

**CREATIVE ACCOUNTING AND INTERNATIONAL FINANCIAL REPORTING
STANDARDS –AN OVERALL REVIEW**

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Abstract: This paper aims to give a wider picture of creative accounting. The realization of the work is based on secondary data. Regarding to the creative accounting, the pros and cons views, and the basic condition for its application is then IFRS itself. In order to prove the larger existence of creative accounting, the study relies on historical evidence. In addition in order to brief the role of practices and objectives of creative accounting and their contexts. The role of accounting standards according to the moral hazard of the creative accounting is the objective of the IFRS foundation. That “to develop, in the public interest, a single set of high quality, understandable, enforceable, and internationally accepted financial reporting standards based upon clearly articulated principles. Our objective is to show the effect of creative accounting on the performance of the company which uses these techniques manipulate their accounts to show desired results. We also discussed about different types of creative accounting and parties involved in it and what are the motivation factors so that people are involved in creative accounting techniques. We also talked about continental types of creative accounting. We also analyzed involvement of different professionals in creative accounting like accountant, lawyers, and bankers. They help companies in deciding about the different instruments which help company to involve in creative accounting. In this way, a more realistic conclusion is made about creative and related elements.

Keywords: Creative accounting, international financial standards (IFRS)

INTRODUCTION

When we open this true Pandora’s Box: Creative Accounting then we understands when and why exactly the concept first appeared and what influenced its development that arose many questions. With hindsight a few favorable circumstances to this concept can be identified, circumstances, first related to the economical entities to create for them a good reputation in an increasingly competitive and tough economic environment. About this particular moment, that is first mention belongs to the founder of accounting Luca Pacioli. This ambition of making figure more appealing or opposite is as old as 500

years. Thus, Luca Pacioli was shaping in his already renowned De Arithmetical, the first accounting manual, practices of creative accounting. Creative accounting refers to accounting practices that may or may not follow the letter of the rules of accounting standard practices but certainly deviate from those rules and regulations. It may be characterized by excessive complication and using innovative ways of characterizing by excessive complication and using innovative ways of characterizing income, assets, and liabilities. Sometimes word like “innovative” or “aggressive” are also used for defining creative accounting. Creative accounting is a term which is used as a

systematic misrepresentation of the true and fair income, liabilities and assets of corporations or organization.

The financial statements provide information that is used by stakeholders to assess the company's performance, management and decision-making. The accuracy and the validity of the accountancy information is taken as postulated by the users. Also the regulatory legislation of accounting intents to ensure that the information is obtained from a sound base and in support of rules and conditions to be more reliable for the users. However, interoperability between firms and stakeholders may be distorted by the activity of financial statements who want to show a different state of the outlook through financial statements.

CREATIVE ACCOUNTING

The term of creativity of accounting ancient and modern concurrently, it is the term ancient due to the existence of the Anglo-Saxon accounting. The new term is given to developments in the field of accounting standards that led to the emergence of international accounting standards. That are creative accounting is continuing to grow and evolve over time, and then the emergence of international financial reporting standards. The international accounting and financial reporting standards is a guide to improving the presentation and measurement and disclosure of financial and accounting information of the institution and called creative accounting.

The significance of the study comes from showing the creativity of accounting as an attribute that will prepare creative accountant can achieve. The creativity of accounting within the

following areas; use of the methods, unfamiliar to interpret, analyze and solve various Accounting Standards Committee (IASC), introduce amendments and changes to accounting standards and interpretations. Then change to international financial reporting standards, in order to reduce the accountants and firms are using loopholes in the paragraphs of international accounting standards and interpretations. This "in itself " is a purely accounting innovation by the International Federation of Accountants (IFAC) and its committees, reflected in the issuance of international accounting standards would be the amendment, cancelation and change some paragraphs and standards.

CONCEPT OF CREATIVE ACCOUNTING:

The concept of creative accounting has British roots, as well it represents the object of long lecturers within Anglo-Saxon system Literature in 1970s by that resembles the basis of positive accounting. This term complemented by several concepts, the most common being "imaginative accounting" and "Accounting of Intent", regarding the existence of this concept. Creative accounting refers to earnings management, earning smoothing, financial engineering income smoothing and cosmetic accounting.

The concept of creative accounting is usually used to describe the process through which the accounting specialists use their knowledge in order to manipulate the figures included in the annual accounts. Accounting has been described as art: "The art of faking a balance" "The art of calculating its profits" "The art of saving money aside", while says "doesn't hesitate to describe accounting flexible art." In additional, accounting has become

“strategic” because, to ennoble this technique, some articles introduce a policy or optimization accounting. Finally, accounting has described “strategic accounting” and in the recent years, describes “forensic accounting”. Forensic accounting, as a result, is an option of a professional career for future accountants. According to Smart Money magazine, forensic accounting is one of “the top 10 next hot jobs”. In one word, we say: the creative accounting is a combination of the other mechanisms. Considering the numerous publications, it appears essential to reflect aimed to define the concept of “creative accounting” based on many techniques. In addition, many researchers have tried, to establish a definition of the term of creative accounting. In addition, because of the different orientations of these researchers have appeared many definitions of the term, those definitions were built each depending on the point of view who put it.

We can present an academic’s view, offers a definition of creative accounting that is the transformation of financial accounting numbers from what they actually are to what prepares desire

CREATIVE ACCOUNTING DEFINITION

In different literatures, the creative accounting is expressed in different terms. Most popular term in USA is “Managing Profits” but in Europe it refers to “creative accounting”. “However, some authors consider creative accounting as a broader and more comprehensive topic than profit management. It should be noted that accounting manipulates affect both the balance sheet and the income statement. It is considered that the creative accounting involves the transformation of financial

data, using valuation methods and accounting practices permitted by accounting regulations

CREATIVE ACCOUNTING PRACTICES

All steps used to play the financial numbers game including the aggressive choice and application of accounting principles, both within and beyond the boundaries of generally accept accounting principles, and fraudulent financial reporting. Also included are steps taken toward earnings management and income smoothing. This is the motivation to resort to the use of creative accounting by firms.

The remainder of this paper is organized as follows: some research methodology features are discussed, the main part of the paper deals with analyzing theoretical studies in the area of creative accounting, and development the international accounting and financial reporting standards. In order to synthesize pros and cons being documented through accounting research literature, and eventually this study conclude upon the developed analysis by, also formulating some future developments that might complement this study. More precisely, our analysis of each considered study covered the following aspects: question formation, identification of the relevance, evaluation of quality, evidence summarization and interpretation of conclusions.

OBJECTIVES OF CREATIVE ACCOUNTING

The main objectives of the study:

- To manage the financial risks through the approach of hedging at present and future.

- To achieve the vital purposes axial objectives that are; minimization of managers wealth and minimizations of executive costs.

IFRS AS A FUNDAMENTAL CONDITION FOR CREATIVE ACCOUNTING

IFRS allow a large number of accounting estimates, and in this way the amount calculated for a specific component that is reflected in the financial statements is not an exact digit. The space of flexibility that SNRFs provide may imply scope for creative accounting. Often it is difficult to distinguish creative accounting from practicing reasonable business judgment as accounting standards allow the existence of the difference between accounting estimations and reality.

MOTIVATION AND INCENTIVES OF CREATIVE ACCOUNTING

To fully understand the concept of creative accounting, it is important to understand the motivation and incentives that initially lead to the use of creative accounting. If users of financial statements are aware of the existence of these pressures, they have the ability to take them into consideration and to review their decisions accordingly.

CREATIVE ACCOUNTING IN INSURANCE COMPANIES

The insurance market as an integral part of financial market is consolidating its sustainability toward financial empowerment. This development and empowerment should also be responsive to financial reporting, which should be uniform, understandable, transparent to the

clients or to the insured people or companies. For this reason, in march 2004, insurance companies are reporting on a specific IFRS-4 on Insurance Contracts. The general objective of insurance standards is fair value accounting.

GENERAL INTRODUCTION WITH IFRS 4

International Financial Reporting Standard 4: prohibits the creation of provisions for possible contractual claims that do not exist at the reporting date (such as catastrophic provisions and avoidance of bankruptcy). It requires a test performance for the adequacy of recognized insurance liabilities and a impairment test for reinsurance assets; Requires an insurer to keep insurance liabilities in his balance sheet until they are met or cancelled or expired. In particular, an insurer cannot use any of the following practices, although it may continue to user accounting policies that include them: measuring insurance liabilities on an undiscounted basis. Measurement of contractual rights for future investment management fees with an amount exceeding their fair value as implied by comparing current rates used by other market participants for similar services. The standard requires disclosure to help users understand: Amounts in financial statements of insurers deriving from insurance contracts; the nature and magnitude of the risks that emerge from insurance contracts.

Main benefits moving toward this standard:

Transparency- Fair value provides greater transparency to improve disclosure and break through into the financial position of

the insurance company. Representing fair value assets gives a better view of the financial position at a time. In addition, presenting assets and liabilities at fair value have the advantage of avoiding inconsistencies that occur, if these categories are dealt with in different ways. Transparency and improved disclosure can result in better management decisions and better capital targets by investors.

Sustainability- Standardization of accounting will be an important achievement in itself. This will bring greater comparability between companies and may improve the ability of some insurers to enter global capital markets. The existence of a common European standard will also facilitate the promotion of a convergence of global accounting standards.

Improving the management- Sophisticating the tools needed to improve fair value will encourage companies to improve capital management, risk management and compliance between assets and liabilities.

CONSEQUENCES OF USING CREATIVE ACCOUNTING

The consequences of creative accounting are undesirable in many cases. To confirm this, it is important to consider the consequences of using creative accounting.

- **Reduction of Company Value-** Decisions taken to influence short-term profits through the use of creative accounting may impair the health of “long-term” economical entity.
- **Violation of Ethical Standards-** Even if inventive accounting practices do not violate IFRSs, they

are a controversial ethical practice. Creative accounting resembles a steep path with minor accounting frauds, which become more aggressive until they create distortions in the financial statements.

SOME PREVENTIVE MEASURES

Preventing creative accounting practices, the use of which has resulted in many bankruptcy cases of major companies in the world such as Enron, WorldCom, requires the involvement of many stakeholders from organizations that set accounting rules and standards for government up to companies or different industry branches.

- The ability to choose different accounting methods can be reduced by reducing the number of possible methods or specifying the cases when each method can be used. Another way of preventing it is to seek consistency in the use of methods. If a company has used a certain method when its financial condition was good, it should continue to use the same method even if the advantage is not in her side
- Artificial transactions can be prevented by using the concept of “substance over form”. So, the companies should use more economic restraint in the accounting records of these transactions than its legal form. It is necessary for the procedure to be economically conceived and to recognize its economic effect and not to be abused with the legal form which, despite being legally

regular, does not represent the economic reality of any action.

in consideration during implementation phase.

CONCLUSIONS

The manager's efforts to practice creative accounting are motivated by a variety of conditions. Among other things, there is a need to meet analysts' estimates and to have a stable income or to improve revenue. It is important that users of financial statements have knowledge about creative accounting practices for two main reasons: Due to the large number of accounting estimates allowed by IFRSs; And to raise awareness and identification of creative accounting placements.

The basic condition practicing creative accounting is the IFRS itself. They allow a large number of accounting estimates and the amount calculated for a specific component that is reflected in the financial statements. This area of flexibility that SNRFs provide may imply scope of creative accounting.

The overall picture of this paper brought a panorama, on how creative accounting gives impact on businesses, and insurance companies. Pro and against voices exists if creative accounting is taken

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