014) conclude that professional accountants in Serbia believe that creative accounting techniques follow the financial reporting legislation, but it is important to emphasize that a significant number of accountants are not able to distinguish the positive creative accounting from the negative one. The authors believe that it would be necessary to pay attention to the further education of professional accountants and their professional development in the future, as well as to promote the forensic accounting and auditing profession in order to achieve that creative accounting techniques will not be misused.

Veronika, (2005) indicates that the introduction of international accounting standards will help to prevent the formation of creative accounting and this will also increase the trust of external parties in enterprises, improving the ability to raise funds and mutual competitors' comparability. The author also believes that honesty and ethical behaviour in business is largely dependent on fiscal policy of each country. The ethical behaviour is also helpful in prevention of creative accounting.

Ali Shah and Butt, (2011) conclude in the article "Creative Accounting: A Tool to Help Companies in a Crisis or a Practice to Land Them into Crises" that the complex and diverse nature of the business transactions and the room available in the accounting standards and policies make it difficult to handle the issue of creative accounting. By using the Discussion based model the authors conclude that creative accounting solutions are not always wrong. It is the intent and the magnitude of the disclosure which determines its true nature and justification.

Bhasin, (2015) the author revealed in his study that the practice of creative accounting is always a deliberate attempt to gain undue advantage for accountants, managers and companies. Therefore, strong disciplinary measures should be promptly taken against all those found culpable in the act of creative accounting. The author recommends that "effective rules and regulation of accounting, audit and corporate governance. practices should be put in place, within the corporate-sector, to predict the negative incidence of creative accounting practices in India."

Akenbor and Ibanichuka, (2012) the main objective of the authors is to find out the reasons for creative accounting. For this primary data was used. By using the z test findings revealed that to boost the market value of shares is the major objective of using creative accounting practices in Nigerian banking industry and the users of accounting information are adversely affected by the practice of creative accounting. The result of this analysis also indicates that accounting principles and rules should be streamlined to reduce diversities of professional judgment in financial reporting.

## Objectives of this study: -

1. To examine the reasons for using creative accounting practice in financial reporting system.
2. To examine the methods of creative accounting practice used by the manipulators in financial reporting system.
3. To find out whether the creative accounting practices effect the financial reporting system.

## Hypotheses of the study: -

H<sub>01</sub> = There is no significant effect of Creative accounting practices on the financial reporting system.

$H_{02}$  = Implementation of forensic accounting and fraud detection techniques do not have significant effect in preventing creative accounting practices.

## RESEARCH METHODOLOGY

This study is primarily based on “primary and secondary” sources of data, in this study a questionnaire-based survey methodology was used. The sample constituted of respondents including 38 professional chartered accountants, and 27 Research scholars. In order to achieve the purpose of the research a questionnaire was made with 10 questions. However, the 5-point “Likert -scale was adopted for coding the response and recording them into numeric values.” The data generated for this study were presented in a table and analyzed using the percentage and frequencies of respondents. For testing the hypotheses chi-square test was using through SPSS.

## RESULTS AND DISCUSSION: -

**Reasons of creative accounting practices:** - The respondents believe that the following are the most important reasons for using creative accounting practices in the financial reporting system: -

- i. To establish the ground for loan accessibility and investment attraction
- ii. To increase firm’s market value of shares
- iii. To avoid taxes
- iv. To qualify management to earn attractive bonus
- v. To mislead readers in favour of agency

**Methods of Creative Accounting:** - Majority of the respondents believes that overestimation of the revenue is mostly used by the manipulators as creative accounting practice. The other methods are as follows:

- i. Lowering the depreciation charges
- ii. Manipulation in inventory
- iii. Under valuation of pension liabilities
- iv. Delaying expenses
- v. Making contingent liabilities

• All these and numerous such ways and practices are at the disposal of the creative accountant through which he can attain the desired objectives.

In Real, the Creative accounting practices are at the root cause of a number of accounting scandals in the world leading to total loss of corporate image and executive integrity. Some practitioners and academicians see the creative accounting practice as an illegal act, while others consider it as a legal act. Answer given by the respondents is presented in table: 1

A large number of participants 69.2%, consider creative accounting practices to be “Legal” and “Totally Legal” and 13.80% were neutral by saying “Don’t Know”. Whether 16.9% % participants consider creative accounting practices to be “Illegal”. Thus, in order to overcome the unethical and illegal standing of creative accounting practices, some improvement actions for the companies’ CG systems were imposed in India.

When we questioned to participants, “Who, do you think, is the main manipulator of the creative accounting techniques in the corporate financial reporting system,” 29.7% participants declared “CEO’s”, 33.84% feel it to be “Managers”, 9.4% thought it to be “Auditors”, whereas 28.1% said that “Accountants” are primarily the main manipulators of creative accounting techniques.

Furthermore, when the participants were asked about ease of detection of creative accounting techniques in the financial reporting system, a very large number of the participants 67.70% were with the option that it is “Difficult” and “Very Difficult to Detect” the creative accounting practices in the company’s financial

statements. As against this, 20% participants were of the opinion that it is “Easy” and “Very Easy to Detect”, and 12.3% were not clear and appeared to be confused; they gave the reason “Don’t Know”.

**Table: 1 Legal Standing of creative accounting practices, Key Manipulators and Ease of Detection of the creative accounting Practices in Financial Statements.**

Q. Do you think Creative accounting practices legal?	Frequency	Percentage
Totally legal	11	16.9%
Legal	34	52.3%
Don’t know	9	13.8%
Illegal	11	16.9%
Totally illegal	0	-
Q. who do you think the main manipulator of the creative accounting techniques in financial reporting system?		
CEO’s	15	29.7%
Manager	22	33.84%
Auditor	6	9.4%
Accountant	18	28.1%
Q. Do you think it is easy to detect creative accounting practices in financial reporting system?		
Very easy	1	1.5%
Easy	12	18.5%
Don’t know	8	12.3%
Difficult	34	52.3%
Very difficult	10	15.4%

Table: 2

It shows that 32.3% participants “Strongly Agree”, while a large number of participants 61.5% “Agree” that a well-designed framework of accounting regulation by the regulatory agencies in India will help to curb the spread of creative accounting practices in the corporate financial reporting system. However, just 3.1% participants, a small part of the sample-size, are “Undecided” and 3% are with option strongly disagree and disagree respectively.

Similarly, when the participants were asked about the need of more govt. regulations by the various government regulatory agencies in India so as to prevent the creative accounting practices, majority of participants 35.4% “strongly agree” and 55.4% “Agreed”



**Table: 2 Government Regulations to Control Creative Accounting Practices and Accounting Regulation**

Q. Do you think a well-designed framework of accounting regulations will help to curb the creative accounting practices in financial reporting system?		
strongly agree	21	32.3%
agree	40	61.5%
undecided	2	3.1%
disagree	1	1.5%
strongly disagree	1	1.5%
Q. Do you think we need more govt. regulations to prevent and control the creative accounting practices?		
strongly agree	23	35.4%
agree	36	55.4%
undecided	2	3.1%
disagree	2	3.1%
strongly disagree	2	3.1%

The hypotheses of this study were tested by using the chi-square test through SPSS and the results are as follows:

**Ho<sub>1</sub>- There is no significant effect of Creative accounting practices on the financial reporting system.**

Implication-

The calculated value of  $X^2(69.446)$  is greater than the table value of  $X^2= 5.991$  at 5% level of significance. Hence, we reject the null hypothesis (Ho<sub>1</sub>) and accept the alternative hypothesis (H<sub>1</sub>). This indicates that creative accounting has significant effect on the financial reporting system.

**Ho<sub>2</sub> - Implementation of forensic accounting and fraud detection techniques do not have significant effect in preventing creative accounting practices.**

Implication-

The calculated value of  $X^2(43.6)$  is greater than the table value of  $X^2= 5.991$  at 5% level of significance. Hence, we reject the null hypothesis (Ho<sub>2</sub>) and accept the alternative hypothesis (H<sub>1</sub>). This indicates that Implementation of forensic accounting and fraud detection techniques have significant effect in preventing creative accounting practices. On the basis of the results, we can say that to prevent white collar crime, techniques of forensic accounting are helpful. The techniques of fraud detection are General audit technique, Mathematical and statistical technique, Computer Assisted Auditing Techniques (CAATs)/ Computer Assisted Audit Techniques and Tools (CAATT), Data mining techniques.

**Suggestions for Controlling CA Practices**

It is revealed that one of the best ways to prevent the practices of creative accounting is “external audits. As per the responses we seen that almost 70% manipulation in financial statements are done by the internal parties of the company. External audits include expert’s view and checking. creative accounting practices are caught by the external auditors so the fear of checking will also prevent the manipulators to do the practices. It was also recommended that “by creating ethical environment, following formal penalties and policies and segregation of function within the corporate-sector helpful in curbing the practices of creative accounting.

## CONCLUSION: -

This study revealed that the practice of creative accounting is an effort to gain advantage of a form to the managers and companies. Also, it shows that the current GAAP create a gap that can permit and encourage the practice of creative accounting. However, we are of the opinion that a well-designed framework of accounting regulations by the regulatory agencies in india will go a long-way to reduce the creative accounting practice. It was equally revealed that one of the best ways to prevent the practice of creative accounting is External audit. It was recommended that effective rules and regulation of accounting practice should be put in places within the organization to forestall the incidence of creative accounting. It is suggested that accounting rules and regulations should be strictly adopted by companies so that no one can get any benefit of the existing loopholes of accounting framework, otherwise strict legal action must be taken. This may ensure, “true and fair view” of the financial statements. The findings of this study shows that creative accounting practices affect the financial reporting system and forensic and fraud detecting accounting is helpful to reduce the white-collar crime in corporates.

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