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A REVIEW OF EMPIRICAL LITERATURE ON CREATIVE ACCOUNTING

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Abstract:
This paper explores the subject of creative accounting, an area involving the manipulation of financial statements to present a favorable image of an organization's financial position. The use of unstandardized ways of accounting has led to various scandals in organizations. Generally, creative accounting is viewed negatively from the accounting view, but there are some writers who find it necessary to use creative accounting since it responds to the needs of their customers. While it may be legal, creative accounting raises concerns about transparency, fairness, and the potential for unethical behavior. In this paper, the researchers are analyzing the definition of creative accounting, the rationale for creative accounting, the perception of creative accounting, whether positively or negatively viewed and the implications of creative accounting. The study is conducted through a review of the published articles. Creative accounting has gained increasing attention due to its potential for abuse, which has led to the collapse of firms and financial scandals like Enron. The study aims to shed light on how such practices occur and what can be done to mitigate them.

JEL: M41; M42; M48; G34; G38; K22

Keywords: creative accounting (CA), ethics, legal

1. Introduction

The importance of accounting results to the investors has led many organizations to come up with innovative ways of accounting; these innovative ways are the ones referred to as creative accounting techniques. Copeland (1968) was one of the researchers who used the term "*accounts manipulation*" for the first time. He showed the increase and decrease of figures in the Financial Statement (FS) to show the picture of the firm accordingly. Susmus and Demirhan (2013) gave several other terms as synonyms for Creative

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accounting (CA), such as financial engineering, cosmetic accounting, window dressing, innovative accounting, and income smoothing. CA refers to new ways to present accounts, which deviate from accounting rules, to share a positive picture of the financial health of a firm. CA has been the most discussed topic after the fall of major firms in the USA, and surprisingly, the very reason behind the fall of every firm was CA, maybe it was Enron, world.com or Arthur Anderson. It was CA and its effects which led to the passing and implementation of the laws such as Sarbanes-Oxley Act-SOX (Zimmerman, 2015).

There can be several factors influencing the manipulation of FS, which can be economic pressure, reputation and increasing competition, which lead an individual or the firm to take up CA. Thus, it can be said that CA is when accountants do not actually follow the accounting standards laid by the governing bodies. It is not illegal but unethical as it is against the rules laid down by reporting standards. CA techniques simply change accounting standards, which are used to change the financial information for the usage by the company in their own way. Simply, it can be said that CA is just to use the "loopholes" available in the accounting practices and rules to enhance the figures in FS to give a lucrative financial ratio of the firm leading to a march toward financial crimes. It is also seen that auditors, mainly external, usually ignore the CA as it is not illegal, but, yes, it is unethical (Gupta and Kumar 2020).

Naser (1992) and Gowthorpe and Amat (2005a) defined CA as deliberately made changes by the accountants while preparing FS to communicate between firms and shareholders, providing them with the information they want to communicate, by simply keeping everything as per law and using the loopholes provided in the same. Shafer *et al.* (2013) laid emphasis on professionals finding different loopholes in the accounting rules and standards so that the presentation of FS is done in accordance with their choices. Naser (1993) defined CA as a process of changing the FS figures in such a way that they present the picture required by the management, taking into account the advantages of loopholes in the existing rules or ignoring some of them. He further defined CA in two steps: first, the process of manipulating accounting figures, using the weak links of the rules and taking advantage of the same in its favor as required by the management; and secondly, manipulating the figures in such a way that the result is obtained in the desired way.

1.1 Forms of Creative Accounting

According to Gupta and Kumar (2020), earnings management is one of the techniques of creative accounting, earnings management involves having lump sum income and expenditure receipts, manipulation of inventories, intentionally delaying the recognition of expenses, undervaluing provisions, playing with contingent liabilities, playing with balance sheets items, changing policies as per convenience, manipulating revenues and expenditure, exaggerating revenues by fake revenues and fictitious sales and writing off accounts receivable. Another technique that was identified by Schipper (1989) was window dressing, which involves the manipulation of financial statements at the end of the financial period so as to show an improvement in the company's financial performance.

Karim *et al.* (2016) gave emphasis on companies finding the loopholes in the system to enhance or reduce the numbers, which will definitely give an edge and benefit to the company in the short run, but in the long run it is definitely going to hamper the growth of the firm and can even lead the company to the bankruptcy. it was stated that the following ways will help to reduce the challenges that arise with creative accounting; proper maintenance of accounts; following standards; recognizing the role of internal and external audits, use of red flags, reporting of any unfair practice (red flags and whistleblowing), consistency in accounting policies, change in audit rules, hiring independent directors and members of the audit committee, proper rewards for whistleblowers, following of ethics, proper implementation of forensic accounting; and penalty options should be available.

2. Literature Review

Khaneja and Bhargava (2016) in their literature review identified some motives of creative accounting; the first identified was for the purpose of impressing investors with a good image of the organizations even when that might not be the true position, secondly it also aimed in increasing the value of the share in the organization, it is also aimed at lowering costs so as to reduces the costs on taxes, it is also aimed at improving sales expectations and meeting profitability targets. According to the literature review by Khaneja and Bhargava (2016), creative accounting was presented as manipulative and hence negative to the true picture of the organization.

Literature review conducted by Strakova and Zvarikova (2021) on the topic of creative accounting revealed that in some situations, such as in trying to avoid bankruptcy, creative accounting is very helpful because it can save the organization. The study conducted a literature review on the studies conducted between 2000 and 2021. The review covered the topics dealing with reasons for creative accounting, the role of auditors, reasons for creative accounting, ethics and the presence of internal controls in detecting creative accounting. According to these literatures review, creative accounting is not always negative but can sometimes be positive.

3. Methodology

The researchers applied the desk-top review research design, which involved the review of literature based on creative accounting. The researchers selected articles from various databases; the condition for the choice of the article was to contain the word "creative accounting" in the title of the publication in an academic journal. For each individual article, where possible researchers analyzed the definitions of creative accounting, summarized the motivations for using creative accounting techniques, briefly presented the topics covered and concluded what the authors think about the topic, whether they view it negatively or positively. In order to analyze the definitions of creative accounting, the researchers have taken from each article the definitions presented by the author and tried to highlight what the central idea of the definition is, what creative accounting resembles and whether the definition given resembles another.

To establish what the authors' views on creative accounting are, the researchers read the full abstract, introduction, literature review, conclusion and results part for each article and where the researchers could, highlighted what their main ideas on the subject are, whether they are positive or negative. There were also articles where there were conflicting ideas or too few ideas about how the authors view creative accounting, and in these cases, the researchers refrained from concluding what their opinion was. As far as the motivations for using creative accounting techniques are concerned, the researchers only selected the motivations mentioned in the articles and tried to present them as briefly as possible. Each article was summarized with more emphasis on the research method used, the country in which the study was conducted, the research objective(s) and in some cases the result obtained to highlight the issues addressed.

3.1 Creative Accounting Definitions

Khatri (2015) considers creative accounting as the manipulation of accounts within the flexibility provided by accounting standards and gives the following definition: "*Creative accounting is practically using the loopholes provided within the accounting principles or accounting standards to manage identification, measurement or presentation of different accounting facts to serve the purpose of the owners of accounting records rather than the users of accounting information*".

According to Iredele, Adeyeye and Owoyomi (2022), creative accounting is defined as "*creative accounting is a practice that may (or may not) conform to the accounting standards or principles but digresses from what those principles and standards aim to accomplish, in order to express an anticipated image of the company to interested parties.*"

A better definition was given by Škoda, Lengyelfalusy and Gabrhelová (2017), who defined creative accounting as "*a way of changing the books of accounts so as to achieve the expected outcome*". According to Yadav *et al.* (2014) and Ado, Rashid, Mustapha and Ademola (2022), creative accounting is considered a deviation from accounting norms and regulations, referring to it as "*an accounting practice that may or may not conform to the generally accepted accounting rules but clearly deviates from these rules and regulations*".

3.2 Views on Creative Accounting

According to Khatri (2015), creative accounting is viewed as an ornament to cover the ugly face of the financial statements; it does not create the correct position of the organization, but rather is a financial deception, and therefore, Khatri (2015) had a negative opinion on creative accounting. Other scholars who viewed creative accounting negatively include Akpanuko and Umoren (2018), Paul, Francis and Ben-Caleb (2020).

According to Akpanuko and Umoren (2018), creative accounting is viewed as a deceptive and undesirable practice as it promotes the continuity of such practices with managers' self-interest in giving the wrong information to existing shareholders and potential investors. According to Akpanuko and Umoren (2018), the problem with creative accounting cannot be solved by increasing regulations but rather by the correct application of the code of ethics and codes of corporate governance. According to Paul, Francis and Ben-Caleb (2020) and Oshodin and Iyafekhe (2022), creative accounting has contributed to the collapse of large companies, and they view it from a negative aspect.

Iredele, Adeyeye and Owoyomi (2022) view creative accounting as both negative and positive. On the negative aspect, creative accounting was viewed as being responsible for the failure of financial reports to be reliable and credible in assisting users to make optimal decisions. On the positive aspect, creative accounting was seen as being in a position to make the organization to be more competitive in the market it operates. Another researcher who viewed creative accounting positively was Meredith, Baxter and Anwar (2022), according to Meredith, Baxter and Anwar (2022) creativity in the accounting profession is good as a result of the digitization and globalization process, we are going through. Creativity is said to be of value since it helps the organization to be innovative and adjust according to the needs of the clients.

3.3 The Influencers of Creative Accounting

According to Khatri (2015) creative accounting has become popular due to several reasons such as in case of merger it helps in negotiating with regulators or the persons acquiring, helps in maintaining financial performance within agreed limits expected by the owners, it assists the organization in raising additional capital at a fair price, it assists the organization in paying less tax, it is able to cover up the inefficiencies and weakness of the management it also assist in pushing the organization towards meeting the requirements of public listing.

Creative accounting helps in understanding the concept of the agency theory, information asymmetry, which seeks to show the need for close supervision of company managers by the owners so as to minimize potential opportunistic behavior from the management (Balaciu, 2012).

3.4 Issues Noted in the Literature Review of Creative Accounting

Khatri (2015), in his article, shows us what deceptive practices led to two famous scandals, Enron and Satyam Computer Services Limited - India. Enron Limited managed to hide the losses by executing the creative accounting technique of moving a business segment offshore. It could hide the losses resulting from certain business segments by passing the transactions to offshore outfits. The shareholders and regulators could not come to know the losses from such offshore business segments as these were not reflected in the annual accounts of Enron Limited.

The facts about the falsification of accounting facts at Satyam were admitted by its head, Mr. Raju, in a self-declaration type letter, leading to the confession of a crime. Crime, in the sense that a small level of creative accounting resulted in the accumulation of false profits, false assets, and unlawful presentation of liabilities over the years.

Akpanuko and Umoren (2018), in their survey method study of accountants in Nigeria, found that creative accounting contributes 90% to unfair reporting of corporate transactions and is a major ethical issue in the country. This paper set out to determine the extent to which creative accounting has contributed to corporate failures, the motivations for such practices and the challenges of fair reporting. One of the challenges identified would be the issue of applying IFRS in different accounting cultural contexts.

In another questionnaire-based study, this time conducted on financial auditors in Romania, Balaciu, Bogdan, Meșter and Gherai (2012) wanted to identify what auditors think about the existence and forms of creative accounting. The results showed that 68% of the surveyed auditors consider accounting manipulation common in practice, and another 68% consider that stakeholders' interests can be affected by the use of creative accounting practices. Among the most common creative accounting practices encountered are those that impact on the valuation and recognition of provisions, depreciation and impairment of assets, revaluation of property, plant and equipment and valuation of inventories. The least common practices are those impacting on development expenditure and financial assets.

According to Muthusamy, S., & Ganapathy, S. (2021) Strong internal controls help to detect and prevent unethical financial reporting practices. This includes access controls, segregation of duties and regular reconciliation of accounts. It was also noted by Jones (2011) that Clear and consistent accounting standards minimizes the vagueness that may bring in creative accounting. It is very essential that organizations adhere firmly to generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS). Another way in which the weaknesses in creative accounting can be mitigated is that independent audits by external auditors can help recognize inconsistencies or manipulations in financial statements. The external auditor's role is critical in confirming the validity and accuracy of financial reporting (Al-Akra, M., & Ali, M., 2021). Another way of mitigating the weaknesses in creative accounting is making use of advanced data analytics, accounting software and artificial intelligence (AI), which help in detecting irregularities in financial data (Sharma, S., & Kumar, D., 2023).

4. Implications of Creative Accounting

Creative accounting, as earlier noted, is not necessarily illegal but raises some fundamental issues of ethics. Creative accounting has various implications in regard to investors, regulators, businesses and the wider economy. According to Hussainey, K., & Al-Najjar, B. (2020), creative accounting practices underscore the issue of reliability and transparency of financial reports, resulting in unclear assessment of the financial status of the organization. Misleading accounting information leads organizations to make poor investment decisions. Another implication of creative accounting, as noted by Mollaoglu, S., & Yavuz, M. (2020), relates to erosion of trust in the capital markets. Once the investors and other stakeholders start learning of the manipulation of data in the organization, they start losing confidence in the organization, resulting in poor performance in future. According to Gazzola, P., & Pavione, E. (2020), Creative accounting can also lead to regulatory and legal risks, and especially if it turns out to attract fraudulent activities, this may end up attracting huge penalties and court fines, which may be detrimental to the performance and growth of the organization.

5. Conclusions

Creative accounting practices, are said to produce both positive and negative views insofar as the practice is concerned. Through the analysis creative accounting practices can have far-reaching negative effects on a company's long-term sustainability, stakeholder trust and financial integrity. They may also attract legal battles, which may end up being very costly to the organization, it is therefore important for the management to take caution in the use of creative accounting practices. Due to different views held by researchers, it is important for more research to be carried out in this field so as to minimize the risks involved in creative accounting practices. The researchers recommend that the management should try as much as possible to apply the international accounting standards so as to avoid the risk. The researchers also recommend that the International Accounting Standards Board should come up with a way of sealing the loopholes leading to creative accounting practices.

Conflict of Interest Statement
The authors declare no conflicts of interest.

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