

A Study on Creative Accounting Practices in Indian Financial Sector

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Abstract - Nowadays, the Creative Accounting effort is gradually believed as an improvement in the field of accounting. Creative accounting is considered as one of interesting subject in accounting studies and it is well-defined as conscious behavior made to reduce periodic fluctuations of earnings. Creative Accounting is a disconcerting bought up to the process of keeping books of accounts by the rules of standard accounting practices to obtain the chosen results. The study has been piloted to get an in-depth view of accounting practices employed by corporations, in India which come under Creative Accounting. It also studies the purposes and causes of agreeing such untrue exercise by the financial corporations. It was also noticed that constant use of accounting misleads the basic objective of making accounts and financial reports and threatens the integrity of financial recording. Motivationally, creative accounting is a qualitative item affected by several factors. A brief explanation of practices employed by the Indian Financial Sector namely HDFC Bank, ICICI Bank, Nagarjuna Finance Ltd, Home Trade, CRB Capital markets Ltd etc. has been shown. This article is also an effort to learn the relation between Creative Accounting and Practices in Indian financial sector which also encloses the analysis of possible solutions for the creative accounting problem.

Index Terms – Accounting, Creative accounting, financial sector, Accounting practices, Earnings.

INTRODUCTION

Creative accounting has endured an argumentative issue, rising sequence of arguments in the accounting literature. These arguments are established on bifold. This method provides either positive or Negative accounting. Positive creative accounting is built on 'fair' accounting practices whereas negative creative accounting is done based on 'inappropriate' accounting practices that may be inaccurate to the users of accounting records. Management of financial information which is called by Creative Accounting

Practices, Income Smoothing, Earnings Management, and Account Manipulation averts the distribution of funds among the most effective sectors in the economy. Creative accounting discusses the accounting practices that may or may not follow the rules of accounting standard practices but definitely differ from those rules and regulations. Certainly, the Creative Accounting practices can appear even in highly controlled economic systems. In Creative Accounting practices, the manager practices the accounting knowledge to present the accounting data, records and reports in such a way, which appears very eye-catching to the shareholders instead of presenting the actual position or performance of the company, but all these, are done within the restrictions of accounting standards and rules.

Definitions of Creative Accounting: The word 'creative accounting' can be defined in a numeral ways. Firstly we will define it as 'a practice whereby accountants use their knowledge of bookkeeping rules to manipulate the figures reported in the financial statement of a business'. Creative accounting is the science and art of making the accounts look attractive within the existing parameters of performance. In nature, creative accounting makes for a half-filled glass of water look like half-full rather than half empty. Creative Accounting refers to the use of accounting knowledge to influence the reported figures, while remaining within the jurisdiction of accounting rules and laws, so that instead of showing the actual performance or position of the company, they reflect what the management wants to tell the stakeholders.

According to Copeland (1968) "Involves the repetitive selection of accounting measurement or reporting rules in a particular pattern, the effect of which is to report a stream of income with a smaller variation from trend than would otherwise have appeared".

Kamal Naser, (1992) “Creative accounting is the transformation of financial accounting figures from what they actually are to what preparer’s desires by taking advantage of the existing rules and/or ignoring some or all of them”

Jones (2011) ended up with the definition of Creative accounting as follows: “Using the flexibility in accounting within the regulatory framework to manage the measurement and presentation of the accounts so that they give privacy to the interest of the preparer’s, not the users”.

CONCEPT OF CREATIVE ACCOUNTING

Creative accounting is the practice of producing financial accounts that suit a particular purpose but do not really show the true and fair view. Sometimes the accountant may wish to show favorable profits (e.g. to get a bonus) at other times losses (e.g. to pay less tax). Sometimes the accountant may wish to show a healthy balance sheet (e.g. to get a bank loan), at other times an unhealthy balance sheet (e.g. before a management buy-out to get a bargain). Creative accounting often fools auditors and regulators, e.g. Enron, WorldCom, and the recent Madoff case

One of the early researchers, who defined the account manipulation, was Copeland (1968). The term Creative accounting was also used in 1968 in film “the producers” by Mel Brooks. The concept of Creative Accounting appeared in the Anglo-Saxon literature in the 1970s. In view of Management Authority, Accountants exercise a set of accounting techniques to impact financial reports which is known as the creative accounting. According to (Naser, 1993); creative accounting is the alteration of Financial Accounting data from what they really are, to what preparer’s wish by taking benefit of the existing rules. According to (Oriol, 1999); the Creative Accounting is a process whereby accountants use their understanding of accounting rules to influence the figures stated in the accounts of an industry. Creative accounting refers to the use of accounting knowledge to impact the conveyed data, while staying within the regulation of accounting rules and laws, so that instead of showing the actual performance of the company, they redirect what the management desire (Ashok, 2015; Algodah et al., 2015).

Indeed lot has been written on creative accounting. Anglo-Saxon is the first person, who has written about creative accounting in his literature in 1970s. Watts and Zimmerman (1990) state in their literature about accounting practices and provides advice about positive creative accounting. In a same manner Shah et al. (2011) concludes that creative accounting is a weapon which is used in a critical situation of a corporation. They also determine that creative accounting is not that bad if a company shows some flexibility in its accounting procedures. It also depends on the moral environment of any company that how and why management is using creative accounting techniques as a weapon. Some specialists show the dark side of creative accounting practices. They think that mostly obstacles happen because of unethical conduct of creative accounting for example Enron and WorldCom etc. As Gherai and Balaciu (2011) predict in their literature, they said that corporate stake is at threat when it involves in practices of creative accounting. Because these creative accounting practices give a firm only short term benefits. At the end company would be grounded with scandals. So there is really a necessity of close governance of financial reports. It also accomplishes that administration should try to find out all those reasons which may motivate the practices of creative accounting.

OBJECTIVES OF THE STUDY

1. To analyze the Creative Accounting Practices in Indian Financial Sector.
2. To recognize the conceptual context of Creating Accounting Practices in Indian Financial Sector.
3. To study the benefits and drawbacks of Creative Accounting Practices in Indian Financial Sector.
4. To study the impact of creative accounting on the financial accounts.

AN OVERVIEW OF CREATIVE ACCOUNTING

Types of Creative Accounting

Creative accounting techniques vary in essence and regularly change as guidelines to control them change. Here are some creative accounting techniques:

- Overestimating revenues: The most common techniques used by public companies viewing to

falsely boost their income are to prematurely recognize revenue. Revenue recognition is an accounting technique that allows companies to identify sales before they deliver a product or accomplish a service. It is open to exploitation.

- Inventory manipulation: Inventory represents the value of goods that were produced but not yet sold. Overstating the value of inventory will lead to an underestimation of cost of goods sold, and therefore an artificially higher net income, assuming actual inventory and sales levels remain same.
- Delaying expenses: Deferring the recording of current period expenses, such as payments to suppliers and rent to a subsequent period makes current period earnings look improved.
- Lowering depreciation charges: Companies often spread out the cost of assets, rather than expensing them in one hit. Methods to reduce annual charges on these items can include extending the useful life estimate of the asset or increasing its assumed salvage value.
- Masking contingent liabilities: Failure to record potential liabilities that are likely to occur and underestimating how much they are likely to cost can boost net income or shareholders' equity.
- Undervaluing pension liabilities: Pension obligations can easily be manipulated because the liabilities occur in the future and company-generated estimates need to be used to account for them.

The Reasons of Creative Accounting

The aim in creative accounting is to make the company look financially healthier than it really is. Creative accounting refers to artistic way of presenting accounts. These ways differ from the essence of accounting laws. However, they are not illegal. The reasons for creative accounting could be several. To defend the owners of companies the creativity by itself can sometimes come from the very person who maintains the accounts and this is time to question whether that creativity is thoughtful or caused by lack of financial knowledge. At this stage necessary steps have to be taken by the owners. However, such a questions need not to be asked when the owners of creative accounting are also the owners of company.

Creative accountants exploit loopholes in the rules and regulations. There is always a conscious thing. Most of the owners are guided in advance of the possible dangers and risks that result from their decisions. Another element that comes into interaction with the financial statements is management. If it is a big company managers are generally assessed according to company earnings. We should visualize enterprise which owners are also part of administration and therefore there is no parting and all decisions do not go through the management, but directly from stakeholders. Then we can evaluate the reasons for creative accounting. In fact there are always "only" two reasons; the overestimation or underestimation of the individual mechanisms of financial statements and it agrees accordingly to what is desired to get. If an existing company needs to gain a more amount of the loan, it is definite that they must have their assets in the needed positive values. The same technique should be used by even when the company needs to attract the investors. Opposing steps will be arranged with applying for grants or tax optimization. Whatever the reason is creative accounting will always be replicated in financial indicators and eventually I the company's solvency, because not all that appears like profit is really a profit. The truth is that even at the moment of simulated overestimation of financial ratios the company could fall into bankruptcy, insolvency, etc. That is the nature of the creative accounting that eventually impacts everything and leads to a situation where is challenging to protect anything. Most typically the objective is increased profits, inflated asset values, understated liabilities and overstated shareholder value so as to ensure the inflow of capital and investment

Effects of Creative Accounting on Financial Sector

- Loss of investors: The business will always be at a high risk of losing its investors because in case the investors get to understand the manipulations, it will not be good for the business.
- Reputational risk: In the long run, if it is disclosed that the company does a creative accounting practice, then the expectation from the company by their clients will also be at risk; thus, the company may lose its business and dearly earned repute.

When bought the Financial firm to bankruptcy and decided to carry on in the same undertakings. The new stakeholders have decided to ask the bank for a loan/credit, because they want to enlarge and renovate production range. The bank offered a loan/credit for that but the firm had to surrender to the suitable documents, balance sheet, and profit and loss for the earlier period and present period. Stakeholders found out that the requirements of the bank could not be met and have thought to artificially increase the equity accounting and also an inventory item to the balance sheet assets equal liabilities. A Company has received the loan, based on the proof offered to the bank. Hereby the company is committed to the bank to fulfill with the terms of the agreement. It was the year end and it was required to create financial statements and tax proceeds. Even before the artificially inflated value of the stock and capital funds account, the company reported a loss. For purposes of the bank was necessary to recognize so-called "black" numbers. Creative accounting had to be used again and inventory items needed to be adjusted also. Here, the overemphasis of assets as created a large tax obligation, which the firm had to pay. End of the year was closed with a positive economic yield.

Subsequent year there was again a partial change in ownership. There was also a change in management and values. The company started to fulfill its obligations to both traders and the government and the company's debt in fact grew. Banking society is under the terms of the contract that states must submit claims with a certain level as well as the status of binding commitments, which keeps the business in an ever "required" of indebtedness, with added conditions of the loan company is able to stand up for their condition and any required statement undergoes some creative accounting. Presently the position is the company bankruptcy working on her recovery, competitiveness and investment inflows.

IFRS as A Fundamental Condition for Creative Accounting: International Financial Reporting Standards permit a great number of accounting estimates, and in this way the amount considered for a specific factor that is reflected in the financial reports is not an exact digit. The space of flexibility that IFRS provide may involve choice for creative accounting. Often it is challenging to differentiate creative accounting from practicing rational business judgment

as accounting standards permit the presence of the difference between accounting estimates and reality. Based on the earlier considerations the question may arise as, why flexibility is allowed by IFRSs if there is a risk that can be used to manipulate financial information.

Motivation and Incentives for Creative Accounting Practice: To completely understand the theory of creative accounting, it is essential to know the motivation and incentives that primarily lead to the practice of creative accounting. If the users of financial reports are conscious of the presence of these pressures, they have the capability to take them into concern and to analyze their decisions accordingly.

Preventive Measures for Creative Accounting Practices: The practice of which has resulted in many bankruptcy cases of main companies in the world such as Enron, WorldCom, or Parmalat, needs the participation of many shareholders from the organizations that set accounting rules and standards for government companies or different branches of industry.

The capability to select different accounting procedures can be reduced by decreasing the number of possible procedures or by stating the cases when each practice can be used. Another way of avoiding it is to find reliability in the use of methods. If a business has used a certain method when its financial condition was good, it should continue to use the same method even if there is no advantage.

Concerning to the abusing judgment or forecast, there are three methods to avoid it. The first is the acceptance of the rules that reduce the use of judgment or estimate by companies. The second involves the commitment to have a consistent or continuity of the method used in the trial. So if the firm has calculated something in a certain way, there is no need to change that method if it does not use it any longer. Third, auditors need to increase their efforts in identifying incorrect manipulative forecasts. Once auditors audit the company's financial reports, they should carefully see whether the expectations made by the managers are normal or obvious marks of untruth.

Ever since the market and the economy are progressively evolving, chances that specific business areas are not well protected by accounting rules. This problem can be reduced through prolonged review of current standards and their completion with new

standards for problematic zones such as accounting for stock exchange processes.

Difficulties with the reclassification or presentation of financial figures can be answered by setting up distinctive standards for the presentation and classification of financial reports.

Techniques for Preventing Creative Accounting: Effective techniques for preventing creative accounting include:

- Revision and presentation of accounting standards in terms of limited use of estimates and consistency in the use of accounting methods
- Identifying and insisting on the part of internal and external audit in recognising and reporting unfair estimates and preventing accounting modifications.
- Recurrent change of audit service suppliers
- Appointing independent members and directors of the audit group
- Forming operative corporate governance controls
- Teaching regarding the code of ethics
- Long terms incentives and remuneration policies
- Employing importance on the development and application of forensic accounting

Creative accounting practices in Indian financial sector

1. HDFC bank has been showing profits from sale of investments as part of operating profit. During FY 2002, about 4% of such profits came from sale of securities.
2. ICICI Bank: The ICICI wrote off Rs. 813 crores of bad loans against its profit and loss account in 2001, as a result profit fell by 55%. As against this, ICICI wrote-off only Rs. 701crore in the three years 1997 to 1999 and that too against reserves. The one time write off in FY 2001, prior to the ICICI Bank.
3. CRB Capital Market Ltd involved in accounting scam in the year 1996. Mr. Roop Bhansali was accused of draining off Rs 12 billion in the CRB(Chain Roop Bhansali scam). He was accused of using SBI accounts to siphon off bank funds, claiming that he was encasing interest warrants and refund warrants. Due to this scam UTI (Unit Trust of India) and Gujarat Government also incurred losses

4. Home Trade, a Gujarat based company made a fuss of poor investments of Rs. 60 billion which resulted a collective loss of Rs. 800 million of Eight co-operative banks, like Valsad People's Co-operative Bank and Navsari Co-operative Bank from South Gujarat till the year 2002. It was also linked to Rs 82 lakh forgery in a central government undertaking EPF scheme. Mr Sanjay Agarwal (chairman) and Mr. Ketan Seth (director) were arrested in this cases
5. Nagarjuna Finance Ltd was blamed in the year 2003 for a deception about Rs. 1 billion. NFL failed to return about Rs 1 billion to its depositors for the year 1997-98 due to lack of financial management and using of creative accounting techniques in the books of account. The promoter of the company was Mr. KS Raju. NFL could repay only Rs 548 million as at December 2003

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CONCLUSION

All phases play the financial game, counting the aggressive choice and application of accounting principles, both within and outside the borders of generally accept accounting principles, and falsified financial recording. Also included are steps taken toward earnings managing and income smoothing, this is the inspiration to the use of creative accounting by companies. Observes that “creative accounting” can be equated with disclosure management in the sense of a forceful intervention in the financial recording procedure.

Political leaders influence the Accounting scams in Indian financial sector, which rise with the confession of faults by trusted administrators of large public companies. Such offenses usually include difficult methods for mishandling funds, overstating revenues, understating expenses, overdoing the value of

company assets or under writing the existence of liabilities with the cooperation of executives in other organizations or associates. The Creative accounting practices, which may follow the note of the rules of the standard accounting practices, but certainly deviate from the spirit of those rules. They are characterized by excessive complication and the use of novel ways of describing income, assets or liabilities and the intent to influence readers towards the interpretations. In both public and private banks have been practicing, this type of “creative accounting”. Fraudulent and misuse of funds investigations conducted by the government Recognized agencies such as the Securities and Exchange Board of India, Reserve Bank of India in India. We can see that in Indian context those Indian financial sector companies that were involved in investments and finance were doing more misinterpretations as compare to software and banking sector.

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