

## Ethics in Creative Accounting

Dharmeshkumar N. Rana\*

\*Ph.D. Scholar, Gujarat University, Ahmedabad Gujarat (India)

---

### ARTICLE DETAILS

#### Article History

Received: 22 February 2016

Accepted: 04 March 2016

Published Online: 10 March 2016

#### Keywords:

Creative Accounting

Accounting Ethics

Financial Reporting

---

### ABSTRACT

The use of creative accounting has become a controversial issue since there are parties both in favour and against the use of Creative accounting. While the management has its own arguments in favour of Creative accounting, to resort to the practices of Creative Accounting, its critics are of different opinion and have apprehensions regarding its use. Although it is a controversial topic still studies reveal that the practices of Creative accounting can be judiciously applied with ethical considerations. The present paper attempts to highlight the pros and cons of Creative Accounting by enumerating its importance to various interest groups. The study reveals that Creative Accounting helps to solve many problems which are faced by the management in today's complicated and dynamic business environment. But owing to the dynamic and complicated nature of the business transactions and the liberty available in the accounting standards and the procedures, it is difficult to handle the issue of creative accounting.

---

### INTRODUCTION

Creative Accounting allows a manager to change the financial results or the financial statements without deviating from the rules, laws and requirements of accounting by using techniques, options and loopholes left by accounting regulations. In other words, an attempt is made to change the profit either by increasing or decreasing or by misrepresenting the financial statements through grouping of procedures. Creative Accounting was basically developed due to the ever increasing demand of the users of the financial information. The Creative Accounting helps to solve many problems which are faced by the management in today's complicated and dynamic business environment. It helps in various decisions making and forms the base for solving many issues. In Creative Accounting the manager uses the accounting knowledge to present the accounting data, figures and statements in such a manner which seems attractive to the stakeholders instead of showing the real position or performance of the company but all this is done within the parameters of accounting laws and rules. While on one hand, Creative Accounting helps in reducing the risk of a company by increasing the share price and on the other hand, it helps to create a profit trend for the company. Various benefits like raise of capital by issue of shares, defy takeover by other companies and offering own shares in takeover bids go in favour of Creative Accounting. Creative Accounting also helps to reduce the fluctuations of Income of the company which helps the company to gain a good image in the market, this good image in turn, helps the company in many issues directly or indirectly.

#### Definitions of Creative Accounting:

“Creative Accounting is the transformation of financial accounting figures from what they actually are to what preparer desires by taking advantage of the existing rules and/ or ignoring some or all of them”.

---

### IMPORTANCE OF CREATIVE ACCOUNTING

The benefits of creative accounting can be reaped if used with positive intentions and in accordance with the accounting principles and rules. If properly and judiciously used, Creative accounting can prove to be of great importance to the company, its stakeholders and various other parties directly or indirectly influenced by the company's performance.

Some of the importance or benefits of Creative Accounting is that it helps to increase or maintain the share price of the company by reducing the company's debt level thereby showing improved profits. The increased share price helps the company to raise new share capital and also gives a chance to avoid takeover attempts. Sometimes the users of Creative Accounting delay the release of financial information to the market thereby taking advantage arising out of this delay, such types of tools are also a part of Creative Accounting and does not cause any harm to the interest of the shareholders and such practices cannot be termed as dishonest practice.

### LITERATURE REVIEW

Belkaoui (1989), real fraud is defined as ‘falsifying or altering documents, deleting transactions from records, recording forged transactions or concealing significant information’. Due to the difficulty of the distinction between the two, the commission responsible for fraudulent financial reporting defined fraud as ‘materially misleading financial statements’ (NCFRR 1987).

Zimmerman (1978, 1986 and 1990) which represent the foundation of the positive accounting theory. This research trend made the object of several empirical works trying to explain the accounting choices starting from the problem of the political costs that the enterprises are exposed to.

Mathew and Perera (1996) look at creative accounting in both positive and negative light. They opined that creative accounting have positive effect if it enhances the development of accounting practices and negative when it is meant to mislead and defraud investors, creditors, bank-ers and other users of financial statement. Some authors define creative accounting as an assembly of procedures having in view the change of the level of the result in or-der to increase or decrease, or present the financial state-ments, without these objectives being reciprocally exclude (Stolowy, 2000).

Creative accounting is used, according to the opinion is-sued by Burlacu and Pătroi (2005) and for the “consolidation” of the economic-financial indicators of the economic entities, distorting yet their informational content. It is appreciated that in this way the consistency and truthfulness of the accounting information sent by the economic entity to the business environment is being altered.

#### OBJECTIVE OF THE STUDY

1. To understand the concept of Creative Accounting.
2. To understand the Techniques of Creative Accounting.
3. To examine the pros and cons of Creative Accounting.

#### METHODOLOGY

The present research work is mainly based on published secondary sources. The sources of secondary data are the data published by various journals. The study has been conducted on a micro level and is descriptive and conceptual in nature.

#### LIMITATIONS

Limitations are always a part of any kind of research work, as the report is mainly based on secondary data. Whatever the limitations of the secondary data will be the limitation of this research study.

#### TECHNIQUES OF CREATIVE ACCOUNTING

Techniques of Creative Accounting refer to all such practices which are being applied by Creative Accountants in order to manipulate or misrepresent the accounting state-ments and figures. In general, the objective of Creative Accounting is to show higher profits which can be done in number of ways some of which are mentioned below:

1. The current profits can be overstated by ignoring the provisions for bad debt and legal obligations.
2. The cost of goods sold can be decreased by overvaluing the closing stock thereby showing increase profit which show increase in total assets in the balance sheet.
3. Many items of debit and credits can be wisely over or understated as required.
4. Buyback of own assets at an inflated price in order to show increase of assets in Balance sheet.
5. All these and numerous such ways and practices are at the disposal of the creative accountant through which he can attain the desired objectives.

#### ANALYSIS OF CREATIVE ACCOUNTING

Now a day’s Creative Accounting has become a very important tool of management. The management resort to various creative accounting techniques and practices to meet the day to day challenges. Some major merits of Creative Accounting to the various interest groups can be highlighted as under:

##### [A] To the Stakeholders:

- i. Higher returns on their Investments.
- ii. Consistency in Earnings.

##### [B] To the Workers:

- i. Ensures Job Surety.
- ii. Enhances Income.
- iii. Increase in Bonus and Incentives.

##### [C] To the Managers:

- i. Helps to enhance management performance.
- ii. Forms the basis of personal incentives of the Manager.
- iii. To show incompetency of the management of the past.
- iv. To meet internal targets set up by higher management.
- v. Boost reported profits or minimize reported loss.

##### [D] To the Company:

- i. Helps to gain access to Finance.
- ii. Forms the base of Tax Management.
- iii. Helps in Management Buyouts.
- iv. Helps to conceal Financial Risk.
- v. Avoid borrowing restrictions.

#### DEMERITS OF CREATIVE ACCOUNTING

Practical experiences shows that most of the time the creative accounting practices are not being handled judiciously and such techniques are mostly undertaken with unscrupulous intentions in order to misrepresent and mislead the society. And the affected parties are the Investors, Creditors and the employees. The Managers of the company are the one responsible for the misuse and abuse of Creative Accounting since in order to fulfill their selfish motives they defy the ethical consideration which are an essential part of Creative accounting. Sometime they resort to such practices which are totally unethical and out of the limits of accounting standards. Such attempts can lead to uncontrollable situations imposing a threat to the very existence of the company.

#### CONCLUSION

A company has to meet many expectations from external parties. It has to face expectations of higher return from its stakeholders, the employees and customers expects long term survival of the company for their own interest and sup-pliers want assurance of their payments. Moreover, compa-nies want to show steady income to keep their share prices stable and to impress the investors. All these urges the com-pany to seek to Creative accounting practices. But owing to the dynamic and complicated nature of the business trans-actions and the liberty available in the accounting standards and the procedures, it is difficult to handle the issue of creative accounting. It is

basically the responsibility of the users of the creative accounting whether to use it properly and with good intentions or to misuse it. It is really very unfortunate that its misuse or abuse cannot be stopped completely. But efforts could be made to encourage judicious use of Creative Accounting so that the solutions neither mislead nor misrepresents the results of the business and give fair solutions to the problems faced by the management of the business.

## REFERENCES

- [1] H. Collingwood, "Why K-Mart's good news isn't," *Business Week*, March 18, vol.40, 1991.
- [2] H. Stolowy and G. Breton, "A Framework for the Classification of Accounts Manipulations," *HEC Accounting and Management Control*, Working Paper 2000, no. 708, pp.1-94.
- [3] K. Naser, "Creative Financial Accounting: Its Nature and Use," Hemel Hempstead: Prentice Hall, 1993, pp.272
- [4] K. Schipper, " Commentary: Earnings Management," *Accounting Horizons*, 1989 (December), pp. 91-102.
- [5] P. Sweeney, "Debt Covenant violations and managers accounting responses," *Journal of Accounting and Economics*, vol.17, pp. 281- 308, 1994.
- [6] C. Jean, "The Impact of the Corporate Governance Code on Earnings Management: Evidence from Chinese Listed Companies," *EFMA Symposium*, pp.1-62, 2011.
- [7] C. R. Beidleman, "Income smoothing: the role of management," *Accounting Review*, vol. 48, no.4, pp. 653-667, 1973.
- [8] D. Burgstahler and M. Eames, "Management of Earnings and Analyst Forecasts," *Journal of Business Finance & Accounting*, June/July 2006, vol. 33, no. 5-6, pp. 633-652.
- [9] D. Dahi, "Managerial turnover and successor accounting discretion:bank loan loss provision after resignation, retirement or death," *Research in Accounting Regulation*, vol, 10, pp. 95-110, 1996.